ASIC

Australian Securities & Investments Commission

Financial System Inquiry: Submission by the Australian Securities and Investments Commission

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1 ASIC welcomes the opportunity to contribute to the examination of the Australian financial system, and the consideration of how the system can be best positioned to meet the Australian community's evolving needs and support Australia's growth.

2 Overall, Australia's financial system performs well. The financial system has helped facilitate sustained growth of the Australian economy. Australia's compulsory superannuation system has contributed to very significant increases in the level of savings that Australians have for retirement. Investors and financial consumers have access to a wide range of products and services.

3 There have been some failures in the financial system since the 1997 Financial System Inquiry (Wallis Inquiry), and the global financial crisis saw significant disruption in Australian financial markets. However, with the exception of the collapse of HIH Insurance, these occurred outside of the prudentially regulated sector. Australia's financial system emerged in much better shape from the global financial crisis than the financial systems of most other countries. The regulatory structure that underpins our financial system is now being adopted by other jurisdictions.

4 Nonetheless, there are significant developments in the broader economy—and the financial system more narrowly—that warrant careful consideration to ensure we have the policy and regulatory settings that will enable our financial system to best serve the long-term interests of the Australian community. These developments include the ageing population and the growth of superannuation, technological changes, and the growth of China and other Asian economies.

5 There are also lessons—positive and negative—that can be drawn from the experience in the financial system over the last two decades that can contribute to better outcomes for households and businesses.

6 Collapses have had a major impact on some investors and financial consumers, and there are gaps in the way that the financial services sector meets the needs of certain business and consumer segments. There is also potential to reduce costs in the system.

7 Importantly, there are opportunities to build on the successes of Australia's financial system, both in terms of the products and services provided to Australian consumers, the ability of Australian firms to compete internationally, and the funding of economic growth.

8 ASIC looks forward to working with the Inquiry to help identify opportunities to improve the operation of Australia's financial system for the benefit of the whole community.

ASIC's role in the financial system

9 ASIC regulates Australian companies, financial markets, financial services organisations and professionals who deal and advise in investments, superannuation, insurance, deposit taking and credit.

10 The *Australian Securities and Investments Commission Act 2001* (ASIC Act) requires ASIC to:

(a) maintain, facilitate and improve the performance of the financial system and entities in it;

(b) promote confident and informed participation by investors and financial consumers in the financial system;

(c) administer the law effectively and with minimal procedural requirements;

(d) enforce and give effect to the law;

(e) receive, process and store, efficiently and quickly, information that is given to us; and

(f) make information about companies and other bodies available to the public as soon as practicable.

11 As the *financial services regulator*, we have responsibility for investor and consumer protection in financial services. We administer the Australian financial services (AFS) licensing regime and monitor financial services businesses to ensure that they operate efficiently, honestly and fairly. These businesses typically deal in superannuation, managed funds, deposit and payment products, shares and company securities, derivatives and insurance.

12 As the *consumer credit regulator*, we license and regulate people and businesses engaging in consumer credit activities (including banks, credit unions, finance companies, and mortgage and finance brokers). We ensure that licensees meet the standards—including their responsibilities to consumers—that are set out in the *National Consumer Credit Protection Act 2009* (National Credit Act).

13 As the *markets regulator*, we assess how effectively financial markets are complying with their legal obligations to operate fair, orderly and transparent markets. We also advise the Minister about authorising new markets. On 1 August 2010, we assumed responsibility for the supervision of trading on Australia's domestic licensed equity, derivatives and futures markets.

14 As the *corporate regulator*, we ensure that companies, schemes and related entities meet their obligations under the *Corporations Act 2001* (Corporations Act). We register and regulate companies at every point from their incorporation through to their winding up, and ensure that company officers comply with their responsibilities. This ‘cradle to grave’ approach enhances regulatory oversight. We also register and, where necessary, take disciplinary action against company auditors and liquidators. We monitor public companies’ financial reporting and disclosure and fundraising activities.

15 ASIC also promotes *financial literacy*, to ensure investors can have greater confidence when buying financial services, and are able to make sensible and informed financial decisions.

Major developments in financial markets

16 Three key trends in the financial system, especially as they relate to ASIC’s responsibilities, are:

(a) structural change in financial markets;

(b) technology and innovation; and

(c) globalisation.

Structural change in financial markets

17 Financial markets play a central role in the growth and prosperity of our economy. They have the primary role of facilitating the raising of capital and the efficient allocation of resources and risk between parties.

18 Structural change is altering the shape of Australia’s financial markets as well as markets globally. Notably, there is a shift to market-based financing, driven by the growth in the superannuation and pensions sector and increased banking regulation. This makes effective securities regulation even more vital.

19 Markets have become more integrated, competitive, global and complex. Greater integration and global access provides better investment and capital raising opportunities, while competition has the potential to drive down costs and drive up service standards.

20 New types of market-based financing are also emerging, including crowdfunding and peer-to-peer lending.

21 However, these factors also create risks. Growing complexity and the financialisation of markets—for example, through high-frequency trading,

dark liquidity and speculative trading—creates new risks for market resilience.

Technology and innovation

22 Technological change has brought considerable benefits to consumers of financial services over the last two decades, and has the potential to provide more choice and allow new entrants.

23 However, technological developments also raise some challenges and risks for financial stability and regulation. At one level, this involves ensuring that non-traditional entrants are appropriately regulated without imposing unnecessary burdens on innovative technologies. At another level, the risk of cybercrime has increased significantly, posing major challenges for cross-border enforcement.

Globalisation

24 Australia's financial markets are now much more integrated with international markets than at the time of the Wallis Inquiry. International regulation has grown in response to the globalisation of markets, both as a means of controlling the risks associated with those markets and facilitating cross-border activity.

25 Encouraging the development of further cross-border activity and integration of international markets could deliver significant economic benefits to Australian markets, providers, investors and financial consumers. The area where the most immediate potential benefits lie is in the Asian region. Already, efforts to achieve recognition by US and EU authorities of Australia's regulatory regime for over-the-counter (OTC) derivatives have enabled Australian businesses to avoid substantial compliance costs.

26 At the same time, the result of the increased breadth and strength of international standard-setting is that ASIC (and Australia more generally) has needed to introduce, or at least consider introducing, regulation over areas that were not previously regulated. Failure to keep pace with relevant international regulatory standards could lead to the risk of Australia's regulatory system not being assessed as adequately equivalent, and entry to markets being closed off to our market participants.

ASIC's regulatory experience since the Wallis Inquiry

27 Alongside these broader system developments, it is important to understand the lessons—both positive and negative—from our regulatory experience since the Wallis Inquiry.

28 ASIC's regulatory role does not involve preventing the risk of all consumer losses or ensuring full compensation for consumers in all instances where losses arise. Removing risk from the financial system would be highly undesirable. This is true for all market regulators. Nonetheless, financial collapses and failures can cause very significant hardship, and it is important to learn lessons that can help contribute to better outcomes in the future.

29 It is also important to consider the experience in those market segments that have persistently delivered sub-optimal outcomes for consumers, as this suggests that competition is not working well and there may be impediments that policies can address.

30 While each case is different, some common themes in these cases of financial collapse or failure are:

(a) the misalignment of risk, such that the consumer thought they were bearing lower risks than the actual risks of the product or strategy. As a result, in many cases consumers ended up bearing more risk than they could manage. Frequently, the overuse of leverage exacerbated this issue;

(b) conflicts of interest in business models or structures, whether the conflict was disclosed or not;

(c) relevant industries failing to adequately address their own structural problems and poor conduct, or resisting reforms in some cases; and

(d) an inadequate regulatory toolkit, with an overemphasis on lengthy disclosure, and/or inadequate enforcement powers and penalties (such as in the debenture sector).

31 On the other hand, it is also important to consider the lessons from the many successes in the financial system. Just a few of these include the significant growth in the range of products and services available to consumers and businesses, and the technological innovations that have allowed consumers to safely undertake financial transactions online or through mobile devices.

32 Better results for consumers and businesses have emerged where there is greater competition, especially demand-driven competition. It is also apparent that more effective engagement between the regulator and industry participants can help ensure that regulatory efforts are focused on issues that improve market outcomes (e.g. in developing regulation of mortgage broking), or encourage the development of successful co-regulation (e.g. in supporting internal and external dispute resolution arrangements).

33 Finally, there are some important lessons from investor and financial consumer protection regulation in other jurisdictions that can help inform the operation of the financial system in Australia. In particular, Australia has avoided some of the more significant mis-selling problems that have

emerged in other jurisdictions—for example, those that occurred with personal payment insurance in the United Kingdom.

The principles underpinning retail financial regulation

34 This Financial System Inquiry provides an opportunity to reconsider some of the philosophical or economic underpinnings of the financial system and associated financial regulation. The lessons from the global financial crisis, a growing body of economic research and our own regulatory experience reinforce some of the key principles of financial regulation, but suggest that there are sensible reasons to modify some aspects of the economic thinking that has underpinned conduct and disclosure regulation.

Financial products require specific regulation

35 ASIC's experience with regulation since the Wallis Inquiry, including during the global financial crisis, indicates that the well-accepted point that financial products and services require more intensive regulation than other products has not altered, especially in retail markets. While the objectives of financial system regulation are similar to those applying in all markets (i.e. to prevent a range of possible market failures), the means of achieving them often needs to take specific forms due to the nature and complexity of financial products.

36 Financial products and services can represent extreme examples of 'credence goods', where the performance and quality of the good is not apparent even after purchase, and in many cases not apparent for a long time after purchase. This means that assessing quality is very difficult. They are intangible and often complex. Many financial products, especially investment products, are purchased infrequently and, in the case of superannuation, may only be purchased as a result of compulsion. As a result, consumers will often rely on intermediaries for advice or information, but many of the same problems apply to assessing the quality of this advice, or on default 'choices' that do not contribute to competitive outcomes.

37 This means that information asymmetries are likely to be particularly hard to overcome. Furthermore, the nature of many financial products, such as the timing mismatch between purchase and identifying a problem with a product, means that consumer behavioural biases are more likely to lead to flawed consumer decision making, which can undermine competitive forces.

38 Finally, if things go wrong for investors and financial consumers, the consequences can be more severe than for most other purchases; they may lose their home, their provision for retirement, or suffer extreme financial

hardship. After suffering a loss they may not be able to recover their previous financial position.

39 These factors represent one of the reasons why in almost all jurisdictions there are specific regulators for investor and financial consumer protection. Relying solely on generic 'after the event' laws will not address many of the problems outlined above.

Decision making in financial markets: The limits of disclosure

40 On the other hand, the assumption that underpinned much of retail financial services regulation since the Wallis Inquiry— that disclosure was the best tool in almost every instance to fix market failure—has not been borne out in practice. Economic research in behavioural economics, as well as the experience of regulating retail financial markets, indicates that investors and consumers are prone to behavioural biases that mean decision making is often not instrumentally rational. This undermines the effectiveness of disclosure as a regulatory tool. Importantly, these behavioural biases are significant and systematic, rather than random and trivial.

41 One of the fundamentals of behavioural economics is that consumers do not use information optimally in an economic sense. This means that disclosure of certain information does not improve market outcomes, and may simply represent a cost for providers.

42 There is potential, therefore, to improve regulatory design with a better understanding of consumer behaviour and decision making. This will require a more flexible regulatory toolkit to target market-improving actions. It also means that there are opportunities to reduce costs to industry by removing ineffective regulation. It may also mean that when we do use disclosure it can be better designed and can take advantage of new technologies.

Regulatory reforms to improve the performance of the financial system

43 ASIC is proposing several reform issues in light of:

(a) major developments in the financial system and broader economy;

(b) lessons from financial regulation; and

(c) reconsidering regulatory philosophy.

44 The overall aim is to ensure that ASIC can more effectively contribute to a financial system that meets the needs of Australian households and businesses into the future. This is consistent with our statutory objectives.

Requiring ASIC to consider a competition objective

45 Requiring the regulator to formally consider the effect of its decision making on competition would drive a greater focus on the long-term benefits for the end users of the financial system. While ASIC would not be a competition regulator, it would help ensure that ASIC's approach to regulation considered market-wide effects more explicitly.

Ensuring the superannuation system better meets the needs of the retirement phase

46 As the Australian population ages, there is a need for better products to help people manage their retirement savings during the retirement phase. There is also a greater need for good quality retirement advice. Options should be explored to encourage product providers to increase the choice of products available that cater to the retirement phase, to increase consumer demand for these products, and to improve the quality of advice.

Lifting standards in financial advice

47 With compulsory superannuation, there is a critical need for accessible and sound financial advice. ASIC has proposed a package of reforms that include a consistent minimum competency standard for advisers, a comprehensive national register of advisers, and the ability for the regulator to ban managers of advice businesses that cause consumers major harm.

Strategic participation in global financial markets

48 More efficient cross-border financial activity would create significant economic benefits for Australian markets, businesses and consumers. Encouraging the development of 'passporting' arrangements across the Asian markets, and more broadly, will facilitate the integration of the Australian financial system into global markets.

Managing systemic risk

49 A mechanism is required to allow financial regulators to monitor for the emergence of systemic risk in entities or sectors outside the current boundary of prudential regulation, and to bring them within that boundary if necessary.

Improving conduct through a more flexible regulatory toolkit

50 Better policy design, including a more flexible regulatory toolkit, can ensure better market outcomes with less cost for industry. This could be

accompanied by a reduction in some current disclosure requirements that are less effective.

Penalties that provide the incentive for better conduct

51 Effective and credible enforcement of the laws governing the finance sector is critical to the level of trust and confidence in the system. Without effective enforcement, non-compliant firms can capture market share at the expense of compliant firms. A review of penalties under ASIC-administered legislation would help establish whether such penalties currently provide the right incentives for better market behaviour.

A better funding model for ASIC

52 A user pays (cost recovery) funding model that better reflects the costs associated with market regulation can drive economic efficiencies and can also provide better incentives for industries to improve their own standards and practices.

ASIC's submission

53 This submission sets out:

(a) issues for further consideration to contribute to the future development of the Australian financial system (see Section A);

(b) ASIC's role and the economic philosophy underlying the Australian financial services regulatory regime, and why regulation is important to the participants and consumers of financial markets and services (see Section B), and the changes in the financial system that have shaped our regulatory regime, both within Australia and globally (see Section C);

(c) the changing nature of financial markets, including market infrastructure and participants, including a discussion of the lessons—positive and negative—from ASIC's experience in regulating the financial services sector since the Wallis Inquiry (see Sections C, D and F);

(d) key considerations for the future regulatory system, including the regulatory architecture, alternative regulatory forms, and the importance of competition as a consumer policy objective (see Section E);

(e) the origins and effects of systemic risk in the financial system (see Section G);

(f) investors' and financial consumers' experience of the financial system (see Section H), and ASIC's regulatory experience of sectors that have the most impact on investors and financial consumers—financial advice (see Section I) and consumer credit (see Section J); and

(g) the significant role of the managed funds industry in Australia, including the particular place of superannuation (see Section K).

54 Appendices are also attached to this submission:

(a) noting proposals for changes to overcome barriers to ASIC fulfilling our legislative responsibilities and obligations, which we have previously presented in our main submission to the Senate Economic References Committee Inquiry into the performance of ASIC (see Appendix 1);

(b) outlining the work and regulatory tools ASIC undertakes to meet our strategic priorities (see Appendix 2); and

(c) further details on the regulatory regime for managed investment schemes and superannuation funds (see Appendix 3).

A Overview of options for change

Key points

In this section, we have outlined areas for further consideration to contribute to the future development of the Australian financial system. We propose several reform issues for the Financial System Inquiry to consider in light of:

- major developments in the financial system and the broader economy;
- lessons from financial regulation; and
- reconsidering regulatory philosophy.

55 The overall aim of the options for change proposed in this section is to ensure that, consistent with our statutory objectives, ASIC can more effectively contribute to a financial system that meets the needs of Australian households and businesses into the future. Table 1 provides an overview of the areas for further consideration and options for change.

Table 1: Issues for consideration and options for change

Areas for further consideration	Key issues	Regulatory change options
Requiring ASIC to consider a competition objective	ASIC is not formally required to consider the impact on competition of its decision making.	Amend the *Australian Securities and Investments Commission Act 2001* (ASIC Act) to include a competition objective, in addition to ASIC's existing statutory objectives. Deeper consideration of competition issues would drive a greater focus on the long-term benefits for the end users of the financial system. While ASIC would not be a competition regulator, it would help ensure that ASIC's approach to regulation considered market-wide effects more explicitly.
Ensuring the superannuation system better meets the needs of the retirement phase	As the Australian population ages, there is a need for better products to help people manage their retirement savings during the retirement phase. There is also a greater need for good quality retirement advice.	Options should be explored to encourage product providers to increase the choice of products available catering to the retirement phase and increase consumer demand for these products. Note: See also options for improving the quality of advice in paragraphs 347–352.

Areas for further consideration	**Key issues**	**Regulatory change options**
Lifting standards in financial advice	With compulsory superannuation and an ageing population, there is a critical need for accessible, sound financial advice. New measures are necessary to promote high standards in the financial advice industry. Significant problems exist in the financial advice industry in relation to: • adviser competence; • the capacity of 'bad apple' advisers to remain in the industry moving from firm to firm; and • ASIC being unable to appropriately deal with managers.	*Adviser competence through a national examination*—introducing a system requiring advisers to successfully pass a national examination before being able to give personal advice on Tier 1 products. *Mandatory reference checking*—introducing a requirement for mandatory reference-checking procedures in the financial advice industry. *Employee adviser register*—requiring the establishment of a register of employee representatives providing personal advice on 'Tier 1' products. *Controlling who manages the business*—allowing ASIC to ban a person from managing a financial services business or credit business.
Strategic participation in global financial markets	Encouraging the development of further cross-border activity and integration with international markets could deliver significant economic benefits to Australian markets, providers, investors and financial consumers.	Encourage the development of 'passporting' arrangements across the Asian region and more broadly.
Managing systemic risk	While a number of international jurisdictions have amended their regulatory framework to better address systemic risk in response to the global financial crisis, Australia does not have a flexible arrangement to respond to emerging systemic risk in the financial system.	Implement a formal mechanism for Australian financial regulators to monitor for the emergence in the future of unacceptable systemic risk in entities, markets or sectors outside the current boundary of prudential regulation, and bring them within that boundary if necessary.
Improving conduct through a more flexible regulatory toolkit	Traditional disclosure alone is unlikely to overcome problems investors and financial consumers experience in the financial system and foster effective competition.	Better design of regulatory responses, including having access to a more flexible regulatory toolkit going beyond disclosure, can ensure better market outcomes at less cost to industry. A more flexible toolkit could also be accompanied by a reduction in current disclosure requirements that are less effective. Provide consumers with some of the benefits of 'big data' to improve understanding and enhance consumer decision making. Enhance the effectiveness of disclosure through a layered approach and harnessing new media to deliver content in a better way.

Areas for further consideration	Key issues	Regulatory change options
Penalties that provide the incentive for better conduct	Effective and credible enforcement of laws is critical to confidence in the financial system. Without effective enforcement, non-compliant firms can capture market share from compliant firms. Penalties available to ASIC have not been comprehensively reviewed for over a decade. There are a number of differences between penalties available to ASIC and other domestic and international regulators. These differences demonstrate that penalties available for corporate wrongdoing warrant further attention and consideration, to ensure that wrongdoers have an incentive to comply with the law.	Conduct a holistic review of penalties under ASIC-administered legislation to assess whether adequate penalties are available and set at an appropriate level. Such a review would help establish whether such penalties would provide the right incentives for better market behaviour.
A better funding model for ASIC	There are limitations and inefficiencies in the way ASIC is currently funded. Costs currently imposed on our regulated population do not accurately reflect the costs of regulation.	Consider moving to a user pays funding model that better reflects the costs associated with regulation. A user pays (cost recovery) funding model could provide better incentives for industries to improve their own standards and practices.

Requiring ASIC to consider a competition objective

56 Competition has a fundamental role to play in ensuring the efficiency, integrity and growth of the financial system: see paragraphs 479–536. When markets, participants and financial services providers compete vigorously with their rivals, conditions are optimal for efficiencies, innovations and cost savings to emerge, encouraging confident and informed participation by investors and financial consumers.

57 The addition of a statutory objective requiring ASIC to consider the impact of its decision making on competition would drive a greater focus on the long-term benefits for the end users of the financial system. Viewed as one of a range of priorities, rather than an end in itself, considering the role of competition more broadly would add a valuable layer of analysis to our decision making.

58 Currently, in pursuing our statutory objectives, we are not specifically empowered to design regulatory responses that enhance competition. This has created an anomalous situation where APRA is required by legislation to

consider the impact of its actions on competition in the financial system (among other objectives), yet ASIC is not.

Note: As the prudential regulator of the Australian financial services industry, APRA's primary objective is to promote financial system stability in Australia. This objective must be balanced by considerations of competition, contestability and competitive neutrality: *Australian Prudential Regulation Authority Act 1998*, s8(2).

59 This competition objective would be similar to that of the UK's Financial Conduct Authority (FCA); however, the FCA's competition objective is modelled on a consumer welfare standard and gives primacy to the interests of consumers. The ASIC Act is already based on a total welfare standard, which considers the interests of consumers as well as businesses. We consider it important that ASIC continue to balance the interests of different parts of the financial system. However, effective competition analysis should consider how best to promote competition and the long-term interests of the end users of the products and services in question (who may not otherwise have a voice in the decision-making process), rather than the interests of individual competitors.

60 The pursuit of this objective would not take precedence over ASIC's other objectives. Rather, it would enhance them, by recognising the importance of competition in encouraging commercial certainty, efficiency, consumer confidence and the development of the economy. We think that this is a vital step in the development of Australia as a centre of financial excellence and a regional financial hub.

61 As a practical matter, ASIC would need to continue to consider the impact of our own regulatory decisions on competition, as well as including a consideration of whether competition is working effectively when we conduct reviews of market sectors we regulate.

Note: The FCA says that it expects to use market studies as the main tool for examining competition issues in the markets it regulates. To date, the FCA has announced market studies into the cash savings market, the general insurance add-on market and the asset management market.

62 The competition objective would require and enable ASIC to select the most 'competition-friendly' option from a range of potential regulatory responses, provided that this option was also capable of achieving ASIC's other regulatory objectives.

63 Having such an objective would also mean that ASIC would be better placed to engage with other securities regulators on international policy initiatives addressing competition issues in global financial markets.

64 Having a competition objective would not transform ASIC into a competition regulator. Importantly, we are not proposing to increase ASIC's jurisdiction or to carve out responsibility for the financial sector from the Australian Competition and Consumer Commission (ACCC). The ACCC

would continue to promote competition and fair trade throughout the Australian economy, and administer and enforce the *Competition and Consumer Act 2010* and related legislation. The ACCC would remain the competition regulator across the economy.

65 Consequently, ASIC's existing regulatory powers would be sufficient to enable us to pursue a competition objective. If anti-competitive conduct by entities within our regulated population was identified (or other conduct that primarily involves the application of the Competition and Consumer Act), we would refer this to the ACCC for investigation.

66 The importance of competition in the financial system and ASIC's work in this area, international approaches to regulating competition in the financial system and the implications of the changing competitive environments in Australia's financial markets are discussed in more detail in Section B.

Ensuring the superannuation system better meets the needs of the retirement phase

67 The overarching aim of the superannuation system is to provide members with an adequate income in retirement. However, the focus of public awareness of superannuation currently revolves around the pre-retirement phase.

68 Since 1997, the proportion of Australians aged over 60 has increased from 15.9% of the total population to 19.8% in 2013. The Australian Bureau of Statistics (ABS) forecasts that this proportion will continue to rise in the future, reaching 25% of the population in 2040.

69 Superannuation funds and financial advisers will need to adapt their business models and products to the retirement phase. However, currently there are limited product offerings and significant deficiencies in retirement advice.

70 Account-based products dominate the retirement-phase market, but these products generally do not address longevity risk for retirees. Annuities protect retirees against longevity risk, but are relatively unattractive to investors due to their opacity, complexity and conservative investment profile. The annuity market has contracted considerably in recent years.

71 In 2011, ASIC conducted shadow shopping research which looked at financial advice about retirement.[1] We found that, while the majority of advice examples we reviewed (58%) were adequate, 39% of the advice examples were poor, and two examples were good quality advice (3%).

[1] Report 279 *Shadow shopping study of retirement advice* (REP 279).

72 Supply-side barriers to good quality financial advice included product-focused advice and conflicts of interest that limited the quality of the advice being provided, a heavy reliance on pro forma advice and the need to improve training and professional development.

73 On the consumer side, the main problem is the difficulty consumers have in evaluating the quality of advice they receive.

74 These lessons from ASIC's regulatory experience are discussed further in Sections D and G.

Lifting standards in financial advice

75 We consider that, beyond the current Future of Financial Advice (FOFA) reforms (see paragraphs 807–815) there are still some regulatory gaps, the addressing of which would facilitate ASIC's ability to promote high standards in the financial advice industry.

76 Ultimately, such gaps negatively affect the public's perception of the financial advice industry, and reduce ASIC's ability to fulfil our mandate of promoting confidence in the financial system. We are concerned that, in our most recent stakeholder survey, less than a quarter of respondents (23%) agreed that financial advisers act with integrity. We made each of the proposals below in our main submission to the current Senate Inquiry into the performance of ASIC: see Appendix 1.

Adviser competence

77 In ASIC's view, the competence and training of financial advisers requires significant improvement. This was also a conclusion of the 2009 PJC Inquiry into Financial Products and Services in Australia (Ripoll Inquiry). Only well-trained, competent advisers can provide good quality advice.

78 The *Corporations Act 2001* (Corporations Act) requires Australian financial services (AFS) licensees to ensure that their representatives are adequately trained and are competent to provide financial services.

79 However, ASIC surveillances have consistently found that many advisers are not adequately trained or competent to deliver financial advice to investors. This can lead to poor advice outcomes for investors.

