Opening address: Regulating for real people, markets and globalisation

A speech by Greg Medcraft, Chairman,
Australian Securities and Investments Commission

ASIC Annual Forum 2014

24 March 2014

CHECK AGAINST DELIVERY

Introduction

Thank you, Nathan and Uncle Chicka, for your warm welcome to Gadigal Country.

Good morning everyone. Welcome to the 2014 ASIC Annual Forum, our 19th Annual Forum.

On behalf of my fellow Commissioners – Peter Kell, Cathie Armour, John Price and Greg Tanzer – and on behalf of all ASIC staff, I welcome and thank you for supporting this event.

The ASIC Annual Forum is an excellent opportunity to discuss what is happening in financial services and markets, and network with people from around the world.

We are very fortunate to have some distinguished speakers talk to us over the next two days.

I'd also like to welcome Cathie Armour to her first ASIC Annual Forum as a Commissioner. Cathie became a Commissioner in June last year and is a welcome addition to our leadership.

Overview of the Annual Forum agenda

The theme for this year's ASIC Annual Forum is 'regulating for real people, markets and globalisation'.

We have chosen this theme in light of recent innovations and structural change in our financial system, in particular:

- the growth of market-based financing and superannuation
- a renewed focus on behavioural science
- and finally and most importantly, the changing landscape resulting from digitisation of the economy and globalisation.

The Forum will consider how best to regulate for:

- real people, who will not always act rationally
- financial markets, to maximise their potential to fund economic growth while mitigating the risks (particularly systemic risk), and
- facilitating global capital flows.

Conference information and services

Wi-Fi will be available throughout the Hilton conference venue. The access code is on your program schedule in your lanyards.

The ASIC Annual Forum app is available for download for those of you who don't already have it. It can be used on tablets, phablets and smartphones. On the app you will find the conference program and other useful information. If you have trouble downloading the app, you can visit the helpdesk in the Exhibition Area outside the Ballroom until lunch today.

This year, we also have a live Twitter feed at #asicforum.

Lastly, each session is recorded and webcasts will be available after the conference.

Now that the house-keeping is out of the way, I'd like to launch into discussing our conference theme – regulating for real people, markets and globalisation.

I will consider each of these topics in turn.

Real people

We have witnessed the harm caused by regulations that assume all investors and financial consumers will act rationally.

Disclosure, the way it has been done in the past, is not the disinfectant it was once thought to be.

This is why regulators around the world are considering behavioural science, and insights from it, to better understand how investors really behave.

For example, over and over behavioural research shows that investors:

- have a bias towards the default option
- prefer a small reward today over a larger one later
- tend to disengage when faced with complexity and too many options, and
- are influenced by nudges, framing and, most importantly, their relationship with the person delivering the message.

In regulating for real people, we need to think carefully about behavioural insights in terms of:

- effective disclosure
- deregulation, and
- penalities.

On effective disclosure, investors may not have the time, inclination or capacity to read disclosure documents, so we need to consider how best to ensure investors process and understand the information given to them.

This can be by:

- multi-layering information for investors – for example, Key Fact Statements which summarise the product being offered, with more detailed information being made available online, and
- multi-channelling– that is, realising the opportunities from digitisation by using multiple channels such as social media, videos and apps to deliver disclosure.

And, there could even be a place for optional online self-assessment tools to help investors understand what they are buying and for manufacturers to be comforted in what they are selling.

Despite improving disclosure, we may still need to consider if there may be some situations when disclosure can never be effective.

On deregulation,, behavioural insights should be leveraged to deliver smarter, not more regulation. This is a win–win outcome:

- lower costs for business, and
- regulators can better achieve the policy goals set by government.

On setting penalties, behavioural insights need to be considered in what motivates people to break the law. And often this is the fear versus greed equation. We need penalties that incentivise the right behaviour.

Fear versus greed

On penalties, the public expects ASIC to take strong action against serious corporate wrongdoers.

It is frustrating – both for us and the public – when the penalty available to respond to misconduct is much less than the profit someone made in the process. If this is so, unscrupulous players in the market may quite rationally decide to make the trade by looking at the risk versus reward. And in doing so, break the law.

We've got to have penalties that inject fear and overcome the urge someone may experience to break the law when driven by greed.

Those who intentionally break the law and cause severe damage should face tough penalties. This will make them – and others – think twice about their actions.

After all, think about human behaviour – tough penalties have a powerful deterrent effect.

Although, this is just one side of the story. We must adopt a balanced approach.

At the lower end of the scale, more proportionate sanctions can work better. For example, infringement notices can provide a more timely, appropriate and efficient outcome, particularly for those who unintentionally break the law.

Our report on penalties for corporate wrongdoing,[1] released last week, reviews penalties in Australia to assess whether they are proportionate and consistent.

We hope the report will inform public discussion over the coming months, including through the Financial System Inquiry.

Markets

Moving on to the next conference theme – markets.

Markets assist fundamentally in funding the real economy and, in turn, and most importantly, economic growth.