80 ASIC provides guidance on our expectations regarding training standards in Regulatory Guide 146 *Licensing: Training of financial product advisers* (RG 146). The training standards in RG 146 are minimum standards and vary depending on the adviser's advice activities—that is, they vary depending on whether the adviser gives general or personal advice and what

products the adviser gives advice on. Advisers who provide advice on Tier 1 (broadly speaking, more complex) products must meet the standards at a different educational level from those advisers who provide advice on Tier 2 products (simpler products).

81 ASIC considers that an objective process is required to determine whether advisers have met a minimum standard of competency, and the most transparent and effective way to achieve this is through a national examination model.

82 Under a national examination model, advisers would need to successfully pass the examination before being able to give personal advice on Tier 1 products. In addition to an entry examination, advisers should complete regular knowledge updates to ensure they maintain their competency once they have passed the examination.

83 The national examination proposal would require amendments to the general obligations for AFS licensees in the Corporations Act to stipulate that representatives must have passed the national examination to be deemed competent.

84 Some practical advantages of a national examination include:

(a) *consistent competency standards*—all advisers would be required to sit and pass the same examination, ensuring investors and financial consumers have access to competent advisers;

(b) *assistance to industry*—a single, nationally consistent standard, coupled with a national register, would greatly assist AFS licensees in complying with their obligations to ensure their advisers are adequately trained;

(c) *mutual recognition*—the United States, the United Kingdom, Canada, Singapore and Hong Kong all have national examination approaches to adviser competency. Implementing a national examination in Australia would then facilitate mutual recognition arrangements with these countries on adviser competency, potentially allowing Australian advisers to advise clients in those countries and vice versa; and

(d) *greater transparency*—a national examination coupled with an enhanced register of employee representatives (see paragraphs 88–91) would create greater transparency and assist investors and financial consumers in better assessing their adviser's skills and competency; it should also lead to increased investor confidence in advisers.

Mandated reference checking

85 There is a real and significant problem with 'bad apples' in the financial advice industry. These bad apples typically change employment when they

are identified, moving from one AFS licensee to another. In many cases, the new licensee is unaware of their bad apple status because either:

(a) the new licensee failed to conduct a proper reference check; or

(b) the former licensee failed to provide accurate and honest feedback on the adviser or did not agree to provide feedback at all, sometimes out of apprehension of liability for making defamatory statements.

86 To overcome the current problems associated with poor or non-existent reference checking, mandated reference checking should apply to all advisers who provide personal advice on Tier 1 products (i.e. the more complex products, in relation to which quality of advice is particularly important).

87 The advantages of mandated reference checking include that:

(a) it would aid transparency and efforts to improve standards in the financial advice industry;

(b) the process of reference checking would be more efficient and certain for those licensees affected;

(c) bad apples would be identified earlier and more quickly removed from the financial services industry, by allowing ASIC to better target our surveillances towards higher risk advisers;

(d) investors and financial consumers would benefit from increased protection from dishonest, incompetent or unethical advice;

(e) industry would benefit by not receiving as many claims for bad advice; and

(f) the overall reputation of the financial services industry would be enhanced.

Enhanced register of employee adviser representatives

88 Under the current financial services regulatory regime, authorised representatives must be registered with ASIC; however, there is no central register for employee representatives. This means that ASIC has no direct oversight of employee adviser representatives, including those who provide personal advice, and must rely on AFS licensees to ensure the competence and integrity of these representatives. This can result in very real difficulties in ASIC's ability to locate and take action against bad apples in the financial services industry.

Note: An 'authorised representative' is a natural person or corporate entity to which an AFS licensee gives an authorisation to provide financial services on its behalf. An authorised representative may be structured as a separate business from the licensee. 'Representative' is a broader term, incorporating all persons that act on a licensee's behalf, including employees, directors and authorised representatives.

89 ASIC should be given power to extend our current financial services registers to include all individuals authorised to give personal advice on Tier 1 products, not just AFS licensees and authorised representatives. We think that the current authorised representatives register should be expanded to:

(a) cover those employee advisers who provide financial advice about Tier 1 products; and

(b) include a comprehensive competence and employment history.

90 We expect that an enhanced public register would provide a real opportunity for investors and financial consumers to more effectively shop around when looking for a financial adviser. Seeing information about how long an adviser has been in the industry, how often they have moved from AFS licensee to AFS licensee, any disciplinary action against the adviser, and their training and competency records could provide powerful information for investors.

91 A public register for all advisers who advise on Tier 1 products would significantly improve transparency by:

(a) providing a centralised repository of current and relevant data relating to competency, employment and any potential misconduct by individual advisers;

(b) enabling ASIC to streamline compliance activities and act expeditiously where problems are identified;

(c) assisting industry to address risk where bad apples are concerned; and

(d) supporting industry's efforts to lift standards in a transparent and public way.

Preventing a person from managing a financial services business or credit business

92 While the initial licensing process is important as the point of entry to the financial services industry and credit industry, it is also critical for ASIC to have sufficient powers to remove persons from operating within each industry where warranted. However, a difficulty that ASIC faces is that the regime focuses on entities to the exclusion of their managing agents (such as managers or directors). This means ASIC can have difficulty removing those managing agents from the industry in circumstances where there is a strong argument that it is warranted.

93 While ASIC has powers to cancel an AFS licence or credit licence, or ban a person from providing financial services or credit services, a missing element is a power to prevent a person from having a role in managing a financial services business or credit business.

94 ASIC recommends amending the law to provide ASIC with the power to ban a person from managing a financial services business or credit business.

Strategic participation in global financial markets

Cross-border transactions

95 The provision of financial facilities, services and products across borders can deliver significant economic benefits to Australian markets, businesses, investors and financial consumers.

96 When those financial facilities, services and products are provided into Australia, the benefits to Australian investors can include:

(a) enhancing competition and innovation in the financial industry; and

(b) increasing Australian investors' access to financial facilities, services and products that meet their risk and return preferences.

97 When those financial facilities, services and products are provided from Australia, the benefits to Australian providers can include:

(a) facilitating access to a wider pool of investors;

(b) making it easier for Australian issuers to raise capital; and

(c) providing Australian market intermediaries with access to a broader range of markets and clients for their services and products.

98 Such cross-border activity can make Australian markets deeper and more liquid by increasing the number of investors in Australian facilities, services and products.

99 While it is desirable to access those benefits, often by removing unnecessary regulatory barriers and reducing regulatory costs, financial regulation must still ensure that Australian investors are adequately protected, the integrity of Australian financial markets is not compromised, and systemic risks are not created in the Australian financial system.

100 ASIC's approach is to facilitate access by providers from overseas regulatory regimes that are 'sufficiently equivalent' to the Australian regulatory regime in relation to the degree of investor protection, market integrity and reduction of systemic risk that they achieve. Where an applicant's home regulation is found to be sufficiently equivalent, then the applicant may be exempted from the equivalent parts of the Australian regulatory requirements (which would otherwise impose unnecessary duplication).

Modes of cross-border regulatory recognition

101 Cross-border transactions can be facilitated by unilateral recognition of another country's regulation, by mutual recognition or multilateral recognition. Such arrangements can reduce the regulatory burden for providers seeking to access foreign markets. They have the potential to facilitate quicker entry to markets, reduced regulatory costs, increased competition, greater capital flows, and more liquid markets and investor choice.

Mutual recognition

In 2008, Australia and New Zealand entered into an agreement on trans-Tasman mutual recognition of securities offerings. This is an example of a successful cross-border regime based on mutual recognition.

The regime allows issuers from either country to offer securities (including shares and debentures) or interests in managed investment schemes in the other country, using their home prospectus or Product Disclosure Statement (PDS), without complying with most of the substantive requirements of the host jurisdiction. It is premised on the principle of 'substituted compliance'—that is, each jurisdiction relies on an issuer's compliance with the rules of the other jurisdiction. It is an arrangement based on trust and confidence between governments and regulators in the equivalent regulatory systems of their partner jurisdiction.

On 23 October 2009 ASIC, in consultation with the New Zealand Securities Commission, released Report 174 *Effects of the Australia–New Zealand mutual recognition regime for securities offerings* (REP 174). It found that the regime had reduced legal and documentation costs for some issuers by between approximately 55% and 95%. The time to go to market was also significantly reduced. From 30 June 2008 to 15 March 2013, the number of offers made under the regime was 66 New Zealand offers to Australia and 834 Australian offers to New Zealand. This arrangement can be expected to have encouraged cross-border offerings, and to have provided significant benefits in both countries.

Unilateral recognition

An example of unilateral recognition is the relief provided by ASIC set out in Regulatory Guide 176 *Foreign financial services providers* (RG 176). RG 176 sets out how and when such providers of services to wholesale clients can be exempted from the requirement to hold an AFS licence. Essentially, ASIC will grant such relief where it has been shown that the financial services are regulated and overseen by an overseas regulatory authority whose regulatory regime is sufficiently equivalent to the Australian regulatory regime and there are effective cooperation arrangements between the two regulators.

Under this arrangement, relief has been provided to providers from the United Kingdom, United States, Singapore, Hong Kong and Germany.

Multilateral agreement

One of the best known examples of a multilateral agreement is the European Union's Undertakings for Collective Investment in Transferable Securities (UCITS).

The UCITS Directives establish a uniform regulatory regime for the creation, management and marketing of collective investment vehicles in the countries of the European Union. The original aim was to allow a collective investment scheme authorised by one European member state to operate throughout the European Union and this aim has been realised successfully.

Within the European Union, UCITS has given investors a wider choice of funds and reduced costs for issuers. The UCITS 'brand' of scheme has, however, acquired international recognition and reputation that has made it attractive and allowed UCITS-compliant funds to be sold globally, including in Asia. Total net assets in UCITS vehicles stood at €6.5 billion at the end of January 2014.[2]

Developing further cross-border activity

102 Australia has a well-developed, sophisticated and internationally credible financial sector. It is a net importer of capital. Yet its imports and exports of financial services are low by international standards and the volume of funds under management in Australia sourced from offshore is low.[3] Total funds under management in the Asian region at the end of 2013 was approximately A$3,200 billion, 12% of worldwide funds under management, although Asia accounts for 60% of the world's population.[4]

103 There are many and complex reasons for the limited amount of cross-border activity in the Australian financial sector. One significant cause identified by the report *Australia as a financial centre: Building on our strengths* published by the Australian Financial Centre Forum in November 2009 (the Johnson report) is the cost of complying with different and duplicated regulatory requirements across countries.

104 There appears to be an opportunity to facilitate cross-border activity by reducing the regulatory barriers and, in particular, the costs that come from complying with more than one set of national regulations.

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[2] European Fund and Asset Management Association, *Long-term UCITS continue to register strong net inflows of EUR 65 billion in Q2*, 2013, www.efama.org/Publications/Statistics/Quarterly/Press%20Realeases%20Quarterly%20Statistics/130906_PRESS_RELEASE_Q2_2013.pdf.

[3] See *Australia as a financial centre: Building on our strengths,* published by the Australian Financial Centre Forum in November 2009 (the Johnson report). The 2013 *Australian investment managers cross-border flows report*, published by the Financial Services Council and the Trust Company, notes, however, a 78% increase from 1 January 2010 to 31 December 2012 in Australian managers' overseas-sourced managed investment trust funds—66% of those funds came from the Asia–Pacific region. The report covered managers who managed 47% of Australian overseas-sourced funds.

[4] Financial Services Council and the Trust Company, *Australian investment managers cross-border flows report*, 2013.

Opportunities in Asia

105 The area where potential benefits from the recognition of foreign regulation are most striking is Asia. It is a natural area for Australia to build greater ties with, being geographically close with similar time zones. The Johnson report noted the impressive growth in the region and the dramatic increase in personal wealth and high private sector savings, combined in some areas with a limited range of financial assets in which to invest. The Government's white paper *Australia in the Asian century*, released in October 2012, also noted the opportunities Asian development created for Australia. The Government said it would remove unnecessary regulatory measures or impediments to cross-border business activity over time and continue to better align regulatory frameworks with other countries in the region. It considered continued financial market integration a priority and would continue efforts to increase access by foreign investors and businesses to Australian financial markets and to secure greater regional use of Australian financial services.

106 While Asia is poised for further growth, in some areas its markets are diverse, relatively fragmented and weak. Asian countries have recognised the value of creating better connections between financial markets in the Asia region and the potential benefits this could bring. Better connections and integration could:

(a) provide all investors with a more diverse range of investment opportunities;

(b) deepen the region's capital markets to attract finance for growth in the region;

(c) facilitate the recycling of the region's savings locally, by growing the pool of funds available for investment in the region; and

(d) strengthen the capacity, expertise and international competitiveness of financial markets in the region and the fund management industry, with a view to supporting sound economic development.

Further integration could also be designed with a view to maintaining legal and regulatory frameworks that promote investor protection and fair, efficient and transparent markets for financial services.[5]

107 The Johnson report recommended the development of an Asia Region Funds Passport (Passport) for managed investment schemes, a recommendation that was also supported by the *Australia in the Asian century* white paper, and by other Asian nations. Australia and its regional counterparts are currently working to develop the Passport.

[5] Asia–Pacific Economic Cooperation, *Statement of intent for the Asia Region Funds Passport*, 20 September 2013, www.apec.org/~/media/Files/Groups/FMP/20130923_ARFP_SOI_Signed.pdf?bcsi_scan_A0B24AD6DE328DEC=CYSdGwa3sh5QM7PwoUSMeD0L2zgiAAAAgahCBw==&bcsi_scan_filename=20130923_ARFP_SOI_Signed.pdf.

108 The Passport is being progressed under the auspices of the Asia–Pacific Economic Cooperation intergovernmental forum. The Passport proposal envisages a regulatory framework under which managed investment schemes that satisfy certain conditions on structure and operation and are registered in one Asian jurisdiction can be sold into other Passport jurisdictions with minimal additional regulatory approval. It will facilitate the cross-border marketing of managed funds across participating economies in the Asia region. It is also hoped that the Passport will become recognised as a strong local brand, attracting greater investment as it becomes known as a safe and reliable product.

109 On 20 September 2013, finance ministers from Australia, Korea, New Zealand and Singapore signed a statement of intent on the Passport.[6] The statement outlines an undertaking by signatories to publicly consult on detailed arrangements and sets out a process to see the Passport implemented by 2016. A broader group of 13 regional countries (including the four signatories) contributed to the process to develop the Passport and may subsequently also become members of the Passport.

110 The Passport represents a significant shared step by countries in the Asian region to expand, develop and link their markets, for the benefit of all. ASIC supports the Passport initiative.

111 The Association of Southeast Asian Nations (ASEAN) has launched a similar initiative. Its *Framework agreement on mutual recognition arrangements* (which is geared to promote cross-border trading of financial products) is intended to allow fund managers of any member state within the region to offer locally constituted and authorised funds to retail investors in other member jurisdictions under a streamlined process. The ASEAN bloc has a combined population of more than 600 million people, and there are currently 10 member states, of which Singapore, Malaysia and Thailand have so far signed the relevant memorandum of understanding.

112 The relevant jurisdictions will explore how the ASEAN initiative and the Passport initiative could potentially complement one another.

Future developments

113 We consider that there would be benefits in encouraging the Government to explore the possibility of using similar arrangements more widely. For example, it might be possible to permit ‘passporting’ in the Asian region for securities offerings such as bonds or equity investment, as well as for managed investment schemes, to further encourage the regional integration

[6] Asia–Pacific Economic Cooperation, *Statement of intent for the Asia Region Funds Passport*, 20 September 2013, www.apec.org/~/media/Files/Groups/FMP/20130923_ARFP_SOI_Signed.pdf?bcsi_scan_A0B24AD6DE328DEC=CYSdGwa3sh5QM7PwoUSMeD0L2zgiAAAAgahCBw==&bcsi_scan_filename=20130923_ARFP_SOI_Signed.pdf.

of Asian markets and to strengthen all the markets involved. Developing further passporting arrangements would not only provide immediate benefits and facilitate cross-border activities in the particular relevant areas to the benefit of local investors, issuers, markets and the financial sector industry, it would also help to foster links among the Asian countries in financial markets.

114 In current international conditions, this could also give Asian countries a stronger voice in international forums. Recently, the United States and the European countries have developed some aspects of their financial sector regulation with extra-territorial reach, as discussed in Section B. This trend is of concern to other regulators, such as those in the Asian region. One benefit of forming closer links among Asian markets is that smaller countries like Australia will then be able to speak as part of a group and as such improve their ability to have their views taken into account and their legitimate interests respected.

115 While the current focus in developing multilateral regimes has been on Asia, the Government could also explore the feasibility of using passporting arrangements outside Asia and New Zealand. For example, it could explore the possibility of passporting with the United States.

116 We acknowledge that passporting arrangements can be difficult to achieve. They must accommodate differences in regulation, the expectations and needs of investors and issuers, market conditions and financial industry practices. Nonetheless, the potential benefits can be considerable, and crucially can accrue to all the countries involved.

117 For more detail on the increasing globalisation of financial markets and international regulatory responses, see Section B.

Managing systemic risk

118 In response to the global financial crisis, a number of countries have recalibrated their regulatory systems to address financial stability concerns (e.g. the United States and the United Kingdom). They have adopted flexible arrangements to extend and clarify how and when prudential regulation is used to address systemic risk. This enables an ongoing assessment of the regulatory perimeter.

119 Consistent with the philosophy of the Wallis Inquiry, Australia’s prudential framework addresses systemic risk arising out of sectors and entities currently regulated by APRA, authorised deposit-taking institutions (ADIs) and insurers.

120 We consider it would be useful to consider establishing a formal mechanism for monitoring for the future build-up of unacceptably high levels of systemic risk in entities, markets or sectors outside the boundary of prudential regulation and to respond if necessary. Flexibility in applying elements of the existing prudential regulation framework to newly identified systemic risk (where appropriate) would promote systemic stability.

121 The manner in which the current prudential regulation framework addresses financial stability, efforts in other jurisdictions to establish integrated oversight of systemic risk, and the potential for systemic risk to arise from outside the current prudentially regulated perimeter are addressed in Section G.

Improving conduct through a more flexible regulatory toolkit

122 ASIC considers that having a broader and more flexible regulatory toolkit would enhance our ability to foster effective competition and promote investor and financial consumer protection. Market problems such as information asymmetries are particularly acute in markets for financial products and services and disclosure has not always been effective to address them. While disclosure remains a central tool, in some situations other tools would be more effective and provide scope to reduce disclosure requirements.

The limitations of disclosure

123 In addition to regulating the conduct of institutions and intermediaries in their dealings with investors and financial consumers, a significant focus of the regulatory system ASIC oversees lies in mandating the provision of disclosure. Disclosure is used to overcome some of the market problems that typically arise in the financial system, particularly to correct informational asymmetries.

124 However, while disclosure is necessary for arming investors and financial consumers with key information to guide decision making, certain limitations mean that it is not sufficient for this task. Additionally, a person's knowledge, experience and cognitive biases will affect exactly how they use that disclosure. For example:

(a) the behavioural biases discussed in Sections A and G, which lead people to rely on beliefs and preferences in decision making, may also mean that people will not read mandated disclosure documents, or inadequately understand or even misunderstand those documents;

(b) people may lack the resources (e.g. financial literacy skills, motivation and time) to read and understand disclosure documents;

(c) the complexity of many financial products may mean that disclosure for such products:

(i) is very lengthy and complex, which may make it unrealistic for many people to read and understand it in the time available to them; or

(ii) is over-simplified or generalised in an attempt to deal with this complexity, which may make people over-confident about their understanding of a product and its risks; and

(d) disclosure alone is unlikely to correct the effect of broader market structures and conflicts that drive product development or distribution practices that result in poor investor outcomes (e.g. conflicted remuneration structures), especially where the interests of issuers and distributors are fundamentally misaligned with those of investors.

125 All of these factors are likely to explain the observation that many people do not read or understand mandated disclosures. Many people rely on other information and advice sources, including website information and advertising: see Section B for further discussion of the role of advertising.

126 Disclosure is more effective at addressing some market problems than others. Before imposing disclosure requirements, analysis is necessary about whether disclosure is the appropriate solution to the particular problem. For example, in ASIC's experience, disclosure has proved relatively ineffective in enhancing consumer understanding of the level of risk involved in a product or service, or in addressing problems associated with conflicts of interest. But well-designed disclosure can be a useful mechanism to enhance consumer understanding of the costs and fees of using a product or service if the fee structure is not too complex. Simple, very prominent and clear warnings about, for example, whether a product is prudentially regulated or covered by the deposit guarantee can be effective.

127 The focus of regulation should be on outcomes rather than limited to ensuring full disclosure. Where appropriate and necessary, regulation should seek to enhance investors' behaviour either by improving their understanding or improving the environment in which they are required to make decisions.

Ways of moving beyond disclosure

A more flexible regulatory toolkit

128 Internationally, regulators are looking for a broader toolkit to address market problems. For example, the International Organization of Securities Commissions (IOSCO) has published a consultation paper on retail structured products, which proposes an optional 'regulatory toolkit' organised along the financial product value chain, covering product design and issuance, disclosure and marketing, distribution, and post-sale practices.[7]

[7] Board of IOSCO, *Regulation of retail structured products*, IOSCO CR05/13, consultation report, IOSCO, April 2013.

129 In the United Kingdom, the FCA has access to a variety of new regulatory tools, described below. While these range in degrees of intervention and, in serious cases, could include a ban on products or product features, use of such tools is likely to be rare. Rather, having access to a range of different types of regulatory approaches allows the FCA to design and implement targeted responses that are suited to achieving a particular market outcome.

FCA's new interventionist approach

In recent years, the United Kingdom has restructured its financial regulatory system, including establishing a new consumer protection and market regulator, the FCA. The FCA commenced operation in March 2013.

The FCA will continue a move initiated by its predecessor, the Financial Services Authority, towards 'product intervention'. It will periodically review particular financial services market sectors and examine how products are being developed, and the governance standards that firms have in place to ensure fairness to investors in the development and distribution of products.

The FCA has also been given a spectrum of temporary 'product intervention' powers, to address problems seen in a specific product. These may include rules:[8]

- requiring providers to issue consumer or industry warnings;
- requiring that certain products are only sold by advisers with additional competence requirements;
- preventing non-advised sales or marketing of a product to some types of consumer;
- requiring providers to amend promotional materials;
- requiring providers to design appropriate charging structures;
- banning or mandating particular product features; and
- in rare cases, banning sales of the product altogether.

Rules could apply to specific products, or a class of products, and may remain in place for 12 months.

The FCA has said that the extent and intrusiveness of the rules it will make will be based on finding the type of intervention best fitted to the problem it identifies.[9] It will look to find a proportionate response to the problem, based on the perceived risk to:

- consumers;
- competition failings; and/or
- market integrity issues.

The FCA has also published a guide, *Applying behavioural economics at the Financial Conduct Authority*. This will support the FCA in taking into account lessons from behavioural economics in designing effective interventions. This guide indicates that not all such interventions need to be strongly interventionist, and that simple 'nudges' (i.e. small prompts in decision making that do not restrict choice) are likely to achieve cost-effective results in many cases.

[8] FCA, *The FCA's use of temporary product intervention rules*, PS13/3, policy statement, March 2013.
[9] FCA, *The FCA's use of temporary product intervention rules*, PS13/3, policy statement, March 2013.

130 Similarly to the approach taken in the United Kingdom and elsewhere, the Government may wish to consider ways in which Australia's financial regulatory system can move beyond traditional disclosure to address the types of problems investors and financial consumers often experience in financial decision making.

131 Options for regulatory tools and approaches other than disclosure include:

(a) helping investors better understand the information presented to them, including through financial literacy programs—as described in Section G, this is a significant aspect of ASIC's work;

(b) where investors and financial consumers need to make important choices, presenting those choices in a clearer way, or in a way that will encourage them to take the path most beneficial to them;

(c) changing the way products are distributed to investors and financial consumers, to reduce the risk of mis-selling of products; and

(d) intervening in the way products are designed and developed, to improve the quality of products being sold to investors and financial consumers.

The availability of such tools could be traded off against reduced disclosure requirements in some cases.

132 As detailed in Table 2, although the Wallis philosophy places principal reliance on disclosure, Australia has in the intervening period made some targeted use of other regulatory tools that have involved intervention in product marketing or distribution and, in some cases, intervention in product design.

133 The national credit regime imposes responsible lending requirements, requiring both lenders and intermediaries to assess the suitability of a loan for a consumer. This recognises that experience has proved that consumers have difficulty making decisions that involve the trade-off between current expenditure and future liabilities. The ban on conflicted remuneration introduced by the FOFA reforms (see paragraphs 810–814) has sought to remove incentives that may have undermined the quality of advice and address a problem that increasing disclosure had failed to address. The national credit regime has restricted the sending of unsolicited offers to increase credit limits in recognition that that marketing technique was resulting in adverse outcomes for some consumers.

134 In terms of product design, the national credit laws ban early exit fees on home mortgages because of their potential, even when adequately disclosed, to restrict mortgage switching and completion. The credit laws also impose other price restrictions such as the limits on the charges that can be imposed on payday or short-term loans. Finally, the Australian Consumer Law prohibition on unfair contract terms applies to most financial products and

services. It acknowledges that investors and financial consumers have little ability to discover or renegotiate unfair contract terms at the point where they are choosing a product or service.

135 There is also international interest in more limited interventions that do not ultimately restrict available choices, but prompt people to act in a certain way. These two types of regulatory tool have been described as 'shoves' and 'nudges', respectively.[10] Both are likely to be useful in different types of situations, and it may be important to test how interventions work in practice through trials before they are applied broadly.

136 Suggestions about how these types of tools might be used (both nudges and shoves) are detailed in Table 2.

Access to data and choice engines

137 It is clear that we have entered an era of 'big data', in which businesses are able to collect, store, analyse and use a much greater range of data on consumers—for example, to tailor products to their needs and market the products in a way that will appeal to the consumers.

138 Internationally, governments and regulators are increasingly considering what can be done to ensure that this trend can be harnessed to empower consumers and improve their decision making to enhance consumer outcomes and drive competition by, for example:

(a) making useful data directly available to consumers; or

(b) requiring product and service providers to make machine-readable data available to third parties, who may then be able to aggregate such data into useful 'choice engines' (see paragraphs 141–144).

139 The type of data that might be provided includes data that are personal to the consumer (e.g. patterns of past usage of products and services to inform the consumer's choice of a new product or their switching to a new provider) and data that are not personal to any particular consumer but would be informative in assessing the quality and value for money of a provider or goods and services.

[10] Cass Sunstein and Richard Thaler define these terms in *Nudge: Improving decisions about health, wealth and happiness*, Yale University Press, 2008. The application of these different types of approaches in the Australian context is discussed in Office of Best Practice Regulation, *Influencing consumer behaviour: Improving regulatory design*, research paper, Department of Finance and Deregulation, December 2012.

Table 2: Tools to change the way financial services are provided to investors and financial consumers

	Approach	Explanation	Ways we already do this	Further ideas to consider
'Nudges'	**Presenting information better**	Providing information to investors and financial consumers in ways that are easier to comprehend and less likely to exacerbate decision-making biases	ASIC has worked to improve the quality, clarity and effectiveness of mandated disclosure documents in a number of ways, including through providing guidance and reviewing issued documents. For particularly complex products, we have asked financial services providers to structure PDSs in the form of disclosures against a series of benchmarks, so that potential investors can quickly assess how the product measures against the benchmarks. Note: See, for example, Regulatory Guide 227 *Over-the-counter contracts for difference: Improving disclosure for retail investors* (RG 227).	• Provide information in different forms and channels, including using new media (e.g. to break down complex information into a manageable scale, require active participation and test understanding). • Give prompts at the point of decision making that are designed to align behaviour with a particular policy goal.
	Helping investors and financial consumers better understand information	Providing financial literacy programs that increase financial comprehension and drive long-term improvements in financial decision making	Financial literacy is a significant aspect of ASIC's role: see Section G.	• Continue to find new and better ways to reach a wide range of Australians to deliver our financial literacy programs.
	Changing the presentation of choices to investors	Changing the way choices are presented to address decision-making biases	There are various ways in which the regulatory system sets default options that are beneficial to investors and financial consumers, which harness people's tendency to procrastination and inertia to encourage them to remain in that state. For example, the new lower cost MySuper accounts will eventually replace existing default superannuation accounts to ensure that those who do not exercise superannuation choice are not adversely affected by their inaction: see paragraphs 314–316.	• Set default options, and require investors to opt in to take up alternative options. • Help investors and financial consumers understand how financial and credit products work when there are product features that are optional extras that many do not need. • Provide decision-making websites, which combine information about products and information about the investor or financial consumer to help them make the best choice for their situation.

	Approach	Explanation	Ways we already do this	Further ideas to consider
'Shoves'	**Influencing product distribution**	Enhanced conduct rules that impose requirements on product issuers or intermediaries for the way they market, recommend or sell products to retail investors and financial consumers	The national credit regime requires credit providers and intermediaries to assess the suitability of credit for consumers before lending takes place. This recognises that the trade-off between accessing credit today and having fewer available funds in future when repayment is due may be difficult for consumers to readily appreciate, and that decision-making biases lead people to overvalue immediate gratification relative to future needs. The FOFA ban on conflicted remuneration has removed some incentives to distribute certain products relative to others, in order to address the impacts these incentives have had on the quality of advice and the resulting outcome for clients. The national credit regime bans unsolicited offers to increase credit limits. It may be consumers' natural inclination to accept such offers, without necessarily being able to predict their future capacity to repay this additional credit. This means that such increases cannot be distributed directly to consumers.	• Require advice to be provided before products are sold. • Require products to be issued or sold through particular channels (e.g. some complex products only sold to retail investors through advisers). • Require products to be marketed in a particular way, or restricted to particular types of investors. • Require issuers or other intermediaries that provide products directly to investors to carry out suitability tests.
	Influencing how products are designed and developed	Banning product features or products	The Australian Consumer Law prohibition on unfair contract terms applies to many financial and credit products. This means that products cannot be designed with standard terms that are inherently unfair to the investor or financial consumer. Similarly, bans apply to early exit fee terms in mortgage contracts. The national credit regime applies interest rate caps on loans.	• Ban a feature of an investment product that will erode any investment gains. • Intervene in the product design process to ensure products are suitable for the types of investors and financial consumers to which they will be marketed. • In extreme cases, ban products.

Source: Adapted from K Erta, S Hunt, Z Iscenko and W Brambley, *Applying behavioural economics at the Financial Conduct Authority,* Occasional Paper No. 1, research paper, FCA, April 2013.

Making more information available to consumers in the United Kingdom and United States

The United States and the United Kingdom have recently implemented initiatives directed at making more government and private sector data available to the public. These 'smart disclosure' policies help consumer markets work more competitively by providing consumers with relevant data, not only about products or services but also about the consumer's own consumption history or patterns of use.[11]

United Kingdom: The MiData project

The MiData project works with businesses to give consumers better access to the electronic personal data that companies hold about them. It also aims to give consumers greater control of their data.

Giving people greater access to electronic records of their past buying and spending habits can help them to make better buying choices. For example, data that a phone company holds about a person's mobile use may help them choose a new tariff.

The MiData project aims to:

- get more private sector businesses to release personal data to consumers electronically;
- make sure consumers can access their own data securely; and
- encourage businesses to develop applications that will help consumers make effective use of their data.

Specific tools to be developed out of this project will include a comparison tool for bank accounts and other bank products, including the fees, charges and benefits attached.[12]

United States: Smart disclosure

Smart disclosure is intended to promote innovation and empower consumers by freeing up data bottlenecks.

Smart disclosure in the United States has a number of components, including:

- an executive order, *Making open and machine readable the new default for government information*;
- a website, www.data.gov; and
- a Task Force on Smart Disclosure: Information and Efficiency in Consumer Markets.[13]

140 ASIC thinks that there is merit in considering making more data available to Australian investors and financial consumers, particularly in situations of market failure where disclosure is failing to facilitate adequate choice and competition. As has been considered overseas, this could include both:

[11] US General Services Administration, *Smart disclosure research and demonstration design competition*, www.data.gov/consumer/challenge/smart-disclosure-research-and-demonstration-design-competition.
[12] UK Department for Business Innovation and Skills, *Government to make it easier to check you've got the right bank deal*, media release, UK Government, 16 March 2014, www.gov.uk/government/news/government-to-make-it-easier-to-check-that-youve-got-the-right-bank-deal.
[13] US General Services Administration, *An introduction to smart disclosure policy*, www.data.gov/introduction-smart-disclosure-policy.

(a) encouraging or compelling the provision of data and information (particularly personal data) to investors and financial consumers to help them make decisions and ensure they can benefit from the 'big data' trend; and

(b) going further in situations of market failure (e.g. evidence of poor investor and financial consumer decision making and outcomes, mis-selling of products, ineffective or distorted competition, products and services that are objectively poor value for money, high levels of complaint and dispute), and mandating the provision of more data and information designed to address that market failure and promote informed consumer decision making and competition.

141 For example, 'choice engines', such as decision-making or comparison websites, can provide consumers with an interface to more easily compare products and to interpret disclosure information to help them find a product or service that best meets their needs. Where designed responsibly, they can also increase competition between product and service providers by giving consumers potentially greater choice, better quality and competitive prices: see Section G.

142 Many choice engines already exist for financial services and products, comparing everything from insurance policies to margin loans. However, the provision of more and better data would further empower consumers to use mandated information from product providers to inform their decision making.[14] Such information might include, in the case of an insurer, the average length of time to pay a claim or, for a managed investment scheme, how often the fund has made a distribution. Additionally, the ability to access personal data could enable choice engines to base recommendations on both personal preferences provided by the consumer and revealed preferences demonstrated by past behaviour.

143 Such an approach is likely to be particularly effective in markets where some products can represent poor value for money, but mandated disclosure is not sufficiently arming investors and financial consumers to compare products and effectively exercise choice. For example, the UK FCA has conducted a market study of add-on products in the general insurance market, finding that competition is not working effectively in the market for such insurances. As part of a range of proposed remedies, it has suggested that it could require firms to publish claims ratios in order to increase transparency and put pressure on firms to improve product value.[15] Such information may help consumers understand the value for money of the type of product involved and the relative value for money of a particular supplier's product. The

[14] R Thaler and W Tucker, 'Smarter information, smarter consumers', *Harvard Business Review*, January–February 2013, pp. 47–54.
[15] FCA, *General insurance add-ons: Provisional findings of market study and proposed remedies*, MS14/1, market study, 11 March 2014.

mandated provision of complaints data may play a similarly useful role in assisting consumers choosing a product supplier.

144 The provision of data and information through such choice engines would be a form of advice that would potentially need to be monitored and possibly specifically regulated to ensure information is provided in an appropriate way. For example, regulation could specify the range of information that should be provided to ensure choice engines provide a balanced range of data. In the United Kingdom, the FCA is currently undertaking a broad and ongoing thematic review of price comparison websites for insurance, out of concern that some may have an unhelpful focus on price and brand, which may not result in consumers finding the most appropriate product for them.[16] Depending on the findings of the review, the FCA may issue further rules about the range of information that should be displayed on such websites.

Ways of enhancing disclosure

145 While we have discussed the limitations of disclosure, above, we think that disclosure could be enhanced by presenting information in ways that make it more useful to investors and financial consumers in the decision-making process, including by harnessing new media.

146 Traditionally, disclosure regulation has focused on what information about the product must be disclosed by issuers, rather than how the disclosure can help investors understand the product.

147 Currently, the disclosure requirements are very broad. A provider must include all information that an investor would need to make an investment decision, as well as disclosing other, specific information.

148 This has typically resulted in the provision of lengthy documents, that are unlikely to function well as a tool to help investors understand financial products. For example, ASIC recently undertook a review of the length of 193 product disclosure statements (PDS) (required for financial products other than securities) and prospectuses (required for securities) across a range of different product types. We found that the average length of documents in our sample was 63 pages.

149 Additionally, to make an informed choice about competing financial products may require the reading of not one disclosure document, but multiple documents of similar length.

[16] FCA, *The FCA launches review into price comparison websites*, media release, 24 November 2013, www.fca.org.uk/news/the-fca-launches-review-into-price-comparison-websites.

ASIC's past work on disclosure

150 We have worked extensively to improve the quality of disclosure, within the scope provided to us by the current law. This has included:

(a) developing regulatory guidance on how disclosure document should be presented, to better assist investors to locate and understand information they require to make an investment decision; and

Note: See, for example, Regulatory Guide 228 *Prospectuses: Effective disclosure for retail investors* (RG 228).

(b) encouraging and facilitating the online delivery of disclosures, to allow investors to receive documents in more convenient ways.

Note: See Regulatory Guide 221 *Facilitating online financial services disclosures* (RG 221) and RG 107 *Fundraising: Facilitating electronic offers of securities*.

151 However, enhancing the presentation and delivery of traditional disclosure still generally results in a static document that is likely to be lengthy.

Combining disclosure with other tools

152 We think that a better approach is to combine disclosure with tools to help investors understand products (e.g. generic education material and investor self-assessments). These concepts are different in that 'disclosure' generally means giving people facts or information, while 'investor education' generally means giving people a rounded comprehension of a subject.

153 While both are intended to help investors make informed decisions, many people do not read or understand mandated disclosure documents. This means that there is likely to be a resultant knowledge gap between what the investor actually knows and what they ought to know about a financial product.

Layered disclosure

154 Providing information to investors in layers (including electronically) may help achieve this dual approach. It may also meet the different needs of diverse investors, as well as meet an individual investor's needs at different points of their engagement with financial products. Importantly, this approach means that:

(a) investors can access the various forms of information at a point that is meaningful to their decision-making process (i.e. different layers at different points in time as outlined in paragraph 155); and

(b) different delivery methods can be harnessed to provide information in a way that will engage and facilitate understanding, including new media.

155 The different layers of information might include:

(a) essential information required for decision making in a short document (e.g. the product's key features, risks and costs);

(b) more detailed information about the characteristics of the product, the rules governing it and its potential performance under different scenarios;

(c) generic educational material about the relevant class of products, and information that could help an investor determine whether that class of products is suitable for them; and

(d) post-purchase information (e.g. cooling-off periods and complaint processes).

156 This approach would involve short mandated disclosure that all investors would receive, with more detailed or deeper layers of information being provided at the issuer's discretion. This would be available for the benefit of those investors who want it and also for analysts and advisers. This would be a novel approach—while the current regime mandates short-form disclosure for certain types of financial products, providers are still required to make available additional mandated information on specific topics (e.g. more extensive fee information and information about investment options other than the default option). The short mandated disclosure is likely to better suit most people who would prefer not to read long documents, and wish to receive disclosure in a more accessible format (e.g. in a format readable on a mobile device).

Note: The shorter PDS regime mandates tailored, prescriptive disclosure for a limited number of products that are considered simple, easy to understand and relatively standardised (e.g. simple managed investment schemes). It prescribes PDS content and maximum page length, with some additional mandated information and the option for further information to be incorporated by reference.

The products to which the shorter PDS regime applies include superannuation products (excluding defined-benefit or pension products, or products that have no investment component), simple managed investment schemes, margin loans and first home saver accounts. These products have a maximum prescribed PDS length of four to eight pages: see regs 7.9.11D and 7.9.10D of the Corporations Regulations 2001 (Corporations Regulations).

New media

157 Another component of a combined focus on disclosure and investor education would be providing the layers of information in ways that are more innovative and engaging, including through 'new media'.

158 ‘New media’ refers to content delivered through the internet and encompasses technology, images and sound.[17] It can provide greater interactivity. New media has the potential to deliver information in more digestible chunks and in more engaging ways. The popularity of mobile devices also presents new ways for investors to engage with product disclosure and is another example of how new media could be used to increase consumer engagement. Other options provided by new media include:

(a) video and audio content;

(b) calculators;

(c) animations; and

(d) drop-down menus and other features that require active interaction.

159 ASIC thinks that investor decision making could be further enhanced through the addition of an investor self-assessment component, where investors can test their understanding of the information provided to them about a product before making a decision whether to invest. This could be done as a self-assessment—for example, through an online quiz provided by the product provider.

160 While there is no legal requirement for product providers to develop investor assessments, ASIC is exploring the potential for product providers to develop these tools for investors, on a voluntary basis.

161 ASIC thinks the benefits for product providers of combining short disclosure, new media and investor self-assessment include:

(a) providing early warning about whether investors understand the product, or whether there is a problem with the disclosure material;

(b) reducing compliance costs through providers being subject to fewer mandated disclosure requirements, and facilitating more information provision online;

(c) reducing the likelihood that investors will acquire the products without really understanding their risks and features (particularly for more complex products), resulting in fewer investors experiencing difficulties and making complaints; and

(d) giving providers the opportunity to innovate using new media.

ASIC’s work on product disclosure and investor self-assessment

ASIC is exploring a proposal for a simple managed investment scheme where issuers give investors:

[17] B Socha and B Eber-Schmid, *What is new media?*, The New Media Institute, 2012, www.newmedia.org/what-is-new-media.html.

ASIC's work on product disclosure and investor self-assessment

- *a key facts sheet with prescribed content*—links to additional information (provided by the issuer or third parties) may also be given. This additional information would be optional and would not form part of the PDS; and
- *a tool to assess investors' understanding of the key facts* outlined in the key facts sheet and (at a basic level) the suitability of the investment for them (investor self-assessment).

The key facts sheet and additional information could be given electronically and incorporate new media.

An issuer who adopts this approach would not need to issue a PDS that complies with the shorter PDS regime.

Note: See note to paragraph 156 for an explanation of the shorter PDS regime.

162 Internationally, investor assessment requirements have been developed to create a better connection between the information provided to investors and their decision making about the suitability of the product for them. In some cases, particularly for products deemed to be more complex, investor assessment requirements have been applied as mandatory pre-requisites to issuing a product.

Investor assessment: International approaches

European Union

In EU member states, under the Markets in Financial Instruments Directive (MiFID), investment firms are generally required to assess the knowledge and experience of investors before selling a complex product in an 'execution-only' situation. The list of products that are 'complex' for this purpose is likely to be extended as part of an upcoming review of MiFID, to be implemented by around 2015.[50]

Where the obligation to make this assessment applies, investment firms are required to seek information from an investor to determine whether they have the knowledge and experience—to the extent appropriate to the nature of the investor, service and product—to understand the risks involved in the transaction or service that is envisaged. However, firms are able to determine in what form this information is sought from the investor (e.g. in a telephone or face-to-face interview, or through an online or hard-copy test).

United Kingdom

In addition to the investor assessment requirements applied to MiFID products, the FCA has recently finalised new rules applying restrictions similar to MiFID to investment-based crowdfunding platforms. The investor assessment requirement will apply unless certain other conditions apply, such as the investor having received financial advice, or having certified that they will not invest more than 10% of their net investible portfolio in such schemes.

Korea

Since February 2011, investors in Korea have been required to take a one-hour training class, either online or offline, before investing in equity-linked warrants. Training programs are provided by the Korea Council for Investor Education, a non-profit organisation dedicated to investor education founded by several capital market related organisations.

Investor assessment: International approaches

Japan, Hong Kong and Singapore

Intermediaries are required to assess investors' knowledge and experience about certain complex products before providing any services to them. For example, in Singapore, intermediaries dealing with an investor in a non-advised situation are required to formally assess an investor's investment knowledge and experience before selling certain specified products.

Penalties that provide the incentive for better conduct

163 The harm caused by corporate wrongdoing (misconduct that occurs in the corporate, financial market or financial services sectors) can be significant. For example:

(a) investors can lose money if they have relied on inappropriate advice and invested in products that are not suited to their risk appetite, financial situation, or needs and objectives; and

(b) people who obtain financial advantages by exploiting information asymmetries between well-informed 'insiders' and less well-informed market participants (including retail investors) undermine confidence and trust in the fairness of our markets and discourage participation in them.

164 Effective regulation depends on achieving enforcement outcomes that act as a genuine deterrent to misconduct. The public expect that we will take strong action against corporate wrongdoers. Effective enforcement is therefore critical for ASIC in pursuing our strategic priorities of promoting fair and efficient financial markets, and ensuring confident and informed investors and financial consumers.

165 Central to effective enforcement are penalties set at an appropriate level, and having a range of penalties available for particular breaches of the law. ASIC's credibility as an effective regulator depends on our ability to detect corporate wrongdoing and use our regulatory and enforcement toolkit in a way that maximises the deterrent effect on corporate wrongdoing. Effective rules that are monitored and enforced will not achieve this objective alone. Rather, having a range of penalties (including criminal, civil and administrative penalties, and infringement notices) allows ASIC to calibrate our response with sanctions of greater or lesser severity commensurate with the misconduct. This aims to deter other contraventions, and promote greater compliance, resulting in a more resilient financial system.

166 The toolkit of criminal, civil and administrative sanctions needs to adequately cover the typical range of corporate wrongdoing, with corresponding penalties that are set at an appropriate level given the nature

of misconduct and the type of entity (individual or corporate) likely to be involved. Any gaps in this toolkit can present a barrier to taking an effective enforcement approach because appropriate remedies may not be available.

167 In our submission to the Senate inquiry into ASIC's performance, we noted that a holistic review of penalties would be timely. Penalties under the relevant legislation have not been comprehensively reviewed for over a decade. For example, civil penalties in the Corporations Act have not been increased since they were enacted in 1992, when the maximum penalty for an individual was set at $200,000. In 2004, they were extended to include bodies corporate, with a maximum penalty for a body corporate of $1 million. These are flat dollar amounts (not linked to penalty units), and have not been altered for inflation.

168 To inform such a review, we conducted research on penalties for corporate misconduct in Australia, and how penalties for corporate wrongdoing in ASIC-administered legislation line up with other domestic and international practices: see Report 387 *Penalties for corporate wrongdoing* (REP 387).

Findings of Report 387

169 REP 387 looked at the penalties available to ASIC compared with those in Canada (Ontario), Hong Kong, the United Kingdom and the United States. We also made some domestic comparisons between the maximum penalties available to other comparable Australian Government regulators, as well as the penalties available in the different pieces of legislation we administer.

International comparison

Criminal penalties

170 Our research indicates that both maximum terms of imprisonment and fines available to ASIC are broadly consistent with those available in other jurisdictions (see Table 3and Table 4). Exceptions include the higher prison terms available in the United States, and the lower fines in Australia for punishing unlicensed conduct and contraventions of continuous disclosure obligations.

Table 3: Comparison of Australian and overseas jurisdictions' prison terms (years)

Country	Insider trading	Market manipulation	Disclosure	False statements	Unlicensed conduct	Fraud
Australia	10	10	5	10	2	10
Canada*	10	10	5	5	5	14
Hong Kong	10	10	—	10	7	10

Country	Insider trading	Market manipulation	Disclosure	False statements	Unlicensed conduct	Fraud
United Kingdom	7	7	—	7	2	10
United States	20	20	20	20	20	20**

* References to 'Canada' in this section are to 'Canada (Ontario)'.

** Fraud offences that amount to 'securities and commodities fraud' attract a maximum prison term of 25 years under the Sarbanes-Oxley Act: see 18 U.S.C. § 1348.

Table 4: Comparison of Australian and overseas jurisdictions' fines for individuals (AUD)*

Country	Insider trading	Market manipulation	Disclosure	False statements	Unlicensed conduct	Fraud
Australia	Greater of $765,000, or 3 times the benefit gained	Greater of $765,000, or 3 times the benefit gained	$34,000	Greater of $765,000, or 3 times the benefit gained	$34,000	Greater of $765,000, or 3 times the benefit gained**
Canada	Greater of $5.25 million, or 3 times the benefit gained	$5.25 million	$5.25 million	$5.25 million	$5.25 million	—
Hong Kong	$1.44 million	$1.44 million	—	$1.44 million	$720,000	—
United Kingdom	Fine (unlimited)	Fine (unlimited)	—	Fine (unlimited)	Fine (unlimited)	Fine (unlimited)
United States	$5.6 million	$5.6 million	$5.6 million	$5.6 million	$5.6 million	$5.6 million

* All monetary conversions are based on the daily exchange rate published by the Reserve Bank of Australia as at 31 December 2013.

** This is the maximum fine for dishonest conduct under s1041G of the Corporations Act. While this section is not specifically directed towards fraud, conduct that constitutes fraud also frequently raises issues of dishonest conduct.

Non-criminal monetary penalties[18]

171 The comparison with international practices indicates that a broader range of non-criminal monetary penalties is available in other jurisdictions.

172 The other jurisdictions surveyed have greater flexibility to impose higher non-criminal penalties and scope to use non-criminal penalties against a wider range of wrongdoing. For example, in some jurisdictions, the quantum

[18] For the purposes of our research, we defined 'non-criminal monetary penalties' as both administrative penalties and civil penalties. In comparing our penalties to those in other jurisdictions, we found that our overseas counterparts use administrative penalties in a similar way to how we seek to use civil penalties. Consequently, we considered the two as equivalents using the term 'non-criminal penalties'.

of non-criminal penalties may be a multiple such as three times the financial benefit for some contraventions. This can be an effective way to link civil penalties to the benefit obtained as a means of ensuring that the potential penalty exceeds any benefit obtained from the wrongdoing, which is important in deterring future contraventions: see Table 5.

Table 5: Comparison of Australian and overseas jurisdictions' civil and administrative penalties for individuals (AUD)

Country	Insider trading	Market manipulation	Disclosure	False statements	Unlicensed conduct	Inappropriate advice
Australia	Civil: $200,000	Civil: $200,000	Civil: $200,000	—	—	Civil: $200,000
Canada	Administrative: $1.05 million	Administrative:$ 1.05 million	Administrative: $1.05 million	Administrative: $1.05 million	Administrative: $1.05 million	Administrative: $1.05 million
Hong Kong	Administrative: unlimited	—	Civil: $1.12 million	—	—	Administrative: $1.4 million, or 3 times the benefit gained
United Kingdom	Civil and administrative: unlimited	Civil and administrative: unlimited	Administrative: unlimited	Civil and administrative: unlimited	—	Administrative: unlimited
United States	Civil: 3 times the benefit gained*	Civil: greater of $111,000, or the benefit gained	Civil: greater of $111,000, or the benefit gained	Civil: greater of $111,000, or the benefit gained	Civil: greater of $111,000, or the benefit gained	Administrative: $83,850

Note: This table does not address the availability of disgorgement, which is addressed in Table 6. Some contraventions that do not attract a civil or administrative penalty may nonetheless be subject to disgorgement orders. For example, in Hong Kong, market manipulation does not attract a civil or administrative penalty; however, disgorgement is available.

* For control persons, the maximum non-criminal penalty is the greater of $1.12 million or three times the benefit obtained.

173 In addition, administrative penalties are more widely available in overseas jurisdictions and can be used to punish serious wrongdoing. For example, in the United Kingdom, the FCA can impose a penalty of such amount as it considers appropriate for any contravention of the *Financial Services and Markets Act 2000* (UK).[19] In Hong Kong, the Securities and Futures Commission can order a regulated person to pay a penalty of three times the benefit gained.

174 ASIC does not have an administrative fining power, as significant penalties can only be imposed by courts. Instead, we can issue infringement notices to provide a prompt and visible means of enforcing the law for minor regulatory offences and the lower end of the scale of more serious misconduct (see paragraphs 180–182).

[19] *Financial Services and Markets Act 2000* (UK), s206.

Note: Constitutional considerations limiting the exercise of judicial power to the courts mean that the relevant statute cannot impose an obligation on the recipient of an infringement notice to pay the penalty specified in the notice. For this reason, the penalty under such a notice cannot be properly characterised as an administrative penalty.

Disgorgement

175 Other international jurisdictions have the ability to require disgorgement — that is, the removal of financial benefit that arises from wrongdoing (e.g. profits gained or losses avoided). In the overseas jurisdictions we surveyed, the power to require disgorgement is either provided in legislation (as in Canada (Ontario), Hong Kong and the United States) or incorporated as a step in the process of penalty setting by the regulator (as in the United Kingdom).