Markets need to be sustainable and resilient so that investors, particularly retail investors, can participate in them with confidence. In equity and debt capital markets, with no confidence you have no real investors and, without them, no market.

To ensure resilience, we need four things:

Firstly, we need to mitigate the risk of financialisation of our markets.

Secondly, we need to maintain good governance. This includes in audit quality. The decline in audit quality around the world, particularly in emerging markets, is an issue. Here, we need to strengthen the current system.

Thirdly, we need to think about how we can facilitate market-based financing to assist in funding economic growth by harvesting benefits and mitigating the risks. For example by:

- reducing barriers to the flow of capital through passporting. This is something I'll talk about later when discussing globalisation, and

[1] Report 387 *Penalties for corporate wrongdoing* (REP 387).

- using regulation to help provide access to capital for sectors that are experiencing difficulty because of recent changes in banking regulation – for example, liquidity and capital charges. Key sectors that come to mind are:
  - long-term financing for infrastructure, and
  - SMEs – here, crowd funding and multi-tiered equity markets may assist, such as what has recently been launched in China.

Lastly, to be resilient, fair and efficient markets need to be cyber-resilient. This is integral to combating the risk posed by cybercrime and ensuring investors remain confident.

Of these four things, I will talk about financialisation of markets and cyber-resilience in more detail.

Financialisation of markets

At their core, markets assist in funding the real economy and in doing so help fuel economic growth. Markets do not simply exist to feed on themselves.

The financialisation of markets – for example, through high-frequency trading, dark liquidity and speculative trading – creates new risks for market resilience.

Last week this was recognised by the New York Attorney General, who called for 'market reforms to eliminate the unfair advantage commonly provided to high-frequency trading firms at the expense of other investors'.[2]

Financialisation has the potential for parasitic outcomes that can destroy confidence and potentially stall economic growth. To be clear, this does not mean a need for more regulation. What we do need is for industry to mitigate this risk for themselves.

Mitigating the risk of financialisation of markets is particularly important to Australia, not just in our equity markets, but also in our commodity markets, particularly as Australia is a significant commodity exporter that uses commodity derivatives. Those that participate in our markets must not focus only on the short term. They must also play the long game to ensure markets remain resilient and that investors and other end users – especially the less sophisticated – can take part without second-guessing their decisions.

[2] New York Attorney General Eric T Schneiderman, *A.G. Schneiderman calls for new efforts to eliminate unfair advantages provided by trading venues to high-frequency traders*, press release, 18 March 2014, http://www.ag.ny.gov/press-releases

Cyber-resilience

As I mentioned before, the other aspect I am going to expand on is cyber-resilience.

Before I talk about cyber-resilience I want to talk about cybercrime.

Advances in technology have led to the rise of cybercrime around the world.

The links between market players and infrastructure mean that the impact of a cyber attack can spread quickly and has the potential to dangerously affect:

- the integrity and efficiency of global markets
- the protection of investors, and
- ultimately, trust and confidence in the financial system.

Cybercrime is a systemic risk and I think it is the next black swan event. It is an issue that's captured the interest of global policy makers, including the G20.

So, how do we counter the threat of a cyber-attack?

Cyber-resilience through risk management is vital.

For organisations, risk managements systems must be granular enough to ensure a good level of resilience in an organisation.

To this end, the International Organization of Securities Commissions (IOSCO) is looking to develop a global standard on risk management for cyber-crime.

And in the United States, the White House released its *Cybersecurity framework* last month. It aims to help organisations manage cyber risks by establishing an analytical framework:

- identifying and protecting against cyber risks, and
- detecting, responding and recovering from a cyber attack.

Globalisation

My final topic this morning is globalisation.

In respect of globalisation, I believe the key opportunity to be harvested is allowing the free flow of capital across world markets.

In order to do this, regulators need to be able to rely on one another. To do this, we need trust and confidence.

For this we need:

- *a global rulebook* – with measures to promote consistent regulation between jurisdictions in financial services and markets
- *supervision* – that is, cooperation among regulators on surveillance arrangements, and
- *enforcement* – which is about cooperation and information-sharing on cross-border enforcement.

Through the work of IOSCO these things are being realised. IOSCO:

- is actively developing a global rule book in respect of the many sectors, financial services and market regulators look after – for example, IOSCO has already done this through its standards for financial benchmarks and credit ratings agencies
- is working on cross-border supervisory arrangements, and
- has a Multilateral Memorandum of Understanding in place for enforcement-related cooperation and information sharing. The MMOU already has over 100 signatories from around the world.

Conclusion

Ladies and gentlemen, to conclude, I want to reiterate the importance of market-based financing. In the coming decades it will be a cornerstone of funding economic growth.

All of us – industry, ASIC and investors – have an interest in realising its potential.

As market-based financing is largely regulated by ASIC, it is important that we continue to regulate for real people, markets and globalisation.

Thank you. I will now hand over to Commissioner Tanzer, who is moderating our first plenary session.