176 Table 6 sets out the availability of disgorgement in these jurisdictions. Disgorgement can also be used as an effective mechanism for removing the financial benefit of the wrongdoing separate from any additional penalty or remedy.

Table 6: Availability of disgorgement in non-criminal proceedings

Country	Insider trading	Market manipulation	Disclosure	False statements	Unlicensed conduct	Inappropriate advice
Australia	×	×	×	×	×	×
Canada	✓	✓	×	✓	✓	✓
Hong Kong	✓	✓	×	✓	×	×
United Kingdom	✓	✓	✓	✓	×	✓
United States	✓	✓	✓	✓	✓	✓

Domestic comparison

177 Our survey revealed differences between the penalties available under the Corporations Act and penalties in other legislation for corporate wrongdoing, whether administered by other Australian Government regulators or by ASIC for similar categories of wrongdoing.

178 Table 7 sets out the maximum available civil penalties in relevant Australian legislation. It shows that in the jurisdictions of other Australian Government regulators, the maximum civil penalties available are higher than those available in the Corporations Act. In addition, the ACCC has the ability to seek a penalty against corporations in civil proceedings that is three times the value of benefits obtained. As noted earlier, the approach of linking civil

penalties as a multiple of the benefit obtained can be an effective way of ensuring that the potential penalty exceeds any benefit obtained from the wrongdoing, which is important in deterring future contraventions.

Table 7: Comparison of maximum civil penalties in Australia

Act	Maximum penalty for an individual (AUD)	Maximum penalty for a body corporate (AUD)
Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Australian Transaction Reports and Analysis Centre)*	$3.4 million	$17 million
ASIC Act (ASIC)	$340,000	$1.7 million
Australian Consumer Law (ACCC)	$220,000	$1.1 million
Competition and Consumer Act (ACCC)	$500,000	Greatest of $10 million, 3 times the value of benefits obtained or 10% of annual turnover
Corporations Act (ASIC)	$200,000	$1 million
National Credit Act (ASIC)	$340,000	$1.7 million

* The civil penalties under the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* apply to all civil penalty offences covered by that Act, not only terrorism-related offences.

179 Across legislation administered by ASIC, the maximum penalty amounts available for some comparable types of wrongdoing also vary. For example, the provision of financial services without an AFS licence attracts a criminal penalty under the Corporations Act with the maximum fine that may be imposed on an individual being $34,000. In contrast, an individual who engages in credit activity without an Australian credit licence is subject to the same criminal penalty, or alternatively a civil penalty up to 10 times greater—that is, up to $340,000.

Infringement notices

180 Infringement notices occupy the gap in our regulatory toolkit between imposing fines for minor regulatory offences, which carry a maximum penalty of not more than five penalty units (see s1313 of the Corporations Act) and the lower end of the scale of more serious misconduct. They are an efficient regulatory and enforcement tool because they are comparatively quick and easy to issue. For example, as a form of agreed settlement, there is less need to compile evidence to meet a criminal or civil standard beforehand. This means they can be imposed frequently and increase awareness of the need to comply with the law.

181 Currently, the Corporations Act does not provide infringement notice powers for certain types of misconduct. This may be seen as creating a regulatory gap for ASIC as we are unable to pursue this type of action in circumstances

where it may be fitting, which in turn may affect ASIC's ability to enforce the law efficiently and effectively with less desirable outcomes.

182 In conducting a comparison between ASIC-administered legislation for the purposes of REP 387, we considered the number of civil penalty provisions in ASIC-administered legislation and infringement notices that attach to those provisions: see Appendix 1 of REP 387. This research indicated that the Corporations Act has approximately 50 civil penalty provisions, two of which (s674 and 675) have infringement notice provisions attached, while the National Credit Act has approximately 90 civil penalty provisions with over one-third of those also being infringement notice provisions.

Implications of Report 387

183 The findings of REP 387 highlight a number of differences between penalties available to ASIC and other domestic and international regulators. They demonstrate that penalties available for corporate wrongdoing warrant further attention and consideration.

184 Accordingly, ASIC suggests that it would be timely for a holistic review of penalties under ASIC-administered legislation to be conducted to assess whether adequate penalties are available and set at an appropriate level.

185 A review of this nature could consider exploring:

(a) whether maximum criminal penalties are adequate;

(b) the availability and level of civil penalties, including the potential to use multiples of any benefit obtained through the wrongdoing, and converting the current maximums into penalty units;

(c) the availability of administrative penalties;

(d) the availability of disgorgement of profits gained or losses avoided from corporate wrongdoing to remove that money from wrongdoers in civil penalty proceedings; and

(e) whether the infringement notice regime should be expanded to cover a broader range of contraventions.

186 There are clear economic benefits to conducting a review of this nature. In particular, promoting effective regulation and enforcement is the cornerstone of helping ASIC pursue its strategic priorities of ensuring fair and efficient corporate, financial services and markets sectors.

187 Further details on the importance of enforcement, and ASIC's approach to enforcement, are set out in Section 256 and Appendix 2.

A better funding model for ASIC

188 ASIC has a diverse range of regulatory and registry functions, both of which have expanded significantly in recent years: see Section B.

189 Activities within ASIC's regulatory function now include:

(a) licensing and registering individuals and entities engaged in regulated activities;

(b) monitoring companies and businesses, including financial services providers;

(c) assessing how effectively authorised financial markets comply with their legal obligations;

(d) enforcing the law where required; and

(e) advising the Minister responsible for authorising new markets and licensing.

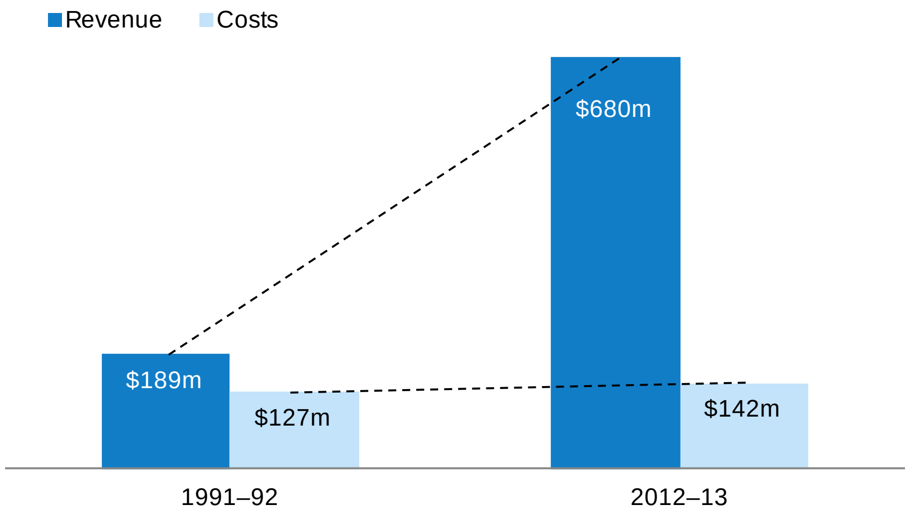
190 The changes in ASIC's regulatory functions have not been fully reflected in the manner in which ASIC collects revenue for the Government or in the way that the Government funds ASIC to perform its functions. ASIC does not retain for our own use any of the revenue we collect whether it be fees and charges or the proceeds of enforcement activities.

191 Figure 1 compares the revenue collected and costs incurred from company regulation and registration in the 1991–92 financial year (by the Australian Securities Commission) with revenue and costs from the 2012–13 financial year. In 1991–92, the then Australian Securities Commission's responsibilities were largely centred around registering and regulating companies; its costs were largely aligned with the revenue it collected from company registration. Since then, the revenue collected from company registration has grown and significantly outstripped ASIC's current costs of providing this function.

192 Over the years, ASIC has evolved into a financial services and markets regulator: see Section B for a discussion of the expansion of ASIC's remit in recent years. Figure 2 shows the proportion of ASIC's costs that are now spent regulating sectors other than companies (e.g. AFS licensees, financial markets, credit providers and insolvency practitioners), compared to the Australian Securities Commission's responsibilities in 1991.

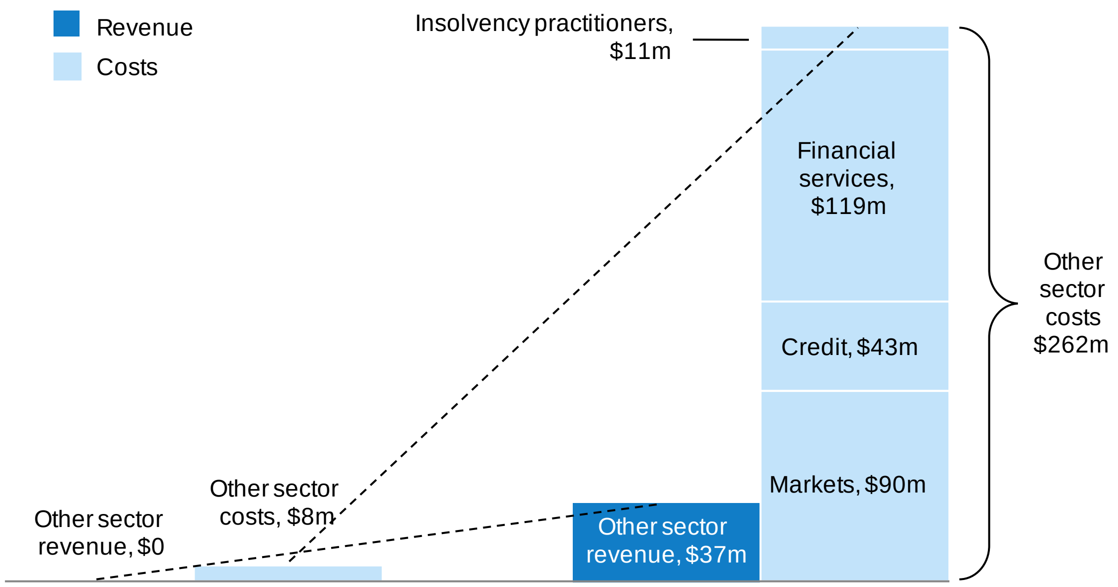
193 The revenue collected by the Government from the new sectors we now regulate is increasingly misaligned with ASIC's cost of regulation in these areas. For example, it costs ASIC about $108 million to regulate AFS licensees; however, ASIC collects for the Government only $3.7 million in registry fees from AFS licensees, approximately 3.5% of the cost of regulation.

Figure 1: Revenue and costs—companies, business names and searches, 1991–2013 (nominal terms)



Note: Figure 1 is an estimate only, and is not adjusted for inflation. Costs include depreciation. Revenue is from companies, business names and searches; costs are from regulating companies, including administering business names and searches.

Figure 2: Revenue and costs—all other sectors, 1991–2013 (nominal terms)[20]



Note: Figure 2 is an estimate only, and is not adjusted for inflation. Costs include depreciation. 'Other sectors' includes insolvency practitioners, AFS licensees, credit providers, exchange market operators, market participants and consumers. 'Financial services' includes financial advisers, insurers, responsible entities, superfund trustees, deposit takers, investment banks, consumers and custodians.

[20] 1991–92 'other sector costs' are all sectors consolidated and include $0.68 million for statutory bodies.

194 This misalignment raises concerns about the fairness of the current means of collecting revenue. While regulation imposes compliance costs on industry, it also brings a number of benefits to a regulated population. Regulation can enhance the reputation of an industry, provide clear operating rules and standards, and reduce the risk of market problems. However, at present, the populations ASIC regulates are not charged in proportion with the benefits they receive from our regulation.

195 At present, there are also no economic incentives (price signals) in the market for the use of ASIC's resources. Stakeholders acting rationally will seek to efficiently allocate their own resources and may choose low-cost or no-cost ASIC services over other, more costly, alternatives available in the market (e.g. private legal advice).

196 Price signals associated with the use of ASIC's resources would allow business to identify the cost of regulation required to achieve the desired regulatory outcome. If industry can deliver the Government's desired policy outcomes more efficiently and effectively through co-regulation or self-regulation, and therefore require less use of ASIC's resources and cost less to regulate, they would have an incentive to allocate resources to undertake part or all of the regulation themselves. This would ensure that the desired policy outcomes are delivered in the most economically efficient way. However, these price signals are not currently in place.

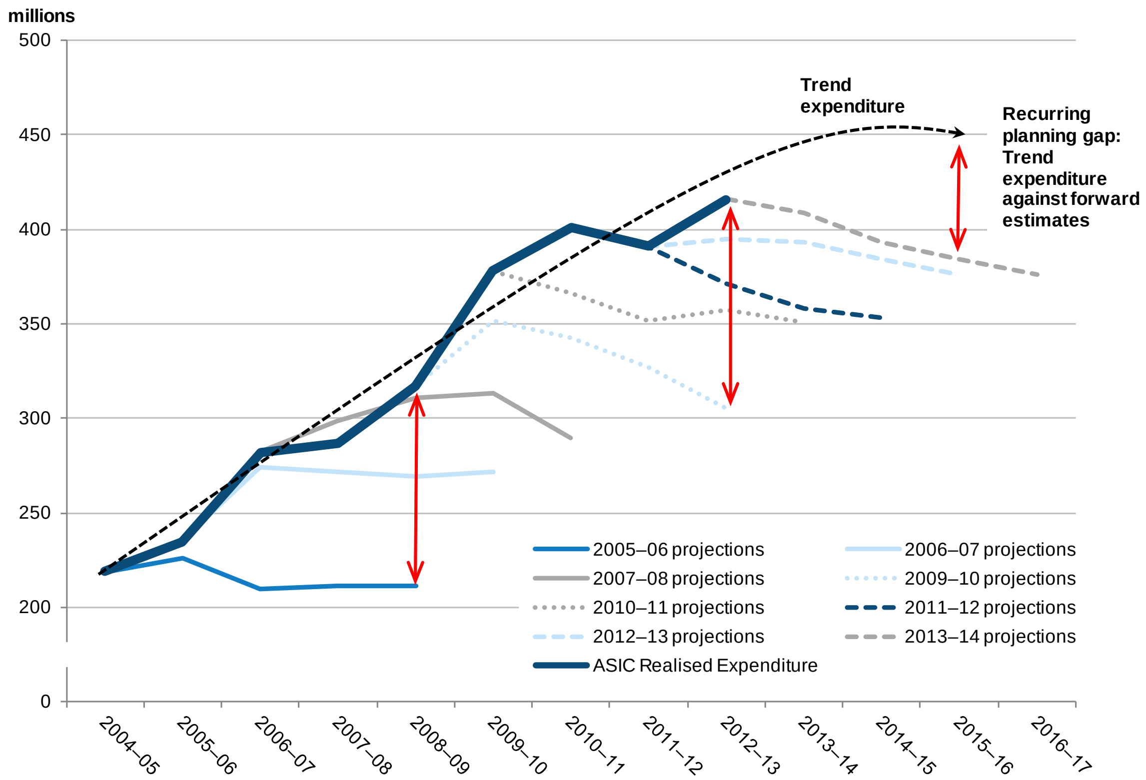
197 ASIC is largely funded by government appropriation. Variance in funding from year to year exacerbates the uncertainty inherent in the budget process and results in inefficiencies in the allocation of ASIC's resources to achieve regulatory outcomes. Since 2005, there have been significant differences between the forward projections of ASIC's budget expenditure and our realised expenditure: see Figure 3.

198 For example, there was a 50% difference between ASIC's 2008–09 realised expenditure and the expenditure forecast in the Treasury's 2005–06 Portfolio Budget Statements. Similarly, the realised expenditure in the 2011–12 financial year was 34% more than the projections that had been made in the Treasury's 2008–09 Portfolio Budget Statements. The differences between the forward and realised expenditure limit ASIC's ability to forward plan in response to market and regulatory developments. Our ability to forward plan is also limited by the growing percentage of our operating budget that is provided by new policy proposal funding (i.e. ad-hoc funding provided by the Government for specific purposes and for limited time periods).

199 ASIC's current funding model was criticised by the Financial Stability Board (FSB) and the International Monetary Fund (IMF) in November 2012. The IMF expressed concerns about the government-funded models of Australia, the United States, Japan and Argentina. They were concerned

about a lack of stable funding, an inability to commit resources to longer term projects and weaknesses in proactive supervision.

Figure 3: ASIC's realised expenditure against forward projections, 2005–13



Source: Based on Treasury data.

A new 'user pays' funding model

200 In light of the issues associated with the current funding model, ASIC has developed a new 'user pays' funding model, based on a cost recovery approach for ASIC's regulatory functions.

201 The proposed user pays funding model is not concentrated on increasing ASIC's budget but on providing economic incentives to drive the regulatory outcomes set by government.

How would cost recovery work?

202 Under the proposed funding model:

(a) our regulatory costs would be recovered from industry—costs would be recovered specifically from those who engage in regulated activities and those who benefit from a well-regulated market and financial system; and

(b) the current fees would be rationalised to simplify the fees paid by industry participants who use our services.

203 This would involve a combination of fees for services and levies and would be based on the recovery of costs attributed to regulatory activities: see Figure 4.

204 Fees for services would be directly linked to the costs ASIC incurs in delivering a particular service (e.g. assessing applications for relief from the law). Stakeholders engaged in those regulated activities would be charged the fee each time the service was required. These fees would ensure the users of those services bear the costs in accordance with principles set out by the Government in its Finance Circular 2005–09 *Australian Government cost recovery guidelines*.

205 All costs not recovered by fees would be aggregated at the stakeholder-group level, and would form the basis of levies charged to external stakeholder groups on an industry basis. The levies would cover the costs of regulatory activities that generally relate to those groups, but not to individual entities (i.e. costs that would not be recoverable through direct, activity-based fees).

Figure 4: ASIC's estimated costs to be recovered for regulatory activities#

$m	
284.06	'Core' funding per 2012–13 budget
65.64	Ongoing costs component of separate new policy proposals (excluding implementation)
349.69	**Total funding for a typical year's ongoing spending**

Allocated to

68.75	Registry
272.44	Regulatory
8.50	Regulatory bodies (CALDB, SCT)
349.69	

272.44	*Regulatory*
14.11	*Capital added*
286.55	***Typical year's funding for regulatory business***

Recovered by

37.84	13%	Fees
248.71	87%	Levies

Represents the cost of activities in 2012–13.

206 The levies would be based on volume-related metrics. By way of example, the cost of regulatory activities would be recovered from financial advisers as part of an AFS licence sector levy based on the size of financial adviser groups as determined by the number of authorised and employee representatives. Tiered models would be used to distribute the industry levy between industry participants. In accordance with the *Australian Government cost recovery guidelines*, the levies would recover costs for ASIC's work in monitoring ongoing compliance, and in investigation and enforcement.[21]

207 This approach would not be novel, given a range of Commonwealth agencies currently access revenue collected under cost recovery arrangements. For example, Intellectual Property Australia, which administers intellectual property rights and legislation including patents, trademarks and designs, primarily funds its activities through the collection of fees for applications and renewal of registrations for intellectual property rights.

208 One possible regulatory cost recovery approach is for ASIC to collect and retain the proposed fees as own-source revenue under s31 of the *Financial Management and Accountability Act 1997* for demand-driven regulatory activities (e.g. applying for an AFS licence). This would allow ASIC to more readily respond to increased demand. Levies could be similarly collected and retained to offset any fluctuating shortfalls and surpluses between years. This is an approach that has been adopted by other regulators, including those discussed in paragraphs 209–210.

Comparisons with other regulators

209 Other comparable regulatory and registry agencies have largely implemented funding models that recover the cost of regulation from their regulated populations. For example:

(a) a large number of comparable domestic and international financial services regulators and registry agencies have adopted either an industry-funded or combined industry–government-funded model; and

(b) many financial services regulators use a combination of models for industry charging, including transaction levies, cost allocation, standard annual fees, and volume-related annual fees, charging directly for core services, fees based on a risk assessment, income from fines and revenue from other activities.

[21] See Figure 4, p. 26, of the *Australian Government cost recovery guidelines.*

United Kingdom: FCA funding model and operations

The FCA operates entirely through industry funding and takes a judgement-based, pre-emptive approach to market supervision, focusing on those entities with the greatest potential to cause risks to consumers or market integrity.

To achieve this, the FCA adopts a 'conduct classification' that informs its supervisory activities, coupled with cost recovery through an annual fee consultation with industry.

This combination enables the FCA to be highly responsive to market fluctuations and areas of emerging risk that require heightened regulatory attention. The annual fee consultation—requiring accountability to both HM Treasury and the regulated population—also explains how the FCA will allocate its funding across its regulated population, taking into account its regulatory responsibilities, which provides greater transparency on how it uses its money.

Revenue received by the FCA does not form part of consolidated revenue. Any surplus is offset against costs the following year and if there is a shortfall in funding, the FCA has overdraft facilities with banks (which are rarely used).

210 France's Autorité des Marchés Financiers (AMF) is an independent public authority (rather than a government agency) that is funded by fees levied on market participants, the rate of which is fixed by the Ministry of Finance within a range established by law. The AMF can engage in multi-year planning and has full independence in deciding on the allocation of its budget, and retains surpluses or funds deficits independently of government.

211 Similarly, the Ontario Securities Commission (OSC) does not receive any government appropriations and the revenue it receives largely does not form part of consolidated revenue. The proposed user pays funding model for ASIC would be also consistent with those used by many others of our international counterparts, including the NZ Financial Markets Authority.

Potential benefits of a cost recovery model

212 If implemented by Government, a user pays funding model could:

(a) drive economic efficiencies through:

(i) using price signals to encourage self-regulation and co-regulation, where essential preconditions for such alternative models exist (see Section I);

(ii) limiting the overuse of ASIC's resources, particularly where it is more economically efficient for industry to allocate their resources to achieving the desired regulatory outcomes;

(iii) creating cost transparency of ASIC's regulatory activities and services, and greater cost accountability for ASIC;

(b) foster opportunities to better target regulatory outcomes by granting ASIC additional flexibility to allocate resources and plan to address emerging risks without the constraints of year-to-year funding decisions;

(c) cultivate greater equity in who pays for regulatory activity by minimising the extent to which stakeholders demanding more regulatory attention are cross-subsidised by those requiring less; and

(d) strengthen ASIC's operational independence to better manage internal operational risks and externally focused market risks.

Separation of regulatory and registry functions

213 In addition to our regulatory responsibilities, ASIC also has a registry function.

214 ASIC's registry function focuses on maintaining the data on the 42 registers for which ASIC is responsible. In the last five years, ASIC's registry business has expanded to include new registers for the purposes of credit licensing, national business names registration, SMSF auditor registration and a liquidator portal.

215 ASIC's combination of regulatory and registry responsibilities makes it unique among leading financial services regulators and corporate registries internationally. Generally, regulatory and registry functions are performed by separate agencies in most other jurisdictions.

216 The different focus of each of ASIC's regulatory and registry functions means that—aside from the current sharing of technological infrastructure, corporate support, and data held on the registers—each function is able to operate independently of each other. This has become increasingly important as ASIC's regulatory and registry responsibilities and functions have expanded significantly in recent years and, accordingly, focused efforts on more specialised services provision. For example, in practical terms the regulatory function has needed to become more proactive in approach with a strong external stakeholder focus, while the registry function is carried out by a dedicated team of staff skilled in operational registry management.

217 Significant opportunities to introduce economies of scale at the whole-of-government level exist by combining other 'like' registers with ASIC's registry business and creating a simpler, more direct, process for Australia's business community. This could be achieved through corporatisation of ASIC's registry business.

218 ASIC has undertaken an internal separation of the operations of the regulatory and registry functions to assist with transparency of cost and also to provide greater focus on the specialisation of each business. This separation is also a logical interim step to facilitating any future moves the Government may wish to undertake with registry businesses generally.

219 The separation of ASIC's registry function from our regulatory function is in line with the typical structural division of corporate registers from financial

regulation in many overseas jurisdictions. The United Kingdom, United States, Hong Kong, New Zealand, Republic of Ireland, Sweden and Italy each have separate entities dedicated to company registration and other registry administration and management functions, including the provision of information services from these registers. This highlights the differences in focus of regulatory and registry businesses, and the ability to exploit time and cost savings more readily when focused on a core business. While it is not ASIC's intention to propose that our registry function be cost recovered, for completeness, it should be noted that international corporate registries are typically funded on a cost recovery basis. Such funding mechanisms appear to drive operational efficiencies even further in these organisations.

220 The internal separation of ASIC's regulatory and registry operations that we are currently undertaking supports the implementation of an alternative funding model for our regulatory business, by providing greater transparency around how costs are allocated to operate each of ASIC's regulatory and registry functions.

B ASIC's role and regulatory principles

Key points

ASIC regulates Australian companies, financial markets, financial services organisations and professionals who deal and advise in investments, superannuation, insurance, deposit taking and credit. We operate under an extensive accountability framework.

The legislation under which ASIC operates generally envisages that we will act primarily as a conduct and disclosure regulator. Retail financial regulation is based on the premise that financial services markets pose particular problems for consumer choice and competition because of the complexity and long-term nature of the products involved. More recently, policy settings have included features that go beyond disclosure as a regulatory tool, including prohibitions on certain conflicts of interest in retail investment advice.

Internationally, regulators are looking for a broader toolkit to address market problems, moving beyond traditional conduct and disclosure regulation to design regulatory interventions that better address decision making by investors and financial consumers.

ASIC's role in the financial system

221 ASIC regulates Australian companies, financial markets, financial services organisations and professionals who deal and advise in investments, superannuation, insurance, deposit taking and credit.

222 The ASIC Act requires ASIC to:

(a) maintain, facilitate and improve the performance of the financial system and entities in it;

(b) promote confident and informed participation by investors and financial consumers in the financial system;

(c) administer the law effectively and with minimal procedural requirements;

(d) enforce and give effect to the law;

(e) receive, process and store, efficiently and quickly, information that is given to us; and

(f) make information about companies and other bodies available to the public as soon as practicable.

223 As the *financial services regulator*, we have responsibility for investor and consumer protection in financial services. We administer the Australian financial services (AFS) licensing regime and monitor financial services

businesses to ensure that they operate efficiently, honestly and fairly. These businesses typically deal in superannuation, managed funds, deposit and payment products, shares and company securities, derivatives and insurance.

224 As the *consumer credit regulator*, we license and regulate people and businesses engaging in consumer credit activities (including banks, credit unions, finance companies, and mortgage and finance brokers). We ensure that licensees meet the standards—including their responsibilities to consumers—that are set out in the *National Consumer Credit Protection Act 2009* (National Credit Act).

225 As the *markets regulator*, we assess how effectively financial markets are complying with their legal obligations to operate fair, orderly and transparent markets. We also advise the Minister about authorising new markets. On 1 August 2010, we assumed responsibility for the supervision of trading on Australia's domestic licensed equity, derivatives and futures markets.

226 As the *corporate regulator*, we ensure that companies, schemes and related entities meet their obligations under the Corporations Act. We register and regulate companies at every point from their incorporation through to their winding up, and ensure that company officers comply with their responsibilities. This 'cradle to grave' approach enhances regulatory oversight. We also register and, where necessary, take disciplinary actions against company auditors and liquidators. We monitor public companies' financial reporting and disclosure and fundraising activities.

227 ASIC also promotes *financial literacy*, to ensure investors and financial consumers can have greater confidence when buying financial services, and are able to make sensible and informed financial decisions.

ASIC's accountability framework

228 As an agent of the Australian Government and the public, ASIC is accountable for all aspects of our work, including our financial management, and our regulatory and law enforcement decisions.

229 ASIC is ultimately accountable to the Australian Parliament for our operations and performance. We are also accountable through administrative and judicial review and through the broader scrutiny of the general community.

230 Being accountable is a component of ASIC's responsibilities in its own right, and demands time and other resources as much as any other task we perform.

ASIC's governance arrangements

231 The ASIC Act establishes ASIC's Commission and sets out its functions and powers as well as the statutory governance requirements for ASIC, including:

(a) the terms and conditions of the appointment of members of the Commission;

(b) provisions governing meetings of the Commission;

(c) delegation by the Commission and its members; and

(d) arrangements for preventing conflicts of interest and misuse of information.

232 The Commission has also established a number of external committees to provide guidance to ASIC on various issues. These include:

(a) the External Advisory Panel, which assists ASIC in meeting our objectives, including to better understand the market that ASIC regulates and to be more forward-looking in examining issues and assessing systemic risks;

(b) the Consumer Advisory Panel, which provides advice to ASIC on current consumer protection issues and gives feedback on ASIC policies and activities;

(c) ASIC's Audit Committee, which provides independent oversight of, and reporting to, ASIC's Chairman and the Commission regarding ASIC's risk management and internal control frameworks. The Audit Committee Chairman, Deputy Chairman and one other member of the Committee are appointed from outside ASIC. An ASIC Commissioner and senior executive from ASIC are also members;

(d) the Market Supervision Advisory Panel, which advises ASIC on our approach to our responsibilities in day-to-day supervision of the Australian market and on broader market developments. Members are from the financial services industry with experience in the legal, compliance, retail and institutional aspects of broking; and

(e) the Registry and Licensing Business Advisory Committee, which advises ASIC on the impact of current and proposed services with an emphasis on small business and registry services.

233 ASIC's Commissioners have a statutory obligation to disclose to the Minister certain interests, such as direct or indirect pecuniary interests and any previous, existing or possible new business relationships. All of ASIC's staff are also required to disclose and take reasonable steps to avoid any real or apparent conflict of interest in relation to their employment.

Oversight of ASIC

Accountability to government

234 The Minister responsible for ASIC is the Treasurer, assisted by the Assistant Treasurer and the Parliamentary Secretary to the Treasurer. Particular responsibility for the administration of ASIC has been allocated to the Assistant Treasurer. The Commission reports to government through ASIC's annual report and through briefings, submissions and meetings with both the Treasurer and the relevant Minister. ASIC also meets with, and provides briefings to, officers of Treasury.

235 The Minister may direct ASIC to investigate a matter and prepare a report about our findings. Under s12 of the ASIC Act, the Minister may also direct ASIC about policies and priorities in using our powers or performing our functions, but may not direct ASIC about a particular case.

Accountability to the Parliament

236 ASIC is accountable to the Parliament in a number of ways, including through:

(a) ASIC's annual report, which is tabled in Parliament;

(b) parliamentary scrutiny of any legislative instruments ASIC makes under the *Legislative Instruments Act 2003*; and

(c) ASIC's obligation to appear before and respond to questions of certain parliamentary committees, including the Parliamentary Joint Committee on Corporations and Financial Services (PJC) and the Senate Standing Committee on Economics as part of the budget estimates process.

237 In addition to appearing before the PJC and the Senate Standing Committee on Economics, ASIC also regularly appears before, and participates in, other Government inquiries, including the recent Senate Economics References Committee inquiry into the performance of ASIC.

Administrative and judicial review of ASIC's decisions

238 The ASIC Act, the Corporations Act and other Commonwealth regulatory legislation confer various powers and discretions on ASIC. The exercise by ASIC of most of our powers is subject to judicial review (review of the legality of the exercise of the power) and/or merits review (review of whether a decision was the correct decision) by the Federal Court and the Administrative Appeals Tribunal (AAT), respectively.

239 ASIC's actions can also be the subject of complaints to the Commonwealth Ombudsman. The Ombudsman can investigate complaints about actions and decisions of Australian Government agencies to see if they are wrong, unjust, unlawful, discriminatory or unfair.

Other sources of oversight and accountability

240 There are a number of other bodies that oversee regulators such as ASIC. These include Auditors-General and Ombudsmen.

241 There are a number of laws and agreements that affect ASIC, including:

(a) the *Financial Management and Accountability Act 1997* (FMA Act), sets out the financial management, accountability and audit obligations of agencies such as ASIC that are financially part of the Australian Government; and

(b) the *Freedom of Information Act 1982* (FOI Act), which, broadly speaking, gives Australians a right of access to documents held by government agencies.

242 ASIC is also accountable to the public, beyond our formal legislative obligations, through our:

(a) regular surveys of our stakeholders, which have to date been conducted in 2008, 2010 and 2013;

(b) Service Charter, covering the most common interactions between ASIC and our stakeholders, and setting performance targets for each type of interaction;

(c) publication of our policies and procedures; and

(d) interaction with the media.

Principles underpinning ASIC's role

243 The economic philosophy on which the Wallis Inquiry based its recommendations, and on which the current Australian financial services regulatory regime[22] is based, is that:

(a) free and competitive markets can produce an efficient allocation of resources, and provide a strong foundation of economic growth and development;

(b) where any factor impedes a market from producing efficient outcomes, there may be a case for government to regulate participation in or operation of that market; and

(c) the financial system warrants specialised regulation to ensure that market participants act with integrity and that consumers are protected, due to:

(i) the complexity of financial products;

[22] 'Australian financial services regulatory regime' refers primarily to Ch 7 of the Corporations Act. It also includes Chs 5C and 6D, as well as the financial services provisions of the ASIC Act.

(ii) the adverse consequences of market participants breaching financial promises; and

(iii) the need for low-cost means to resolve disputes.

244 Compulsory superannuation is premised on a different assumption, notably that retail investors are unlikely to make decisions in their long-term interest (i.e. save adequately for retirement) in the absence of compulsion.

245 The basic features of the current financial services regulatory regime were developed following these principles, and favour:

(a) efficient and flexible allocation of risk and resources;

(b) promotion of competition, innovation and flexibility; and

(c) retail investors having access to a wide range of products.

246 This approach accepts that regulation is necessary to deal with factors that prevent the market operating efficiently (e.g. information asymmetries, which can enable fraudulent conduct by industry participants and anti-competitive conduct, or manipulative conduct not in the best interests of the market as a whole (e.g. insider trading)), as long as such regulation is set at the minimum level necessary to respond to market problems.

247 These information asymmetries also create opportunities for conflicts of interest on the part of the people—product providers, distributors, advisers, and other gatekeepers—on whom consumers are relying for help. Their information advantage gives institutions and intermediaries opportunities to profit at the expense of investors and financial consumers.

248 In the most extreme cases, institutions or intermediaries can use their informational advantage to defraud their customers by deliberately misleading them.

Conduct and disclosure regulation

249 While the objectives of financial system regulation are similar to those applying in all markets (i.e. to prevent a range of possible market failures), the means of achieving them often need to take specific forms due to the nature and complexity of financial products.

250 For this reason, the financial services regime implemented following the Wallis Inquiry's recommendations includes specific types of financial regulation (conduct and disclosure regulation) to ensure:

(a) markets operate in a sound, orderly and transparent manner, participants act with integrity and the price formation process is reliable; and

(b) retail customers have adequate information, are treated fairly and have adequate avenues for redress.

251 The financial services regime's conduct regulation includes rules aimed at ensuring industry participants behave with honesty, fairness, integrity and competence. The regime uses a licensing system to control who can operate within the industry, and, if they do not meet conduct standards, exclude them by licence cancellation.

252 The financial services regime's disclosure regulation includes rules designed to:

(a) overcome the information asymmetry between industry participants and investors by requiring disclosure of information required to facilitate informed decisions by investors; and

(b) promote transparency in financial markets, and the efficient and appropriate pricing of assets and risks—for example, through continuous disclosure by companies of price-sensitive information.

253 Finally, the regime includes some additional investor protections to help address situations where consumers are likely to be at a particular disadvantage relative to industry participants. An example of this is the system of internal and external dispute resolution, which provides a free, accessible, fair and efficient process for retail investors and financial consumers: see Section H for more details. This system recognises that retail investors and financial consumers might otherwise find it difficult to resolve market disputes (e.g. through the courts) being non-expert and infrequent disputers with relatively few resources.

254 Conduct and disclosure regulation for financial products, including Australia's own regulatory system, has traditionally not been considered to involve 'merit' regulation. They have traditionally focused on the transparency of the sales process (through disclosure) and the conduct of the intermediaries involved in the sale. Unlike regulation for many non-financial products, conduct and disclosure regulation is typically not concerned with the 'safety' or quality of a financial product and the services associated with it. This is partly due to the acceptance that consumers must take on some level of risk for investment products.

255 There is currently growing international interest in redirecting financial services regulation to more actively influence the quality of financial services and products provided to investors and financial consumers: see paragraphs 128–129 of Section A.

Why financial products and services require specific regulation

256 The premise that financial products and services warrant a specific regulatory regime continues to have a solid policy basis and, in our regulatory experience, has been justified.

257 The Productivity Commission, in its 2008 *Review of Australia's consumer policy framework*, defined the overarching objective of consumer policy as:

> … to improve consumer wellbeing by fostering effective competition and enabling the confident participation of consumers in markets in which both consumers and suppliers trade fairly and in good faith.[23]

258 The Productivity Commission's report goes on to outline where it may be appropriate for particular markets to have specific regulation that overlays a generic regime to provide more effective and certain consumer protection—specifically:

(a) where the risk of consumer detriment is relatively high and/or the detriment suffered if things go wrong is potentially significant or irremediable; and/or

(b) where products are 'credence goods'—that is, their suitability and quality is hard to gauge before or even after purchase.[24]

259 Markets for financial products and services exhibit both these characteristics. While market problems such as informational asymmetries are a feature of many different types of markets, there are specific features of financial products and services that make informational asymmetries particularly difficult to overcome. This means that there is a higher risk than in most markets for mis-selling (i.e. that an investor or financial consumer will acquire a product not aligned with their financial situation, risk profile, objectives and needs) due to the investor or financial consumer's own choices alone, or as a result of the exploitation of informational asymmetries by service providers due to conflicts of interest or outright misconduct.

260 These factors may make it more difficult for competition to effectively operate in markets for financial services and products.

261 Competition may take different forms and lead to different outcomes. Effective competition can empower consumer decision making, and deliver innovation, improved services and lower prices. However, there are also forms of (supply driven) competition that operate in conjunction with complex markets and information asymmetries, and can develop in ways that do not improve overall economic welfare, by driving market fragmentation, dispersed liquidity, and reduced market depth and quality (see paragraphs 507–514 of Section E) or vertically integrated supply networks (see paragraphs 529–536 of Section E).

262 Competition requires consumers to be fully informed and freely able to exercise choice. However, as described in Table 8, there are specific

[23] Productivity Commission, *Review of Australia's consumer policy framework,* Inquiry Report No. 45, 30 April 2008, p. 2, www.pc.gov.au/projects/inquiry/consumer/docs/finalreport.

[24] Productivity Commission, *Review of Australia's consumer policy framework,* Inquiry Report No. 45, 30 April 2008, p. 25, www.pc.gov.au/projects/inquiry/consumer/docs/finalreport.

characteristics of markets for financial products and services that are likely to inhibit investors and financial consumers from exerting competition pressure.

Table 8: Issues in the exercise of competition forces over financial products

Lack of useful information/ability to use information	While information may be provided to investors and financial consumers about products in the form of disclosure, disclosure may not be sufficient to overcome informational asymmetries for a variety of reasons, including the typical complexity of the document and the financial comprehension of the investor or financial consumer. Note: The limitations of disclosure are discussed further in paragraphs 123–126 of Section A.
Difficulty making judgements brought about by complexity or difficulty in assessing quality and risk	Financial products may be relatively complex (from the point of view of the investor or financial consumer) and also have some features that impart some inherent complexity. More so than other types of products, financial products have a number of features that seem to provide competing indicators of their quality (e.g. price to acquire the product, past performance, rewards for acquiring the product (e.g. initial rates), and ongoing costs). It is difficult to be aware of and effectively evaluate all of these aspects simultaneously. Some products have particularly complex features that are likely to be difficult for many to understand (e.g. embedded leverage or inverse returns).
Timing mismatch between purchase and identifying a problem with a product	Because many financial and credit products have a long lifespan, any detrimental aspects of a product may only become apparent long after the product is purchased (e.g. whether the product meets claimed investment performance or not). This means that investors and financial consumers only receive valuable feedback on their purchase long after that information would have been useful.
Infrequency of purchase	As financial products are not a common purchase, it is more difficult for investors and financial consumers to effectively exert competition pressure by choosing a range of providers until they find a product meeting their needs, and some products may be structured to restrict investors' ability to withdraw from them in any case.

Source: Based on an analysis undertaken by the then Financial Services Authority (FSA), *Product intervention*, DP 11/1, discussion paper, January 2011, and S Lumpkin, 'Consumer protection and financial innovation: A few basic propositions', *OECD Journal*, vol. 2010, issue 1, 2010.

263 As noted in Table 8, even if information is provided to investors and financial consumers to correct informational asymmetries, they may not take the opportunity to use this information, or, if they do use the information, may not use it optimally. This may be caused by a variety of factors.

264 Firstly, this may be a result of low levels of financial literacy. A substantial body of research has been amassed indicating that many Australians lack adequate financial literacy skills,[25] which may make the process of

[25] For example, Australia's most comprehensive financial literacy study, the ANZ survey of adult financial literacy, is generally relied on as Australia's core baseline measure of financial knowledge, with the most recent survey results published

comprehending and applying information about a financial or credit product more difficult. The complexity of financial and credit products, which combine risk, uncertainty and financial concepts, means that understanding them adequately requires a certain degree of financial literacy: the importance of financial literacy is discussed in Section H.

265 Secondly, psychological research (behavioural economics) suggests that decision making is influenced by cognitive, social, situational and emotional factors, which in turn give rise to systematic biases in behaviour.[26] Specific attributes of financial and credit products—such as their complexity, risk, uncertainty and long-term nature—can accentuate people's natural inclination to eschew difficult reasoning and fall back on these behavioural biases.[27]

266 This can cause investors and financial consumers to make mistakes that lead to loss or harm, by making decisions on the basis of hasty and/or emotional responses to information or circumstances, by not taking into account relevant facts, or even by putting off decisions that need to be made to avoid loss or harm (e.g. taking out insurance). Aggravating this problem are marketing techniques that seek to exploit these biases to encourage investors and financial consumers to act in a particular way, or buy a particular product. These behavioural insights are discussed in greater detail in Section H.

267 All of these factors together risk the mis-selling of products to investors and financial consumers—that is, that they will acquire a product not aligned with their financial situation, risk profile, objectives and needs.

268 The difficulty in assessing products and services before delivery is a particularly strong rationale for the imposition of a licensing regime,[28] being a regulatory regime that provides minimum standards of conduct and education for providers of certain services in a manner that may be effectively enforced both before and after the point of sale. Licensing is a forward-looking regulatory tool: it imposes standards and rules before the point of sale, rather than simply reacting after the problem is discovered, unlike generic consumer product regulation.

269 Additional advantages of an adaptive licensing regime as a regulatory tool to enhance generic consumer product regulation are that it can be targeted (i.e. enabling regulation to be applied proportionately to the risk of the activity

in 2011: see ANZ, *ANZ survey of adult financial literacy in Australia*, The Social Research Centre, ANZ, Melbourne, December 2011, www.financialliteracy.gov.au/research.

[26] See Report 230 *Financial literacy and behavioural change* (REP 230).

[27] See, for example, FSA, *Product intervention*, DP 11/1, discussion paper, January 2011.

[28] Productivity Commission, *Review of Australia's consumer policy framework*, Inquiry Report No. 45, 30 April 2008, p. 27, www.pc.gov.au/projects/inquiry/consumer/docs/finalreport.

involved), and modified quickly to address emerging risks.[29] Licensing also increases confidence in an industry, which has advantages for both consumers and industry participants alike.

270 If things go wrong in relation to financial products and services, the consequences can be severe: investors and financial consumers may lose their home, their provision for retirement, or otherwise suffer extreme financial hardship. Although detriment arising from financial product mis-selling has the potential to be remedied by compensation, this depends on many circumstances being favourable (e.g. that the provider is still in business or has the means to provide compensation). The potential scale of losses in the financial system may mean that, if providers do compensate past poor practices or misconduct, this may involve taking on a significant financial burden.

Serious mis-selling of financial products in the United Kingdom

Personal pensions

In 1994, the then UK Securities and Investments Board (the predecessor to the Financial Conduct Authority) announced a review into the mis-selling of thousands of pensions when personal (i.e. not employer-provided or government-provided) pensions were made available in 1988.

Significant mis-selling occurred as a result of personal pensions being recommended where they were not suitable for the client or not in the client's best interest. The differences between personal pensions and occupational pensions were such that personal pensions were only likely to be suitable for those clients who moved frequently between employers.

In 1998, the then FSA estimated compensation payouts owing as a result of this mis-selling could reach up to £11 billion. A subsequent review of the selling of similar products, known as free-standing additional voluntary pensions (marketed as a mechanism to top up occupational pensions), estimated an additional £241 million was owed in compensation.

Compensation for this substantial period of mis-selling between 1988 and 1994 continues to be awarded by the UK Financial Ombudsman Service.

Payment protection insurance

Payment protection insurance covers loan or debt repayments if a borrower is unable to meet them in certain situations (e.g. being made redundant or not being able to work because of an accident or illness).

There was a widespread practice among UK lenders to encourage borrowers to take out payment protection insurance offered by the lender at the same time as a loan or credit card. However, in many cases, borrowers received inadequate disclosure about the insurance policies they were receiving, including the

[29] This can be contrasted with the Australian markets licensing framework, which has not been sufficiently adaptive to keep pace with industry change.

Serious mis-selling of financial products in the United Kingdom

significant exclusions that limited the usefulness of such insurance in some cases. Some borrowers reported feeling pressured to take up policies with their loan.[30]

Mis-selling of payment protection insurance affected a large number of borrowers. Since its establishment in 2000, the UK Financial Ombudsman Service has received over 500,000 complaints relating to payment protection insurance.[31]

In response to this issue, reforms were introduced from 6 April 2012 that generally prohibit lenders from selling payment protection insurance at the same time as providing a loan. However, the legacy of past mis-selling continues to represent a financial burden for industry, with industry payouts totalling over £12 billion to date.[32]

Cost of providing compensation after things go wrong

These examples of large compensation burdens, lasting many years after mis-selling occurred, exemplify the reasons for financial sector-specific regulation, including licensing and consumer protection. The large compensation amounts involved are indicative of the cost of failure to implement appropriate selling practices, and suggest that clear conduct rules are necessary to try to avoid these kinds of outcomes for industry.[33]

271 These features of financial products and services are central to the case for industry-specific regulation of this market. A specific and more intensive regulatory regime does not come without a cost. Nevertheless, the demand-side weaknesses of this market produce sufficient risk of investor and financial consumer detriment to continue to justify such a regime.

Prudential regulation

272 The Wallis Inquiry considered prudential regulation because a more intensive regulatory regime was only required where there was an intense financial promise in an underlying financial product or service.

273 The intensity of the financial promise dictated the level or desirability of financial safety or prudential regulation to prevent or mitigate consumer loss (consumer protection) and financial instability (systemic risk) as a result of a financial failure of an individual entity—thus a breach of an intense financial promise.

[30] UK Financial Ombudsman Service, *Annual review 2008–09*, p. 50, www.financial-ombudsman.org.uk/publications/ar09/ar09.pdf.
[31] UK Financial Ombudsman Service, *Annual review 2012–13*, www.financial-ombudsman.org.uk/publications/ar13/ar13.pdf?bcsi_scan_A0B24AD6DE328DEC=1.
[32] Financial Conduct Authority, *Payment protection insurance complaints: Report on the fairness of medium-sized firms' decisions and redress*, TR 13/7, thematic review, September 2013, p. 3, www.fca.org.uk/static/documents/thematic-reviews/tr-13-07.pdf.
[33] Select Committee on Treasury, *The mis-selling of personal pensions*, ninth report, UK Government, November 1998, www.publications.parliament.uk/pa/cm199798/cmselect/cmtreasy/712/71203.htm.

274 However, it found that there would be no breach of a financial promise if the investment risk in the product was known and retained by the consumer (i.e. a case of no, or a limited, financial promise).

275 Only authorised deposit-taking institutions (ADIs) and general and life insurers are subject to intensive prudential supervision by the Australian Prudential Regulation Authority (APRA).

276 It also affirmed that APRA would be the sole prudential regulator and ASIC, as conduct regulator, would not have a prudential function.

Compulsory superannuation

277 A significant market intervention applies to parts of Australia's regulated superannuation system. Premised on the fact that many people have difficulty making long-term financial decisions in their own best interests, a minimum level of superannuation has been made compulsory (superannuation guarantee). By imposing a superannuation guarantee system, governments have acknowledged that a high degree of regulatory intervention is warranted to promote Australians actively saving for and funding their own retirements.

278 Against this backdrop, recognition has also been given to the fact that many Australians are only participants in our financial markets by virtue of their compulsory superannuation savings, and would not otherwise be investors; therefore, parts of the superannuation system, particularly those relating directly to the superannuation guarantee, require a higher degree of regulatory oversight and investor protection. An example of this enhanced protection is Pt 23 of the *Superannuation Industry (Supervision) Act 1993* (SIS Act), which makes provision for financial assistance to superannuation funds regulated by APRA that suffer loss as a result of theft or fraud.

279 However, once within the compulsory superannuation system, there are relatively few limits placed on the types of investments that people can make, or the risks that may be undertaken. After a certain age, people may withdraw their funds completely from the compulsory superannuation system, as a lump sum. This means that, in order to work as intended, the system places significant reliance on people's ability to make long-term financial decisions that best address their needs.

280 While ASIC works to ensure that the gatekeepers and industry participants in the superannuation system uphold their obligations to investors, the risks inherently associated with financial markets mean that it is likely some investors will suffer losses on their superannuation investments, with sometimes far-reaching consequences for their financial position in retirement.

How the philosophy of the regulatory regime has shaped ASIC's role

281 As a conduct and disclosure regulator, ASIC's role encompasses:

(a) licensing or otherwise authorising people to operate or participate in the markets and industries that we regulate;

(b) providing guidance about the standards of conduct and disclosure we expect of industry participants; and

(c) setting standards for such conduct by enforcing compliance with the law.

282 Within the licensing regimes we administer, particularly the AFS licensing and credit licensing regimes, we have established standards of conduct that must be met to obtain and keep a licence. These include financial requirements the various types of licensees must meet (unless they are regulated by APRA, in which case they must meet APRA's financial requirements).

283 However, unlike those financial requirements typically imposed by a prudential regulator, the financial requirements ASIC imposes do not seek to prevent licensees from becoming insolvent, or failing because of poor business models or cash flow problems.

284 As is characteristic of a conduct and disclosure regulator, we regulate a large and diverse range of entities, rather than the smaller number of more specialised entities as is typical of the regulated population of a prudential regulator.

285 Because of the large population we regulate, we take a risk-based approach to direct our resources, identifying significant and strategically important industry participants and gatekeepers, and directing the most significant resources towards the entities, products or transactions:

(a) where the risk of non-compliance or misconduct is greatest; and

(b) where the non-compliance or misconduct will result in the greatest harm in the context of delivering against ASIC's strategic priorities.

ASIC's work as a regulator

286 As Australia's corporate, markets, financial services and consumer credit regulator, we strive to ensure that Australia's financial markets are fair and transparent and supported by confident and informed investors and financial consumers. We do this by using a range of regulatory tools to enforce and promote compliance with the laws that ASIC administers, as well as to improve consumer understanding and decision making.

287 The regulatory tools available to ASIC include the following:

(a) *Education*—ASIC undertakes educational activities, including financial literacy work.

(b) *Guidance*—ASIC provides guidance to industry about how we will administer the law to provide clarity to industry participants about their obligations under the law. This is achieved by issuing regulatory guides, consultation papers, reports and information sheets.

(c) *Surveillance*—ASIC conducts surveillances by gathering and analysing information on a specific entity or range of entities, a transaction, a specific product or issue of concern in the market to test compliance with the laws we administer and look at consumer and investor outcomes. Following a surveillance, we may publish our findings to inform the market or take further action, such as commencing an investigation with a view to carrying out enforcement action.

(d) *Negotiated outcomes*—ASIC pursues negotiated outcomes (which may arise from surveillances or from investigations), including enforceable undertakings. An enforceable undertaking is a written undertaking given to ASIC that an entity or person will operate in a certain way. It is a flexible and effective remedy in improving compliance with the law and may be enforced through the courts. Regulatory Guide 100 *Enforceable undertakings* (RG 100) provides more information on ASIC's approach to enforceable undertakings.

(e) *Enforcement action*—ASIC undertakes investigations, which may lead to enforcement action such as:

   (i) criminal action;

   (ii) civil action, such as civil penalty proceedings (e.g. for breach of directors' duties), corrective action (e.g. to correct misleading disclosure) and compensatory action (to recover compensation on behalf of consumers); and

   (iii) administrative action (e.g. banning or disqualifying persons from the financial services industry).

Table 9 presents data on some of ASIC's recent enforcement work.

Table 9: ASIC's enforcement team structure, regulated populations and selected key achievements, 2010–13*

Enforcement teams	Significant achievements
Financial services: • all providers of financial services and credit (including provision of these services by unlicensed persons) • AFS licensees and their representatives/advisers • credit licensees and their representatives/advisers Market integrity: • persons and entities trading on licensed financial markets Listed entities Corporations and corporate governance: • corporations • officeholders • liquidators • auditors Note: A dedicated WA enforcement team handles matters across all these areas for that state.	• Completed 554 investigations in 2010–13, with 308 investigations currently in progress. • Obtained 149 outcomes in which persons or entities: – were banned from providing financial services or engaging in credit activities; – undertook not to provide financial services or engage in credit activities; or – had their AFS licence or credit licence suspended or cancelled, or additional conditions imposed. • Obtained 12 infringement notices for alleged breaches of continuous disclosure obligations, and 19 infringement notices issued by the Markets Disciplinary Panel for alleged breaches of market integrity rules. • Assisted in negotiating 62 enforceable undertakings with entities and individuals. • 79 criminal proceedings were completed, including: – 30 convictions for false or misleading statements, misleading or deceptive conduct, or failure to comply with disclosure requirements; – 16 convictions for insider trading and 4 convictions for market manipulation; – 19 convictions relating to breach of directors' duties; and – 7 convictions for misappropriation or theft. • 73 civil proceedings completed. Obtained compensation for former investors in Westpoint and Storm Financial.

* Data is indicative. See relevant sections of ASIC's Annual Report (2013) for 2012–13 data.

288 The regulatory tool or tools ASIC chooses to use in response to a potential breach of the law will depend on the objectives that ASIC is seeking to achieve. These include deterrence and one or more of the following:

(a) punishment;

(b) improving compliance;

(c) protecting the public; and

(d) compensation for investors.

289 These objectives, and the regulatory tools that are used to achieve them, are summarised in Table 10.

Table 10: Regulatory objectives and the regulatory tools used to achieve them

Objectives	Regulatory tools
Punishment	Includes criminal action, civil penalty action and infringement notices
Improving compliance	Includes surveillance, guidance to industry, targeted campaigns and education programs
Protecting the public	Includes ASIC's administrative powers to make banning orders or cancel or suspend licences, as well as Companies Auditors and Liquidators Disciplinary Board (CALDB) and Markets Disciplinary Panel proceedings May also include ASIC's powers to obtain court orders for corrective disclosure (i.e. correcting misleading information that has previously been published) and the use of public warning notices
Compensation for investors	Includes taking action to recover compensatory damages on behalf of a person, which ASIC is empowered to do if in the public interest
Deterrence	When ASIC chooses to use its regulatory tools, deterrence is always an underlying objective

Note: A negotiated outcome can achieve a similar result to many of the actions outlined above, including, in particular, compensation, punishment and improving compliance.

Enforcement: Deterring misconduct

290 Through enforcement of the law, we seek to deter future misconduct—both by those individuals involved in the misconduct (specific deterrence) as well as the broader business community through greater awareness of the consequences of breaching the law (general deterrence).

291 Effective regulation depends on achieving enforcement outcomes that act as a genuine deterrent to future misconduct. The public expects that ASIC will vigilantly and effectively enforce the law. Detailed rules will not achieve effective regulation unless compliance is monitored and enforced.

292 ASIC's credibility as an effective regulator depends on having the right regulatory and enforcement toolkit to maximise the deterrent effect on wrongdoing. The economics of crime and punishment suggests wrongdoers respond to incentives to comply. Deterrence depends on the probability that action will be taken against the wrongdoing and the severity of the sanction.

293 We need a range of sanctions to calibrate our response with sanctions of greater or lesser severity commensurate with the misconduct. The toolkit of criminal, civil and administrative sanctions (including infringement notices)

needs to adequately cover the typical range of corporate wrongdoing, with corresponding penalties that are set at an appropriate level given the nature of misconduct and the type of entity (individual or corporate) likely to be involved. Any gaps in this toolkit can present a barrier to taking an effective enforcement approach because appropriate remedies may not be available.

294 If a sentence or penalty fails to reflect the gravity of the offence it may fail to serve as an effective deterrent to intelligent, competitive professionals in the financial markets, and the community (including those in 'white collar' occupations) may perceive that the individual has escaped meaningful punishment. The importance of adequate penalties is discussed further in paragraphs 163–187 in Section A.

Proactive regulation

295 Particularly since the global financial crisis, many financial regulators around the world have worked to increase their capacity to be forward-looking, to identify problems as they emerge, and to try to minimise the risk of investors and financial consumers suffering problems. ASIC has also worked to ensure we are proactive in our regulatory approach, in a number of ways, so that our role is not only about responding after problems occur.

296 For example, we try to help investors and financial consumers to use financial markets successfully through our work on financial literacy. As described in paragraph 287(c), we try to identify poor practices or problematic conduct at an early stage via our surveillance work.

297 An area of significant focus for ASIC is on advertising. Investors and financial consumers can be heavily influenced by advertisements for financial products and services. Advertisements that do not fairly represent a product or its key features and risks, or the nature and scope of services, can be misleading and create unrealistic expectations that may lead to poor financial decisions.

298 In 2012 ASIC published Regulatory Guide 234 *Advertising financial products and advice services (including credit): Good practice guidance* (RG 234). RG 234 provides guidance to help promoters comply with their legal obligations to not make false or misleading statements or engage in misleading or deceptive conduct when advertising financial products and services. Where we find advertising has breached the law, ASIC has a variety of regulatory options, including:

(a) exercising our information-gathering powers before considering regulatory action;

(b) seeking an injunction to stop an advertisement;

(c) issuing a stop order on related disclosure documents;

(d) accepting an enforceable undertaking; and

(e) seeking a civil penalty.

299 The type of regulatory response ASIC takes will depend on the particular provision that has been breached and the seriousness of the contravention and its consequences.

ASIC's work in relation to superannuation advertising

ASIC has been closely reviewing advertising for self-managed superannuation funds (SMSFs), in particular with a focus on fees, returns and disclosure of risks. ASIC has publicly warned investors about advertising that promotes the use of SMSFs: see Media Release (13-285MR) *ASIC warns consumers about ads recommending SMSFs purchase properties through government scheme* (22 October 2013). ASIC also issued an infringement notice totalling $10,200 to SMSF Property Capital Pty Ltd after labelling products as 'ASIC approved': see Media Release (MR13-351) *SMSF Property Capital pays penalty for ads promoting ASIC approved financial products* (18 December 2013). Additionally, we issued an infringement notice totalling $10,200 to SuperHelp Australia Pty Ltd, after it made potentially misleading statements about a free SMSF establishment service: see Media Release (14-051MR) *SuperHelp Australia Pty Ltd pays infringement notice in relation to 'FREE' SMSF set up claims* (18 March 2014).

ASIC has been actively involved in ensuring advertising more generally in relation to the promotion of superannuation funds and managed funds is not misleading. see Media Release (14-001MR) *Media Super pays infringement notice in relation to superannuation advertising* (6 January 2014) and Media Release (13-242MR) *ASIC issues interim stop orders on Trilogy Funds Management Limited schemes* (2 September 2013).

Investor and financial consumer losses

300 More than any other aspect of our role, ASIC's performance as the enforcer of Australia's corporate and securities laws attracts attention when people lose money in the financial system.

301 In designing the current regulatory architecture, it was never the intention of the Wallis Inquiry that regulation should aim to prevent all institutional collapses or financial losses. Rather, this was accepted as an inevitable aspect of the way markets function.

302 Consequently, ASIC's regulatory role does not involve preventing all consumer losses or ensuring full compensation for consumers in all instances where losses arise. Our underpinning statutory objectives, regulatory tools and resources are not intended to prevent many of the losses that investors and financial consumers will experience. This is true of every financial market regulator around the world.

303 This is a very important issue that goes to the heart of what financial market regulation is intended to achieve, and thus to expectations about ASIC's

performance. Unlike prudential regulators, market conduct regulators such as ASIC do not have the same focus on preventing institutional collapse and the losses this may bring. In addition, our market-based system for investment and for capital raising, which has served Australia's development well, inevitably involves investors assuming an amount of risk in order to make a return.

304 Nevertheless, it must be recognised that the impact of collapses or losses can be deep and cause very significant hardship for those investors and financial consumers directly affected. ASIC sees the effect of such losses first hand, and we understand how such losses can affect the economic wellbeing and confidence of Australians. That is why a key component of our regulatory activity involves minimising the risk of loss for investors and financial consumers.

Regulation beyond disclosure: Recent developments

305 Compulsory superannuation is the most significant policy intervention in financial markets that does not rely on disclosure to address a market failure.

306 Beyond this, there have been other policy reforms that use different regulatory tools or innovative approaches instead of a traditional disclosure-based approach. In most cases this is at least in part because of the failure of disclosure to correct particular market problems. These include reforms in the retail credit market, the financial advice market, and superannuation.

Responsible lending in credit regulation

307 Australia's national consumer credit regulatory regime was implemented in 2010, replacing the previous fragmented, less comprehensive state-based and territory-based regulation: see Section J.

308 In relation to individual consumers, the new regulatory regime recognises that the trade-off between accessing credit today, and having fewer available funds in the future when repayment is due, may be difficult for consumers to readily appreciate, and that decision-making biases lead people to overvalue immediate gratification relative to future needs. Rather than simply disclosing these risks, the regulatory regime sets protections to:

(a) prevent irresponsible lending that places consumers at risk of future hardship; and

(b) allow borrowers to seek a variation of their payments where they are suffering a temporary inability to pay.

309 By setting limits on lending, the regulatory regime also recognises the potentially systemic impacts on the economy of large-scale defaults on borrowing, including on the profitability of the banking sector and on the real economy.

310 In general, the protections in the credit regime apply at an individual level, such as the assessment of credit suitability performed for each consumer. However, some protections apply in a more systemic way, such as caps on the maximum rate of interest that may be charged that apply across all loans.

Financial advice: Prohibiting rather than disclosing certain conflicts of interest

311 From 1 July 2013, advisers have been required to comply with a range of new obligations intended to improve the quality of financial advice, strengthen investor protection and underpin trust and confidence in the financial advice industry: see Section H.

312 Among other things, the FOFA reforms prohibit certain forms of conflicted remuneration that in the past have affected the quality of advice. Previously, conflicts of interests in relation to personal investment advice were allowed, but had to be disclosed. Extensive market experience (including the collapse of financial advice firms), as well as behavioural economic research, highlighted the significant limitations of disclosure as a tool for addressing problems arising from conflicts of interest in retail markets. This was not a problem unique to Australia.

313 These reforms do not alter the balance of risk in the financial services system—investment risk will still necessarily lie with investors—but help ensure that advisers prioritise the interests of their clients.

Stronger Super: Setting defaults

314 Following the Stronger Super reforms, some superannuation funds now offer a new, simple and cost-effective superannuation account called MySuper. MySuper will eventually replace existing default superannuation accounts.

315 MySuper accounts offer:

(a) lower fees (and restrictions on the type of fees that can be charged);

(b) simple features, so members do not pay for services they do not need; and

(c) options for investing at different stages of life.

Retail, industry and corporate funds can all offer MySuper accounts.

316 The new MySuper product recognises that many people will not exercise any choice over the fund into which their superannuation guarantee contributions are made, due to factors such as inertia and procrastination, and minimises the risk that they will suffer adverse consequences from such inaction (e.g. by not switching out of a fund that charges high fees).

C Changes in the financial system

Key points

In the years since the Wallis Inquiry, the Australian financial system has changed considerably.

Major developments in the market include structural change driven by the shift to market-based financing (including the growth in superannuation and emerging sources of funding for small-to-medium enterprises); technology and innovation; and increasingly integrated global markets.

ASIC, in exercising its relief powers, has a role to play in adapting the regulatory system to change and innovation. The role itself has changed, with ASIC's responsibilities expanding substantially over time. International regulation has arisen alongside the integration of global markets to address risks and facilitate cross-border activity.

317 There has been substantial change in the financial system since the Wallis Inquiry released its final report in 1997.

318 This section discusses some of the major developments during this time, both in the markets and in financial regulation. Other market and regulatory changes affecting particular sectors are discussed further in other sections of this submission.

Change in markets

319 The major developments in the financial markets that particularly relate to ASIC's responsibilities are:

(a) structural change in the financial markets driven by the shift to market-based financing;

(b) technology and innovation; and

(c) globalisation.

All these developments are identified in this Financial System Inquiry's terms of reference.

Structural change in financial markets

320 Market-based financing is increasing in importance as a source for funding economic growth. This structural change is being driven by the growth of the pension and superannuation sectors, and increased banking regulation internationally.

Note: Market-based financing refers to using debt and equity capital markets and the funds management sector to raise capital instead of traditional bank lending.

321 New rules to strengthen the banking system internationally are imposing higher capital and liquidity requirements. The net effect of this is often decreased access to lending and an increased cost to business. As a result, many businesses are turning to market-based financing to source their funds.

322 The second driver of market-based financing is the global growth of the pension and superannuation sectors, much of which is invested in debt and equity capital markets. This global growth is expected to continue in the coming decade as:

(a) governments in emerging markets start or expand retirement savings programs; and

(b) in many countries, the population ages and people start to contemplate how to fund their retirement.

Strong growth in the Australian superannuation sector presents a growing opportunity for market-based financing.

323 As market-based financing is one of the major ways to fund future economic growth, this trend makes securities regulation even more vital. In order for market-based financing to be effective, markets must be fair, orderly and transparent, and investors need to be confident and informed. The challenge for ASIC is to ensure we have the right tools and resources to monitor and regulate debt and equity capital markets, so that these markets can perform their critical role in funding economic growth.

Growth in superannuation

324 The superannuation sector has become a major source of capital. Its impact on the Australian economy includes boosting national savings, increasing the depth and liquidity of financial markets and, through its compulsory nature, the participation of nearly all Australians within financial markets.

325 Since 1997, total superannuation assets have increased from $321 billion (58% of gross domestic product (GDP)) to $1.6 trillion (106% of GDP) in 2013, and are expected to rise to over $6 trillion by 2035. Superannuation is the largest source of long-term savings in Australia and the second most significant source of wealth for many Australians after the family home.

Note: See Section K for further discussion on the scope and coverage of the superannuation system today.

326 Compared internationally, Australia's superannuation sector is the fourth largest by assets under management behind the United States (approximately US$18.9 trillion), the United Kingdom (approximately US$3.3 trillion) and Japan (approximately US$3.2 trillion).[34]

[34] Towers Watson, *Global pension assets study—2014*, research report, January 2014, www.towerswatson.com/DownloadMedia.aspx?media={F4AA6417-5BFD-4D75-9614-6423B1AF2133}.

327 Table 11 presents data on current significant features of the Australian superannuation system, as well as projected features of the industry in 2035.

Table 11: Australian superannuation industry in 2035 (including SMSFs)

Feature	1996	2009	2035
Overall industry scale	$245 billion	$1.1 trillion	$6.1 trillion
Ratio of accumulation to de-accumulation assets	N/A	4:1	3:1
Biggest fund (assets)	N/A	$41.5 billion	$350 billion
Number of large APRA funds (excluding eligible rollover funds)	4734	447	74
Average large APRA fund size	$40 million	$1.5 billion	$53 billion
Average accumulation member balance	$15,000	$70,000	$335,000
Total superannuation assets by proportion of GDP	47%	90%	130%

Source: Super System Review, *Final report—Part 1: Overview and recommendations*. Commonwealth of Australia, 2010

328 There have been developments in superannuation over time that may have significant implications for the broader financial system, including:

(a) allocation of assets—the asset allocation of APRA-regulated superannuation (i.e. excluding self-managed superannuation funds (SMSFs));

(b) the ageing population and their transition to the withdrawal phase; and

(c) growth of SMSFs.

Note: See Section K.

Other sources of market-based financing

329 In light of reduced cross-border bank lending as a result of changes in bank regulation internationally, capital markets may be a source of long-term financing for infrastructure. Policies that foster this development may be required. New sources of market-based financing are emerging for small-to-medium enterprises, including crowdfunding and peer-to-peer lending. These are also examples of disintermediation of funding.

Crowdfunding

330 Crowdfunding refers to the raising of funds from a large number of people using the internet and social media. Typically, the amount of funds raised from each person is relatively small. The use to which the funds are put and the ‘reward’ for contributing will vary depending on the type of crowdfunding being undertaken.

331 Crowd-sourced equity funding is often used by entrepreneurs or start-up companies to help establish their business. Those contributing funds, who are typically small investors, receive equity in the company in return for their contribution. Crowd-sourced equity funding is most likely to be regulated by ASIC.

332 This new source of funding carries risks, including:

(a) fraud—the risk that money raised is not used for the intended project; and

(b) failure—the risk of start-ups failing due to mismanagement, poor business models or misadventure, notwithstanding the business operator’s good intentions. This risk is more significant for crowd-sourced equity funded start-ups because the business model is typically unproven.

333 Other risks to investors include a lack of liquidity, the difficulty of valuing assets, and non-traditional business models involved in crowd-sourced equity funding.

334 The regulation of crowd-source equity funding and the identification of a best practice regulatory framework for this has been referred to the Corporations and Markets Advisory Committee (CAMAC) for consideration and advice. CAMAC is in the process of conducting this review and is anticipated to report to Government with its findings and recommendations by the middle of 2014.[35]

Technology and innovation

335 Advances in technology have long been recognised as a key driver behind innovation and change in industries. Notably, these include developments across a range of sectors, from non-cash payment methods and the rise of online-only banks, to the prevalence of algorithmic and automated methods affecting market structures.

[35] More information about CAMAC’s review and submissions it received in response to its discussion paper can be found on CAMAC’s website, www.camac.gov.au.

Examples of technology-driven innovation

Investors and financial consumers: Electronic payment products

Since the Wallis Inquiry there has been significant growth in the use of electronic payments and the channels investors and financial consumers can use for payment. The use of cash and cheques as payment methods has been steadily decreasing. Technology has enabled industry participants to add non-cash payment capability to various products and services, including those that previously were not designed to be payment products. For example, mobile phone credit can now be used to purchase goods and services. This convergence is blurring the boundaries between financial and non-financial products and services.

Electronic payments are becoming faster and more convenient to use. For example, over the last couple of years, technology has developed to allow for contactless card payment.

As investors and financial consumers feel increasingly confident about operating within and accepting new financial services, products and delivery channels, and technology becomes cheaper and more user friendly, increased migration to electronic and online environments is likely to occur. Movement towards frictionless transactions may lead to reduced engagement with the detail of a payment decision (e.g. choosing the account from which to make a payment).

Financial markets: Dark pools and algorithmic trading

There has been significant structural and behavioural change in the Australian financial markets as advances in technology have facilitated more trading away from traditional exchange markets.

It is now easier and more common for market participants to trade directly with clients, or to match client orders with each other. As a result, there has been a proliferation of new types of trading venues known as ‘crossing systems’ and ‘dark pools’: see Section F for further details.

While the proportion of total trading that is occurring ‘in the dark’ has remained fairly constant (at around 25–30% of total trading), the nature of this trading has changed significantly, with fewer large block trades, and many more small trades, being conducted in the dark.

Technology has also fundamentally changed the way orders are generated and executed by all users of the market. Human decision making has largely been replaced by computers. Computer algorithms now generate a large proportion of all orders on Australian financial markets.

Increased automation has provided an ideal platform for high-frequency traders and other users of algorithmic logic. It has enabled fundamental investors, who are also users of algorithms, to more easily break up larger orders to limit their market impact.

Note: See Report 331 *Dark liquidity and high frequency trading* (REP 331).

336 Higher capacity infrastructure and improved networks have resulted in increased interconnection between financial providers and investors and financial consumers. We have seen the rapid growth and acceptance of the internet and network-based technology changing the way people engage with the financial system, including significant growth in consumers accessing the internet through mobile devices. Roy Morgan Research data indicate that, in the 12 months to December 2013, in an average four-week period,

58% (11.2 million) Australians aged 14 and over used internet banking at any financial institution. In contrast, the Wallis Report in 1997 noted that:

> The Internet is currently used primarily as a tool for brand awareness and promotion. While it is possible to conduct financial services transactions over the internet, its use for this purpose is currently minimal.[36]

337 In 2013, over 11 million Australians used the internet for communication, business and social activities, with 83% of Australian households having internet access at home.[37] A 2011–12 study further showed that 71% of Australians believe the internet has improved their day-to-day lives, with almost two-thirds of Australians believing they have the necessary skills to do everything they want to do online.[38] By way of example, the growth in internet banking over time relative to other forms of electronic transacting is illustrated in Table 12.

Table 12: Electronic transacting: Percentage usage across different methods over time, 2002, 2005, 2008 and 2011

Electronic transacting	2002 (*n*=3,548)	2005 (*n*=3,513)	2008 (*n*=3,500)	2011 (*n*=3,502)
ATM	73	78	80	84
EFTPOS	71	74	76	80
Direct debit	50	60	64	70
BPAY	36	46	52	61
Internet banking	28	40	51	61
Mobile phone banking	N/A	N/A	N/A	14

Source: ANZ, *ANZ survey of adult financial literacy in Australia*, The Social Research Centre, ANZ, 2011, www.financialliteracy.gov.au/research.

338 This uptake in technology and improved networks has resulted in changes in the manner in which financial products and services are distributed, with product providers able to market and engage directly with potential investors. In doing so it has broadened a consumer's access to financial products and services, particularly as global markets integrate, and has led to greater informational symmetry and development of industries designed to assist in consumer decision making (e.g. online calculators and comparison websites).

[36] Wallis Inquiry, *Financial System Inquiry final report*, March 1997, p. 193.
[37] ABS, *Household use of information technology, Australia, 2012–13*, ABS Cat No. 8146.0, 24 February 2014.
[38] Australian Communications and Media Authority, *Report 2: Australia's progress in the digital economy—Participation, trust and confidence*, communication report, p. 1, October 2012, www.acma.gov.au/webwr/_assets/main/lib310665/australia's%20progress%20in%20the%20digital%20economy.pdf.

339 While the principles-based legislation has largely been effective in addressing the technology-driven innovations and changes, some technology changes require adaptation of the regulatory system. This is addressed below at paragraphs 347–353.

International integration

340 While the period immediately following the Wallis Inquiry saw an increase in global financial activity, cross-border capital flows have fallen 67.5% since the global financial crisis and are heading back to levels of a decade ago.[39]

341 The main causes of this dynamic include a reduced demand for financing in an uncertain international economic environment, as well as a winding back of cross-border bank lending in light of new capital and regulatory requirements.

342 Despite these reversals at the global level, Australia's integration with offshore financial markets has remained relatively unaffected in the post crisis period. This integration can primarily be seen through the willingness of participants in offshore markets to increase their contribution to domestic financing needs, with issuance of debt securities into offshore financial markets by Australian financial companies (including banks) increasing by almost sevenfold since 1997,[40] and our level of net foreign debt having increased from below 40% of GDP to 55% of GDP.[41] Australian investors have also markedly increased their participation in global equity, bond and derivative markets.

> Note: For example, over the period from June 1997 to June 2013, the level of foreign portfolio investment assets owned by Australians has increased from 11.1% of GDP to 38.8% of GDP and the level of foreign investments (especially in equities) held by Australian superannuation funds has increased from 3% to 20.9% of funds' total financial assets. Further, the level of Australia's foreign derivative activity also increased substantially, with derivative assets increasing from 1.7% to 8.2% of GDP, while derivative liabilities similarly increasing from 1.8% to 8.6% of GDP.[42]

[39] McKinsey Global Institute, *Financial globalization: Retreat or reset?*, report, March 2013, www.mckinsey.com/insights/global_capital_markets/financial_globalization.

[40] Reserve Bank of Australia (RBA), *Debt securities outstanding (D4)*, statistics, www.rba.gov.au/statistics/tables/xls/d04hist.xls?accessed=2014-03-13-12-03-15. Borrowing (through loans and issuance of debt securities) by banks and other depository corporations has increased by 327%, or 10 percentage points of GDP, since June 1997, with the greatest increase occurring in issuance of bonds into wholesale markets (ABS, *Australian national accounts: Financial accounts*, *Sep 2013*, ABS Cat No. 5232.0, 19 December 2013, Tables 8 and 9).

[41] ABS, *Australian system of national accounts*, *2012–13*, ABS Cat No. 5204.0, Table 1; ABS, *Balance of payments and international investment position*, *Dec 2013*, ABS Cat No. 5302.0, Table 28.

[42] ABS, *Australian system of national accounts*, *2012–13*, ABS Cat No.5204.0,Table 1; ABS, *Balance of payments and international investment position*, *Dec 2013*, ABS Cat No. 5302.0, Table 1; ABS, *Australian national accounts: Financial accounts*, *Sept 2013*, ABS Cat No. 5232.0, Table 21.

343 Other indicators also show greater international integration, particularly through the level of debt-raising undertaken by foreign entities within the Australian market.[43]

Change in regulation

Changes in ASIC's role

344 Since the Wallis Inquiry, ASIC's responsibilities have greatly expanded. We have successfully taken on a number of significant new responsibilities, each of which involved a major transition for an industry sector.

345 Among the biggest changes in ASIC's jurisdiction have been the assumption of the primary responsibility for regulating consumer credit from the states, and for frontline supervision of market participants, both in 2010.

346 The information box below sets out data on the scale of some of the key changes in ASIC's role over the years.

ASIC's implementation of new responsibilities

Stronger Super reforms: SMSF auditor registration

- ASIC's new register of SMSF auditors went live on 31 January 2013, allowing auditors doing SMSF audits to apply for registration online using ASIC Connect.
- At the beginning of February 2014, ASIC had registered 7,122 SMSF auditors, and facilitated 97,697 searches of the register through our ASIC Connect system.

Business names registration

- ASIC launched the new national Business Names Register in May 2012.
- We have registered over 1.7 million business names.
- At its one-year anniversary, the national Business Names Register had saved business $34 million in reduced fees to register or renew a name.

ASIC Connect

- In March 2012, we launched a new online user interface, ASIC Connect, allowing ASIC registry searches online through ASIC's website and pay search fees by credit card.
- In 2012–13, over 28.3 million free searches and 250,700 paid searches were conducted through ASIC Connect. The availability of the ASIC Connect online search has seen a 56% decrease in paper searches conducted directly with ASIC (on paper and over the counter).

Financial market supervision and licensing

- ASIC assumed responsibility for frontline supervision of ASX and other markets in August 2010.

[43] For example, the outstanding value of bonds issued by foreigners in Australia as measured by the RBA increased from just under 1% of GDP to just under 10% of GDP in the period from June 1997 to June 2013. Source: RBA, *Debt securities outstanding (D4)*, statistics, www.rba.gov.au/statistics/tables/xls/d04hist.xls?accessed=2014-03-13-12-03-15.

ASIC's implementation of new responsibilities

- Since we assumed responsibility for supervision, our streamlined processes have significantly reduced the time taken to identify and respond to possible misconduct. For example, in the first six months of 2013 alone:
  - our systems produced 20,938 trading alerts, of which we conducted further inquiries into 94 matters;
  - we conducted 45 risk-based assessment visits and 88 surveillances; and
  - we carried out 19 instances of pre-emptive supervision action (i.e. engagement or other action with participants to improve practices), achieved five enforcement outcomes for insider trading offences, and obtained two infringement notices issued by the Markets Disciplinary Panel.

Consumer credit regulation

- ASIC assumed responsibility for regulating consumer credit from the states in 2010: see Section J.
- In the 12 months following the commencement of the National Credit Act, ASIC issued 6,081 credit licences and we recorded the authorisation of over 24,000 credit representatives.

Financial literacy

- Since July 2008, ASIC has been the government agency with overall responsibility for financial literacy: see paragraphs 702–704 of Section H.

Financial Services Reform

- ASIC oversaw the successful implementation of the *Financial Services Reform Act 2001* during the transitional period from 2001–04, to implement the current licensing and regulatory regime for financial services providers.
- This required ASIC to license 3,853 businesses, and to take a leading role in providing guidance to industry on how to comply with the new regime.

Flexible regulation

347 The report of the Wallis Inquiry recommended a 'consistent and comprehensive disclosure regime for the whole financial system, albeit one with flexibility to apply different rules, in response to different situations, beyond a common core'.[44] This statement broadly reflects the way in which the financial services regulatory regime has operated in practice since its implementation, although different rules for different types of financial products and services introduced over time have added to regulatory complexity.

348 For example, some innovations and technology changes call into question the application of the law and sometimes require adaptation of the regulatory system:

(a) Innovation can sometimes outstrip regulation, creating uncertainty. For example, s12DL of the ASIC Act prohibits credit card issuers from sending out unsolicited cards. It is based on provisions that were

[44] Wallis Inquiry, *Financial System Inquiry final report*, March 1997, p. 17.

initially developed in 1975 to address particular concerns about the unsolicited distribution of credit cards at that time. Technological and product changes in the payment card space in more recent years have raised issues about how s12DL applies. For example, credit accounts may now often be accessed by more than one card, and new kinds of devices are now available that do not involve a physical card but still allow access to an underlying credit account (e.g. stickers and SIM cards for mobile phones). The application of s12DL in these circumstances is unclear.

(b) Sometimes the broad regulatory regime needs to be supplemented by technology-specific regulation. The growth in electronic payments has necessitated the development of an industry-specific co-regulatory arrangement, the ePayments Code (formerly the Electronic Funds Transfer (EFT) Code of Conduct). The ePayments Code contains a variety of rules and standards that address unique aspects of electronic payments (e.g. procedures for recovering mistaken internet payments). It is a voluntary code to which virtually all banks, credit unions and building societies currently subscribe, but is administered, monitored and reviewed by ASIC: see paragraphs 462–464 for further discussion.

349 However, there have been more wholesale departures from the principles-based conduct and disclosure regime in response to specific market failures. These include the introduction of the national credit regime, which seeks to ensure certain minimum outcomes for consumers, recent new requirements for financial advisers to remove certain conflicts of interest from their business models to drive better quality advice, and new default options in superannuation for those who do not exercise choice (MySuper): see paragraphs 314–316 in Section B.

ASIC relief

350 ASIC's various discretionary powers to grant relief from the provisions of the laws that it administers are part of the flexibility and adaptability of the regulatory system. ASIC's use of its relief powers is important in making a principles-based regime work in practice. Industry often requests more certainty about how a broad rule applies in particular circumstances, or relief from broad rules that may impede innovations or particular transactions. ASIC may give relief in individual cases or to classes of entities or products.

351 By way of example, in 2012–13 ASIC received 3,094 applications for relief. Of these, 2,047 were approved, 358 were refused, 318 were withdrawn and 371 were under consideration at the end of this period.

352 In many cases, financial innovation would not be possible without ASIC relief; denying business opportunities to expand, and investors and financial consumers the possibility of new and more useful products. On occasion,

relief from the financial services laws has been provided because of issues raised by new products or services. Technological developments or innovation can result in the law applying in ways that were not intended, or that impose unduly burdensome costs on industry participants with minimal regulatory benefit.

ASIC exercise of relief powers—Relief to facilitate the operation of platforms

Many investors want the opportunity to build an investment portfolio through an investment vehicle that gives them the convenience of transactional and reporting services, but also the ability to make all of the investment decisions and access a wide range of financial products that would not otherwise be available to them. Industry has developed a range of such vehicles, which are typically known as 'platforms ' or 'wraps' but are more formally referred to as investor-directed portfolio services (IDPS) and IDPS-like schemes.

The legislation does not specifically recognise such structures, and most technically fall within the definition of a 'managed investment scheme'.

However, meeting the legal requirements for registering and operating a managed investment scheme would be onerous in practice for many platform operators—for example, because investors investing through a platform are able to exercise more discretion in their portfolio than a typical scheme member, or because applying the general product disclosure requirements to platform operators would result in duplication and unnecessary cost.

Because of this, ASIC provides the following relief to platform operators:

- for IDPS-like schemes—relief from fundraising, cooling-off requirements and financial product disclosure provisions (to the extent that these provisions require disclosures about the investments available through the scheme in the PDS; and
- for IDPS—relief from registration as a managed investment scheme, the fundraising and hawking provisions, and most of the financial product disclosure provisions of the Corporations Act.

ASIC has provided this relief to create a tailored regulatory regime for platform operators, which balances the objectives of:

- applying the minimum required regulatory requirements to platform operators, consistent with the objectives of the broader financial regulatory regime; and
- ensuring that there is a high degree of protection for investors through appropriate disclosures and reporting to investors.

Our relief is contained in Class Order [CO 13/763] *Investor directed portfolio services* and Class Order [CO13/762] *Investor directed portfolio services provided through a registered managed investment scheme*. Our relief for platform operators is explained further in Regulatory Guide 148 *Platforms that are managed investment schemes* (RG 148).

> Note: See Section K for further discussion of platforms and the managed funds industry more broadly.

353 ASIC may also use its powers in other situations, such as where the operation of the general principles-based law is unclear in particular circumstances. ASIC only exercises its discretionary powers where there is a net regulatory benefit associated with providing relief or where the regulatory detriment is minimal and clearly outweighed by the resulting

commercial benefit. This allows ASIC to address anomalies and promote competition and innovation in circumstances where there is negligible regulatory detriment in doing so.

Note: Further information on the circumstances in which ASIC exercises its discretionary powers may be found in Regulatory Guide 51 *Applications for relief* (RG 51).

International standard setting

354 International standard setting has arisen alongside the globalisation of markets as a means of both controlling the risks associated with those markets and facilitating cross-border activity.

355 International regulatory standards are relevant to ASIC's activities. In particular, standards released under the auspices of the FSB and IOSCO, and the regulations of peer jurisdictions that concern cross-border transactions or activities involving Australian market participants.

Note: The FSB has responsibilities for strengthening financial stability and coordinating the development and implementation of regulatory standards and supervisory policies by both international standard setting bodies and national regulators. IOSCO is the global reference body for securities regulation. It develops, implements and promotes adherence to internationally recognised standards for securities regulation.

356 Since the global financial crisis, these standards have become more numerous and detailed, and expanded to cover a broader range of regulatory topics. In 2012 alone, for example, IOSCO released 40 reports (including consultation papers) on topics such as OTC derivatives, hedge funds, suitability requirements concerning complex financial products, exchange traded funds, credit rating agencies, securitisation and money market funds. While some of these reports merely set out recommended practices or implementation options, others set out regulatory approaches that IOSCO members are expected to implement.

357 These standards are now backed up by a robust implementation assessment regime that is spread across various international institutions. This regime seeks to verify whether jurisdictions have implemented agreed standards and, through dissemination of the verification findings to jurisdictional peers and publicly, encourage jurisdictions to promptly implement the standards. Since 2012 alone, ASIC has been reviewed by the FSB, the IMF and IOSCO on how well it has implemented various international standards.

358 The result of the increased breadth and strength of international standards is that ASIC (and Australia more generally) has needed to introduce, where relevant and appropriate, or at least consider introducing, regulation over areas that were previously unregulated or lightly regulated. These areas have included OTC derivatives and shadow banking: see Section G.

Importance of foreign regulation

359 Since the crisis, Australia's peer jurisdictions have extended or strengthened their domestic regulation over a number of areas of the financial markets. At times, this regulation has constrained cross-border activity as market participants seek to minimise or avoid overlapping, duplicative or conflicting regulatory obligations of their home and host jurisdictions.[45] To limit this outcome, host jurisdictions have often incorporated mechanisms into their regimes that allow foreign market participants to meet the jurisdiction's regulatory requirements where the foreign market participant's home regulation imposes equivalent or substantially similar requirements on them.

360 When used by those jurisdictions whose domestic markets are a dominant part of the global market, however, these mechanisms effectively require all jurisdictions wanting access to the global market to follow the regulatory lead of those dominant jurisdictions. Failure to craft local regulation that can be assessed as equivalent to those dominant jurisdictions could close off key parts of the global markets.

361 An example of such a risk can be seen in the concern shown by some Asia–Pacific jurisdictions about whether their domestic regimes for central counterparties (CCPs) would mean their CCPs would be recognised as 'equivalent' by the European Commission, a precondition for European Union regulatory recognition of non-EU CCPs. Failure to achieve such recognition would preclude EU market participants from accessing those non-EU CCPs, potentially fragmenting global markets.

Note: The Chairman of the Asia–Pacific Regional Committee of IOSCO, Ashley Alder, wrote to Commissioner Barnier of the European Commission to express this concern in June 2013: www.iosco.org/committees/aprc/pdf/20130606_APRC_letter_to_EU.pdf.

362 Like the increasing strength of international standards, this has affected, and will continue to affect, the freedom of ASIC to adopt regulatory positions of our own choosing. For example, our OTC derivative regulation needed to be substantially similar to those of the United States and European Union for those markets to allow Australian participants access without having to comply with multiple sets of regulatory standards. This has required ASIC to pay close attention to EU and US regulatory requirements in crafting our regime. Further, ASIC implemented credit rating agency regulation that aligned with IOSCO standards, and was also required to demonstrate to the European Union that this new regulation was substantially similar to EU rules to ensure that Australian companies can use their Australian-issued ratings in the EU debt markets.

[45] McKinsey Global Institute, *Financial globalization: Retreat or reset?*, report, March 2013, www.mckinsey.com/insights/global_capital_markets/financial_globalization.

Importance of international cooperation in enforcement

363 The impact of globalisation means that ASIC's enforcement work increasingly requires information and evidence to be obtained from foreign jurisdictions. ASIC also assists foreign regulators by obtaining information and evidence in Australia for their investigations.

Table 13: Foreign regulator assistance requests by and to ASIC

Year	Requests by ASIC	Requests to ASIC
2009–10	312	104
2010–11	191	112
2011–12	167	105
2012–13	271	98

Note: This table refers to enforcement-related requests only (i.e. information sought to assist compliance and enforcement action).

364 ASIC can make requests of overseas agencies for assistance—for example, under a memorandum of understanding (MOU) agreed with individual overseas agencies or the IOSCO Multilateral Memorandum of Understanding (MMOU).

Note 1: For example, ASIC and the US Securities and Exchanges Commission entered into a bilateral MOU on 25 August 2008, The MOU provides a mutual assistance framework between ASIC and the Securities and Exchange Commission for the purposes of investigations and enforcement proceedings.

Note 2: ASIC is a signatory to the IOSCO MMOU, together with 99 other countries.

Assistance from overseas regulators on Ponzi scheme

David Hobbs was the 'mastermind' of a large, unlicensed investment fund that targeted Australian investors and SMSFs.

The investment fund was facilitated by the set-up and operation of corporate structures and bank accounts in around 15 jurisdictions worldwide, including Anguilla, Australia, the British Virgin Islands, Hong Kong, New Zealand, the Turks and Caicos Islands, the United Kingdom, the United States, and Vanuatu. More than $50 million was invested in the fund by more than 500 investors.

In February 2013, Justice Ward in the Supreme Court (NSW) banned Mr Hobbs for life from working in the financial services industry and from managing companies in Australia, and imposed a record pecuniary penalty of $500,000. The matter is currently under appeal.

Pivotal to achieving these outcomes was the evidence obtained with the assistance of around 15 regulators, including the US Commodity Futures Trading Commission, the NZ Financial Markets Authority and the HK Securities and Futures Commission.

Note: See Media Release (13-031MR) *Ponzi scheme 'mastermind' handed record penalty* (21 February 2013).

D ASIC’s experience since the Wallis Inquiry

Key points

From our regulatory experience, we have drawn some broad thematic lessons—both about what has worked well in the financial system, and what has worked less well—in order to consider how financial regulation can deliver better outcomes for Australian investors, financial consumers and industry in the future.

Strengths and successes of our system include a robust market economy, adaptive and flexible regulation, and a capacity to learn from past problems.

Lessons to be learned include drawing some common themes from collapses and failures, and the need to better support Australians into retirement.

365 ASIC’s remit is broad, and the areas of the financial system we regulate have grown considerably over the last decade. We have regulated through a variety of economic and market conditions, including the end of the ‘tech bubble’ at the beginning of the 2000s, the global financial crisis and beyond, and other cycles of upturn and downturn.

366 The following discussion focuses on ASIC’s regulatory experience of the past two decades, concentrating on developments in the financial system within ASIC’s areas of responsibility.

367 We seek to draw out some broad themes—both about what has worked well in the financial system, and what has worked less well—in order to consider how financial regulation can deliver better outcomes for Australian investors, financial consumers and industry in the future. These themes have also informed the issues for further consideration and options for change we have presented in Section A. The regulatory experience from which these themes are drawn is discussed in more detail in further sections of this submission: see Sections F–K.

Strengths and successes of the financial system

368 There are many aspects of Australia’s financial system that have proved to work very well during all phases of the economic cycle and during periods of intense change.

A robust market economy and adaptive regulation

369 Australia's financial system has largely performed very well over the last two decades. While the global financial crisis caused considerable disruption, the Australian system performed better than nearly every other jurisdiction in the world during that period. Australia is world renowned for having safe, stable, high-functioning and well-ordered financial markets. Investors and financial consumers are able to undertake a range of common interactions with the financial system with confidence.

370 Regulation has played a significant role in this. Regulation has set rules to promote integrity and transparency of conduct, and it has also generally worked best where it has allowed sufficient flexibility to adapt to changing circumstances, and has, in this way, promoted resilience. For example, ASIC has worked for many years to remove regulatory obstacles relating to equity capital offerings to promote more cost-effective regulation and facilitate innovation. The various forms of relief we have provided are set out in Table 16 in Section F, and allow companies to undertake capital raising in many different types of structures.

371 This proved particularly important during the height of the global financial crisis. While equity raising very nearly stopped in many jurisdictions during 2008–09, before starting up again in late 2009, this did not occur in Australia. Rather, during 2009, $106 billion of new equity capital was raised in Australia, a record at that time.[46] The ASX has concluded that Australia's flexible regulatory arrangements enabled equity raising to continue during this time, in contrast with markets overseas.[47] This allowed many Australian businesses to survive at a time of diminishing availability of credit, and may have contributed to reducing the number of resulting collapses during this time.

372 Regulation has also promoted confidence in Australians' ability to undertake everyday commerce through the financial system, and to embrace new technologies to facilitate transactions. As discussed in Section C, more Australians than ever before are using the internet to interact with the financial system, make payments, or make contact with a financial institution.

373 This confidence has been significantly facilitated by regulation such as the ePayments Code, a voluntary code administered by ASIC that contains a variety of rules and standards that address unique aspects of electronic payments (e.g. procedures for recovering mistaken internet payments), and to which virtually all banks, credit unions and building societies currently

[46] ASX, *Capital raising in Australia: Experiences and lessons from the global financial crisis*, information paper, 29 January 2010.
[47] ASX, *Capital raising in Australia: Experiences and lessons from the global financial crisis*, information paper, 29 January 2010.

subscribe: see paragraphs 462–464 for further discussion. The ePayments Code has played a significant role in appropriately allocating the risk of loss on those who design and implement the system, providing incentive for them to minimise the risk of unauthorised transactions while facilitating diverse and flexible means of access for consumers. This has allowed consumers to participate and use online and mobile products with confidence.

374 An additional example of regulation facilitating greater use of technology for financial services is ASIC's relief for generic financial calculators.

Relief to provide generic financial calculators

ASIC has provided relief in relation to certain generic financial calculators available over the internet.

This relief is intended to promote the provision of basic online calculators to enable consumers to understand and compare financial products and services without the calculators being classed as providing personal advice (and therefore triggering numerous requirements under the Corporations Act).

Generic financial calculators can be useful educational tools for consumers, providing useful information at no cost to the consumer. However, they also have the potential to mislead consumers, if they are not designed responsibly.

In order to manage this risk, ASIC's relief is only available where:

- The default assumptions of the calculator are reasonable and, with the exception of statutorily-fixed assumptions, can be altered by the user; and
- The calculator includes information about the purpose and limitations of the calculator, why the default assumptions are reasonable and the impact of an significant limitations of the calculator.

Note: See ASIC Class Order [CO 05/1122] *Relief for providers of generic calculators*.

375 Other elements of the financial system have also become easier to deal with because of stricter regulation. For example, there has been a decline in certain types of misconduct involving direct selling of financial products to investors (e.g. telemarketing scams, and problems with door-to-door sales of investment and insurance products, particularly affecting remote and Indigenous communities), following tighter regulation since the introduction of financial services reform in 2001.

Capacity to learn from challenges and adapt

376 As outlined in paragraphs 392–395, our financial system has experienced problems that have had a significant impact on those involved. While there are further lessons to be learned from these events, the financial regulatory system has been able to adapt and respond to problems.

377 Where there have been problems and emerging risks they have been most effectively addressed where there has been early engagement between the regulator and industry and where regulatory interventions have been

carefully tailored to address the problem. Examples of this include the ePayments Code (as discussed in paragraph 348), and the introduction of national consumer credit regulation.

378 In a number of cases, early examination and public reporting on the problems by ASIC has contributed to effective reforms. That process has added to public understanding of the problems, the quality of the debate and the appropriate tailoring of the eventual reforms. Examples include ASIC's work on the consumer credit industry: see Section J.

379 Detailed public reporting and analysis of market problems has also promoted and informed industry changes and self-regulatory initiatives through product changes, codes of practice and other measures. Examples include ASIC's work on underinsurance in the home insurance market that led to industry product innovation, and ASIC's reporting on the risks of reverse mortgages that led to the development of an industry code and subsequently regulation: see paragraphs 472–473 in Section E.

380 Nevertheless, we acknowledge that the reform process can be a slow one, and sometimes comes only after some investors and financial consumers experience significant problems, including losses.

Learning from problems in the credit industry

381 In credit, and particularly in mortgage lending, the period since the Wallis Inquiry has seen new sources of funds made available through securitisation, new lenders and new distribution channels with the rise of the mortgage broking industry. With this came innovation in mortgage products, more ability for consumers to shop around and obtain assistance in doing so, and greater price competition.

382 These were undoubtedly positive developments, and, although the role of new and smaller lenders has reduced since the global financial crisis, with the major banks recapturing market share and taking on ownership of mortgage broking businesses, many of the benefits of these changes remain.

383 At the same time, the new sources of finance, distribution channels, competition and product innovation also generated very significant problems, to which the regulatory system eventually reacted, albeit not before there were significant losses for some borrowers.

384 In particular, there were questions as to whether brokers were providing a service to, 'advising' and acting in the best interests of borrowers, or providing a commission funded distribution channel for lenders. There was a great deal of uncertainty as to who was accountable where brokers provided poor advice or misled borrowers about the loan they were arranging for them.

385 It was eventually concluded that certain product innovations were deleterious to consumers. For example, substituting an early exit fee for an entry fee allowed many consumers to obtain loans with lower upfront costs, but such exit fees were ultimately being charged at levels beyond what could be justified in terms of lender costs, locking consumers into loans and creating a barrier to switching and competition.

386 Other innovative products, 'low doc' or 'no doc' loans, initially designed for the self-employed, were at times used to help a broader range of borrowers into loans of questionable affordability. Supply-side competition over distribution models, remuneration through commissions and the lack of clear accountability for, and regulation of, broker conduct drove lending that, at least in hindsight, was excessive and irresponsible in some cases. The lack of adequate or consistent regulation of brokers allowed too much poor, unqualified or self-interested conduct and, on the fringes of the market, dishonest and criminal conduct. Efforts by industry and ASIC to address some of these issues through self-regulation had some impact but did not solve the broader problems.

387 The regulatory system eventually caught up with these problems, with the implementation of a national consumer credit regime in 2010 introducing licensing and standards for brokers, responsible lending, clear accountability, and a ban on mortgage exit fees. As detailed in Section J, ASIC publicly reported on these issues throughout the previous decade, and some borrowers suffered significant losses before such regulation was introduced.

388 In response to lessons learned from the problem of under-regulation of the credit market, the economic philosophy underlying the current credit regulatory regime is that governments should intervene to set protections for individuals from the risk of hardship following inappropriate lending, and for the broader economy from the systemic impacts of defaults on borrowing. This departs from the historical position, before national credit regulation, where there were no specific restrictions on the amount of credit that could be lent, and the onus generally rested with the borrower. The previous dominant reliance on disclosure was costly for industry but did not improved consumer outcomes.

389 By setting limits on lending, the regulatory regime also recognises the potentially systemic impacts on the economy of large-scale defaults on borrowing, including on the profitability of the banking sector and on the real economy.

Thematic lessons from adverse consumer outcomes

390 In addition to recognising the strengths and successes of the Australian financial system, there are lessons to be learned in relation to aspects of the

system that have not performed as well, whether involving outright collapses of businesses or investments, widespread investor losses, or sub-optimal outcomes for investors and financial consumers due to a poorly-functioning market sector.

391 These lessons include the need to:

(a) address some common themes arising out of failures in the financial system, including misalignment of risk, conflicts of interest and inadequate regulatory tools; and

(b) better support Australians into retirement.

Collapses and losses: Common themes

392 Broadly speaking, investors and financial consumers may experience loss for three reasons:

(a) crystallisation of market, credit and/or operational risk;

(b) inappropriate conduct, often driven by conflicts of interest; and

(c) outright criminal misconduct.

None of these sources of loss can be removed absolutely and no financial regulator can prevent all losses from occurring.

393 Failure and collapses in particular are an inevitable and necessary part of the financial system. They often involve all three of the elements described in paragraph 392. Removing all risk would effectively bring the financial system to a halt—lending and investment would not occur, and growth would be substantially cut. This applies particularly to those parts of the market that are not subject to prudential regulation.

394 While Australia has not had the same levels of failure as many other jurisdictions, there have been a number of high profile failures with significant losses for investors. These include the collapses of Westpoint, Trio Capital and Storm Financial: see Table 24. Such financial failures, mis-selling and fraud can have a devastating impact on the individual investors, financial consumers and businesses involved.

395 While each case is different, we have identified some common themes arising out of such failures. These include:

(a) a misalignment of risk, often amplified by leverage;

(b) conflicts of interest; and

(c) inadequacies in the regulatory toolkit, particularly an over-reliance on disclosure.

Misalignment of risks

396 In many cases, investors and financial consumers who have suffered losses thought that their money was invested in products that were less risky than was actually the case. This resulted in a clear misallocation of risk, in that investors and financial consumers ended up bearing risk that they did not understand, could not manage or control, and in many cases could not recover from once the risk crystallised as major losses.

397 While leverage obviously increases the potential for investor gains, in a number of cases (e.g. Storm Financial: see Table 24), its use was over-promoted without adequate explanation of the risks and without sufficient regard to the needs, objectives and risk appetite of the investors. This also occurred in the home lending market, where—at least on the fringes—loans were promoted and provided that were beyond the reasonable capacity of the borrowers to repay.

Conflicts of interest

398 Conflicts of interest, including from remuneration structures or related party transactions, meant that promoters and managers of the investment did not act in the best interests of the business or of those investing in it, that gatekeepers did not perform their role adequately, or that the quality of advice was tainted (e.g. where commissions led advisers to drive investors towards unsuitable products).

399 From 1 July 2013, advisers have been required to comply with a range of new obligations intended to improve the quality of financial advice, strengthen investor protection and underpin trust and confidence in the financial advice industry. These new obligations were introduced by the Future of Financial Advice (FOFA) package of legislation. Section I outlines in more detail the origins and implementation of the reforms and their potential impact, and ASIC’s role.

400 Among other things, the FOFA reforms prohibit certain forms of conflicted remuneration that in the past has affected the quality of advice, and require advisers to act in the best interests of their clients when providing personal advice.

401 These reforms do not alter the balance of risk in the financial services system—investment risk will still necessarily lie with investors. However, by removing some sources of conflicts of interest for financial product advisers and imposing a positive duty for advisers to act in the best interests of the client, the reforms aim to promote better quality advice to ensure that investors make well-informed and appropriate decisions about what investment risk to take on: see Section I for more details.

Poorly functioning markets impeding competition

402 Outcomes for consumers are often poor within markets that are characterised by supply-side competition and where intermediaries have significant conflicts of interest. In the absence of genuine demand-side competition, there is always a risk that competition by suppliers for distribution of their product through intermediaries will increase costs and end prices, as such supply-side competition increases commissions and other selling incentives. Such situations may also undermine suppliers' ability to appropriately manage the conduct of their intermediaries for fear of the intermediary moving to another supplier. This, along with the incentive of commissions, makes misconduct or pressure selling more likely.

403 The market for consumer credit insurance has been strongly characterised by these types of problems over a long period. There have been repeated regulatory efforts to improve outcomes for consumers, mostly through disclosure but also by placing a cap on commission levels. It is also a market where consumers have difficulty assessing the risks they are ostensibly managing through the insurance. Experience internationally has been consistent with recent mis-selling scandals in the United Kingdom: see the information box at paragraph 270 in Section B.

404 This pattern has also been a causal factor in the long-term problems with quality of financial advice in Australia. Where markets function in this way, additional disclosure has generally not proved effective in addressing the problems. More significant intervention, such as the FOFA reforms, is required to make competition and the market function effectively to deliver quality and cost-effective products and services to consumers.

Inadequate regulatory toolkit

405 In hindsight, the financial services reforms implemented from 2001–04 have arguably not been fully successful in preventing unnecessary losses because the regulatory toolkit placed too high a reliance on disclosure.

406 As described in Sections A and B, the assumption that has underpinned much of retail financial services regulation since the Wallis Inquiry—that disclosure was the best tool in almost every instance to fix market failure—has not been borne out in practice. Economic research in behavioural science, as well as the experience of regulating retail financial markets, indicates that investors and financial consumers are prone to behavioural biases that mean decision making is often not instrumentally rational. This undermines the effectiveness of some 'traditional' regulatory tools, notably disclosure. Importantly, these behavioural biases are significant and systematic, rather than random and trivial. There is potential then to improve regulatory design with a better understanding of consumer behaviour and decision making.

407 Our work in the area of debentures provides an illustration of the limits of our regulatory toolkit, particularly in the area of disclosure.

Debentures and retail investors

A debenture is a security that represents an undertaking by a company promising an investor to repay money at a future point in time.

Debenture issuers: 'Bank-like'

Many debenture issuers have a business model that appears superficially similar to a bank or credit union. They borrow money from investors by issuing at-call or term debentures, often on-lending these funds for mortgage finance or real estate investment.

The debentures are issued in a manner similar to a bank deposit, including allowing people to directly deposit their salary or other payments. Many such debenture issuers operate branches, use BSB numbers, and even have ATMs on site. They often use terminology or marketing that is similar to that of an ADI, such as 'accounts', 'deposits' and 'branches'. Although debenture issuers have some characteristics of a bank, they are not prudentially regulated by APRA and the government guarantee for deposits does not apply. Because they are not subject to prudential requirements, they tend to have a higher risk profile than ADIs.

Debentures: concerns

ASIC has identified four common concerns that are prevalent in the debenture industry; namely:

Aggressive or misleading advertising. The advertisements are often aimed at retirees and play on many older people's need for a fixed, secure income and use words like secure or secured. They use the terminology typical of ADIs noted above and the advertisements do not acknowledge that debentures are more risky than a bank deposit and are not guaranteed or prudentially regulated. Nevertheless, debentures can be particularly attractive to certain retail investors like retirees or SMSF members because they typically offer a fixed rate of interest above that offered by banks. The nature of the risk they involve—which goes beyond the risk of volatility to the risks of collapse and loss of capital—is difficult for less sophisticated consumers to understand. In ASIC's experience it is not unusual for those investing to believe they are being risk-adverse and wisely avoiding more volatile products by choosing a debenture.

Inadequate disclosure, particularly relating to (often inflated) valuations of the security underlying the debentures and bad and doubtful debts.

Related party transactions. Debenture issuers often lend money to related companies or other entities associated with the directors of the issuer. This increases the risk that arms-length lending procedures may not be used, which in turn increases the credit risk.

As a consequence of these matters, retail investors often acquire debentures when they are not, in fact, aligned with financial situation, risk profile, objectives and needs.

Debentures: ASIC's regulation

Regulation of the retail debenture sector has been primarily based on disclosure, with companies required to use a prospectus for offers of debentures to new retail investors.

Debentures and retail investors

Since 2007, in an intense effort to make disclosure more effective, ASIC has required companies issuing a prospectus to disclose against certain benchmarks to provide investors with information about the 'health' of the business on an 'if not, why not' basis. The benchmarks include the debt maturity of the loan portfolio, the status of any related party loans, and the level of equity capital, and liquidity (being an indicator of the short-term financial health of the issuer). While we have asked issuers to disclose whether or not they meet the benchmarks in their guidance, they are not legally required to meet them, and may state in their disclosure that they do not. Many current issuers do not meet one or both of ASIC's equity and liquidity benchmarks.

In addition to our work to improve disclosure, ASIC also undertakes risk-based surveillance of the unlisted debenture sector and has frequently implemented measures to promote investor awareness of the risks associated with investing in debentures. These include releasing public reports on each issuer's compliance with the benchmarks, posting information for investors on our MoneySmart website and through media releases.

Debentures: Testing the limits of ASIC's regulatory toolkit

In spite of ASIC's efforts to improve disclosure and investor understanding, many retail investors have clearly not understood the risks involved with this kind of investment.

Disclosure is dependent on the assumption that:

- first, disclosure against benchmarks will provide information that retail investors can and will understand and effectively evaluate;
- second, retail investors can and will understand and effectively evaluate the implications of a debenture issuer choosing not to disclose.

As set out in Section A, these assumptions are not always reliable and new approaches are needed, such as more effectively labelling the risk of debentures.

Supporting Australians into retirement

408 The overarching aim of the superannuation system is to provide members with an adequate income in retirement.

409 The focus of public discussion and awareness of superannuation currently revolves around the pre-retirement phase which has resulted in positive developments to address shortfalls in investor engagement, such as the MySuper reforms described in paragraphs 314–316 of Section B.

410 Inevitably, as more Australians move into retirement, superannuation funds and financial advisers will adapt their business models and products to the retirement phase (e.g. by building and deepening their professional skill-base, adjusting their product offerings and streamlining their services from accumulation through old age). However, this process of adaptation has progressed slowly; currently there are limited product offerings and significant deficiencies in retirement advice.

Limited product offerings

411 Account-based products dominate the retirement-phase market, but these products generally do not address longevity risk issues for retirees.

412 Annuities protect retirees against longevity risk, but are relatively unattractive to investors due to their opacity, complexity and conservative investment profile. As a result, very few investors opt for an annuity product and the annuity market has, as a consequence, contracted considerably in recent years. Most annuity providers are no longer writing new business.

Deficiencies in retirement advice

413 In 2011, ASIC conducted shadow shopping research that looked at financial advice about retirement.[48] We found that, while the majority of advice examples we reviewed (58%) were adequate, 39% of the advice examples were poor, and two examples were good quality advice (3%). We found that many advisers were still operating with an 'accumulation mindset', rather than providing strategic post-retirement advice.

414 Supply-side barriers to good quality financial advice included product-focused advice and conflicts of interest that limited the quality of the advice being provided, a heavy reliance on pro forma advice, and the need to improve training and professional development. The wealth management sector, in which the advice industry plays a central role, is still emerging from a sales culture. It has primarily focused on products catering to the accumulation phase, with advice focused on product distribution.

415 On the consumer side, the main problem resides in the difficulty consumers have in evaluating the quality of advice they receive. The advice relationship is asymmetric. In the past, advice costs have been obscured so that the true costs of advice are not always appreciated, and disclosure often fails to prompt consumers into making informed decisions about how to find and value good quality advice.

[48] Report 279 *Shadow shopping study of retirement advice* (REP 279).

E Future regulation

Key points

We consider that the financial regulatory architecture established under the Wallis Inquiry continues to work well, both in relation to the broad allocation of responsibilities among regulators, and the general suite of responsibilities held by ASIC.

Alternative regulatory models, such as self- or co-regulation should be considered wherever possible; however, certain preconditions need to be present to ensure that they operate effectively.

An important aspect for future consideration will be how best to ensure that regulation promotes effective competition.

Financial regulatory architecture

Balance of responsibilities between financial regulators

416 In their post-crisis reviews, some international jurisdictions have conducted major restructures of their financial regulatory architecture. They have changed where responsibility lies for key elements of financial system regulation—prudential and market conduct regulation and responsibility for financial stability—by creating new bodies or amalgamating existing ones. This has been done in response to a perception that the existing systems did not adequately anticipate or respond to market failures.

417 In contrast, there does not appear to be any evidence to suggest a similar major restructure is required in the Australian system. Rather, our regulatory structure may have been a factor in our relative resilience during the global financial crisis.

418 The Wallis Inquiry recommended separating out responsibility for market conduct regulation from prudential regulation because it found that the different regulatory approaches would be best handled by discrete regulators with distinct expertise.

419 We do not consider that anything in the financial system has changed to justify arranging regulatory responsibilities in a radically different way. Rather, our experience since the Wallis Inquiry, including during the global financial crisis, has been that Australia’s twin peaks model, aligned with the responsibilities of the Reserve Bank of Australia (RBA) and Treasury, has been very effective.

420 Indeed, since the global financial crisis some international regulators have reformed their regulatory architecture to implement a similar model to Australia's. For example, the United Kingdom has established the Prudential Regulation Authority (PRA) to take primary responsibility for prudentially supervising individual firms, separate from the responsibility for market conduct regulation held by the FCA, as it found that the previous model of a single regulator handling both responsibilities could not exercise sufficiently close and effective scrutiny of prudential soundness.

421 Nevertheless, as discussed in Section G, we think it would be useful to adopt a mechanism to refine the boundary of prudential regulation if entities or sectors outside the boundary are identified as raising systemic risks to the market in the future.

Balance of responsibilities within ASIC

422 Some commentators have raised the issue of whether ASIC has too many different responsibilities. Some have argued that aspects of ASIC's role should be reallocated to dedicated regulators, including:

(a) responsibility for consumer protection; or

(b) responsibility for handling significant financial crime (e.g. serious fraud and foreign bribery).

423 During the Wallis Inquiry, the issue of whether Australia should have a combined securities and consumer protection regulator, or two separate agencies, was under significant debate. While the inquiry received submissions arguing for both models, it concluded that the regulation of financial market integrity and investor and financial consumer protection in the finance sector should be carried out together, due to the significant synergies between the two type of regulation. This approach is common to many other jurisdictions.

424 We think that the risks of separating market conduct and consumer protection regulation include:

(a) regulatory fragmentation, leading to duplication and inefficiencies and/or gaps where regulatory accountability is unclear;

(b) losing the close link between effective market regulation and the protection of retail investors, in particular;

(c) a lack of a holistic viewpoint, in that separate regulators would not have significant capacity to review how their actions could affect the market as a whole and balance consumer protection with market efficiency, and could 'over-regulate' to pursue a consumer protection aim at the cost of market efficiency, or vice versa; and

(d) unclear mandates, as the distinction between 'retail' and 'wholesale' markets is not always sufficiently clear to separate responsibility for each between different regulators.

425 A separate consumer protection regulator is also less likely to have the regulatory means and resources to take meaningful action to remedy the consumer protection problems it identifies. Typically, effective action against a market participant needs to involve the option of revoking their authorisation to operate in that market, or the imposition of ongoing conditions on that authorisation. A consumer protection body that is not also responsible for licensing or authorising market participants is not able to effect this kind of regulatory remedy.

426 Some overseas jurisdictions have chosen to establish separate consumer protection agencies. The US Consumer Finance Protection Bureau is often cited as an example of this type of model. However, it is important to recognise that the Bureau's jurisdiction is very limited in its coverage of consumer financial products (e.g. while it covers consumer credit, its jurisdiction does not include general insurance). Therefore, its ability to cover the range of issues facing financial consumers is inherently limited. Furthermore, there is also a significant overlap between the Bureau's jurisdiction, and those of state regulators.

427 Additionally, retail financial services require specialist regulation, rather than a generic consumer protection regulator that is responsible for regulating all providers of consumer goods and services. For example, it is particularly difficult to assess the quality of financial products and services before they are delivered, due to factors such as the intangibility and often complexity of financial products, and the fact that they are purchased infrequently. This means that the providers of financial products and services are best regulated by a market regulator, which can apply forward-looking regulatory tools such as licensing rather than simply consumer protection standards that apply after any problem is discovered: see paragraphs 256–271 of Section B.

428 Similarly, the potential limitations of establishing a separate agency dedicated to responding to serious financial crime include the potential for regulatory fragmentation between agencies with related responsibilities, and inefficiencies in harnessing information and expertise. There could also be potential for delay in the investigation of a matter while the appropriate regulatory agency is determined.

429 For completeness, the internal separation of ASIC's regulation and registry businesses is also being considered as part of proposals on a user pays funding model: see paragraphs 188–220 of Section A.

Alternative regulatory models: Self-regulation and co-regulation

430 Self- or co-regulatory models involve industry developing and enforcing its own regulatory rules, with a minimum of, or with specifically designated, government involvement.

431 In some situations, self- or co-regulation has distinct advantages over government regulation. However, in others it is less effective. There are several factors that determine whether self- or co-regulatory models are likely to be appropriate for or effective in a particular industry. These factors relate to the nature of the relevant industry, the type of regulatory problem to be addressed by self- or co-regulation and the level of risk to consumers if the regulation fails.

432 While there are a number of existing examples of self- or co-regulation in the financial system, care needs to be taken to ensure that further moves to this type of regulatory structure are only made where consumer protection or industry standards will not be compromised. Unless properly designed and/or targeted, such alternative models will also not necessarily reduce compliance and enforcement costs.

Meaning of 'self-regulation' and 'co-regulation'

433 There are various definitions of self and co-regulation.

434 Self-regulation has been described as a regulatory model where industry (sometimes in conjunction with government) voluntarily develops, administers and enforces its own solution to a particular issue, and where no formal oversight by the regulator is mandated. Examples of self-regulation include:

(a) introduction by industry participants of an industry-wide regulatory code, or professional bodies' codes of conduct;

(b) industry service charters, guidelines and standards; and

(c) industry-based accreditation and complaint handling schemes.

435 Co-regulation generally involves both industry and regulators developing, administering and enforcing a solution, typically underpinned by legislative backing. The Office of Best Practice Regulation's *Best practice regulation handbook* states that:

> *Co-regulation* typically refers to the situation where industry develops and administers its own arrangements, but government provides legislative backing to enable the arrangements to be enforced. This is often referred to as 'underpinning' of codes, standards and so on. Sometimes legislation sets out mandatory government standards, but provides that compliance with an industry code can be deemed to comply with those standards. Legislation may also provide for government-imposed arrangements in the event that industry does not meet its own arrangements.

436 Co-regulatory models are varied and can include legislation that:

(a) delegates the power to industry to regulate and enforce codes;

(b) enforces undertakings to comply with a code;

(c) prescribes a code as a regulation, but the code only applies to those who subscribe to it (prescribed voluntary codes);

(d) does not require a code but has a reserve power to make a code mandatory;

(e) requires industry to have a code and, in its absence, government will impose a code or standard; and

(f) prescribes a code as a regulation to apply to all industry members (prescribed mandatory codes).

Advantages of self-regulation or co-regulation

437 Effective self- or co-regulation has a number of advantages:

(a) *Expertise*—compared with government and government regulators, industry is considered to have greater understanding and knowledge of the conduct of industry participants and the markets in which they operate. This should mean that industry is best placed to both craft regulatory solutions and take appropriate monitoring and enforcement action.

(b) *Flexibility and timeliness*—compared to government and regulators, industry is typically able to respond to emerging regulatory problems in a more flexible and timely manner.

(c) *Cost efficiency*—self- and co-regulatory models ensure that the cost of regulation falls more efficiently on the industry that generates the need for regulation.

Limitations of self-regulation and co-regulation

438 The limitations of self- and co-regulatory models include that:

(a) they may lack credibility and public confidence;

(b) they may lack effective enforceability;

(c) they can prove to be anti-competitive in nature by creating inefficient barriers to entry;

(d) they can be subject to ‘regulatory capture, where the regulation and self-regulatory body comes to serve only the interests of the self-regulated industry;

(e) they may break down under stress, such as when market conditions change, meaningful reforms are proposed, or conflicts of interest arise between the aims of industry members and self-regulatory objectives;

(f) 'free riders' may reduce the model's overall effectiveness (e.g. industry members that choose not to join the self-regulatory scheme, or join but do not properly adhere to the agreed rules).

Characteristics of a successful self-regulatory or co-regulatory model

Effective self-regulation

439 The Office of Best Practice Regulation's *Best practice regulation handbook* states that self-regulation may be considered as a viable option if:

(a) there is no strong public interest concern and, in particular, no major public health and safety concern in relation to the subject matter of the regulation;

(b) the problem the regulation is seeking to address is a low-risk event, or is of low impact or significance; and

(c) the problem can be fixed by the market itself (e.g. there is an incentive for individuals and groups to develop and comply with self-regulatory arrangements to ensure the industry survives or to gain a market advantage).

440 The *Handbook* also notes that, conversely, self-regulation is not likely to be effective if industry has an incentive not to comply with the rules or codes of conduct.

441 In 1999, the then Minister for Financial Services and Regulation, the Hon Joe Hockey MP, established a Taskforce on Self-Regulation in Australia, chaired by Professor Berna Collier. The Taskforce released its final report and recommendations in 2000.[49]

442 It identified a number of factors that would make self-regulation more effective, including:

(a) clearly defined problems but no high risk of serious or widespread harm to consumers;

(b) a mature industry environment with an active industry association and/or industry cohesiveness;

(c) a competitive market that makes industry participants committed to participating, either to differentiate their products, or in fear of losing market share; and

[49] Taskforce on Industry Self-regulation, *Industry self-regulation in consumer markets*, Commonwealth of Australia, August 2000.

(d) incentives for industry participants to initiate and comply with self-regulation (e.g. consumer recognition and preference for members of the scheme).

443 The Taskforce's final report stresses that a self-regulatory system is likely to be more effective if an industry has sufficient resources to:

(a) implement the system;

(b) monitor and enforce compliance with standards, on an ongoing basis; and

(c) apply sanctions to members including removal from industry where necessary.

444 The report states that governance and enforcement are only likely to be effective if an industry is sufficiently cohesive and has a uniform set of standards. If there are multiple sets of standards and governing bodies within a self-regulating industry, this can risk fragmentation and arbitrage, as industry members may be able to move from one governing body to another with lower standards. It also noted that industry associations have an inevitable conflict of interest between enforcing standards of conduct against members, and receiving member fees and encouraging new members.

Effective co-regulation

445 While government backing is an important feature of a co-regulatory approach, this model is still typically devolved to industry to ensure implementation, monitoring and enforcement is carried out. It therefore depends on that industry having sufficient resources, cohesion and incentive to do this effectively. Therefore, the pre-requisites and considerations discussed in the context of self-regulatory models above are also generally relevant to co-regulatory models.

When government regulation is best

446 The *Best Practice Regulation Handbook* states that *explicit government regulation*, typically comprising primary and often subordinate legislation, should be considered where:

(a) the problem is high risk, or of high impact or significance (e.g. a major public health and safety issue);

(b) the community requires the certainty provided by legal sanctions;

(c) universal application is required (or at least where the coverage of an entire industry sector or more than one industry sector is judged as necessary); and

(d) there is a systemic compliance problem with a history of intractable disputes and repeated or flagrant breaches of fair-trading principles, and no possibility of effective sanctions being applied.

Limitations of co-regulatory approach in credit card surcharging

There are currently concerns about the level and lack of transparency of surcharges imposed by some merchants on credit and debit card transactions.

Payment systems, and arrangements between those systems, merchants and users of the payment systems, are generally regulated by the RBA.

Payment schemes are currently allowed to limit surcharges imposed by merchants to the reasonable cost of card acceptance. They may do so via the terms and conditions of their contractual agreements with merchants. The RBA's Guidance Note, *Interpretation of the surcharging standards*, sets out the RBA's view on the costs that can appropriately be included in the 'reasonable costs of acceptance', and those costs that the scheme may need to verify if it believes the merchant is surcharging in excess of reasonable costs.

However, while able to impose such limitations on merchants, payment schemes are not required to do so.

Concerns about surcharges prompted the Commonwealth Consumer Affairs Advisory Council to release a report in November 2013, *Credit card surcharges and non-transparent fees: A study*.

This report noted that the payment schemes face difficulties in enforcing the surcharging limits due to difficulty in monitoring some of the costs outlined in the RBA's Guidance Note, and fact that the commercial nature of the relationship between the schemes and merchants acts as a disincentive to the schemes penalising merchants for excessive surcharging.

ASIC does not have any direct power to restrict the amount of a surcharge to the reasonable costs incurred by a merchant in accepting a card. ASIC has jurisdiction over consumer protection provisions relating to financial services and products contained in the Australian Consumer Law and ASIC Act, such as prohibitions on unfair contract terms.

A surcharge is imposed by a merchant on a consumer by a term of the purchase contract (i.e. the contract to purchase a consumer good or service), and not a term of the contract applying to the use of the credit or debit card (a financial product), so the unfair contract provisions ASIC administers in relation to financial products do not apply.

While adding a fee at a late stage of a purchase transaction has the potential to be considered a misleading practice, in the majority of cases this will essentially relate to the total costs of non-financial goods or services, and so be a matter for the ACCC.

This situation indicates that, while consumers have access to a number of different types of payment methods and payment systems, the complexity of financial transactions and the number of interconnected parties involved means that such competition cannot necessarily result in a better consumer outcome, including to lower costs and prices.

In this situation, a co-regulatory approach to limit an activity appears to have failed because the limitation imposed by payment schemes is not sufficiently clear, and is not being enforced by a regulator with sufficient powers and resources to carry out the enforcement.

Experience of self-regulatory or co-regulatory models in the financial system

Industry codes: ASIC's approval role

447 ASIC has a power, under s1101A of the Corporations Act, to approve codes of conduct that apply to the activities of AFS licensees, authorised representatives and issuers of financial products. This is a voluntary power. ASIC has no power to mandate or prescribe a code of conduct and, further, it is up to any industry representative body to seek ASIC approval of their code.

448 ASIC must consider a code application against criteria set out in the legislation, including that the code must not be inconsistent with financial services laws and that ASIC must be satisfied of the ability of the code applicant to ensure that subscribers comply.

449 We have set out details about how we will assess an application for code approval in Regulatory Guide 183 *Approval of financial services sector codes of conduct* (RG 183). Our general policy approach is that we will only approve a code that either substantially elaborates on, or sets standards that exceed, minimum legal requirements. RG 183 also sets out our expectations about consultation, administration and enforcement arrangements.

450 To date, ASIC has not approved a code under s1101A.

451 As part of the initial suite of FOFA reforms, ASIC was granted a new power to approve a code of conduct under s962CA of the Corporations Act. Membership of an ASIC-approved code would exempt persons from having to comply with the newly introduced 'opt-in requirement' under s962K of the Corporations Act. This was a novel power for ASIC in that it explicitly provided industry with a co-regulatory alternative to complying with conduct provisions in the Corporations Act.

452 ASIC amended RG 183 to accommodate this provision, and received one application for an industry code. This work has not substantively progressed as legislative amendments are currently being progressed to repeal both the underlying opt-in provision and the code approval power in s962CA.

453 ASIC's code approval power can be contrasted with those administered by other regulators, in particular, ACCC and the Australian Communications and Media Authority (ACMA).

454 The ACCC regulates four mandatory industry codes that are prescribed under Pt IVB of the *Competition and Consumer Act 2010* (Competition and Consumer Act). These are the Franchising Code, Horticulture Code, Oil Code, and Unit Pricing Code. There is a regulation making power in the Competition and Consumer Act (s51AE) that includes that regulations can

be made to prescribe an industry code, or specified provisions of an industry code, and to declare the industry code to be a mandatory industry code or a voluntary industry code. The ACCC also has specific powers to obtain information from code subscribers and to audit code compliance.

455 ACMA similarly has a range of powers under the *Broadcasting Services Act 1992*, which enable it to request the development of and enforce codes, and step in with alternative industry standards if it perceives that a code is deficient.

456 While the code approval power given to ASIC is more limited than those applied by ACCC and ACMA, we do not consider that there is a demonstrable need for a mandatory codes approval power under the Corporations Act. The ACCC has an economy-wide jurisdiction and does not have the same licensing and other conduct powers that ASIC does. Further, the licensing and conduct regime that applies to financial services under the Corporations Act, and elaborated by ASIC relief, class orders and guidance, is tailored and increasingly prescriptive in some areas.

457 ASIC acknowledges, however, that there may be limited incentive for an industry applicant to seek approval under s1101A.

Examples of self-regulatory and co-regulatory models in the financial services industry

458 There are many examples of self-regulation in the form of industry codes, professional standards codes and specific standards or guidelines operating in the financial services industry, including the:

(a) *Code of Banking Practice*, an initiative of the Australian Bankers' Association;

(b) *General Insurance Code of Practice*;

(c) The *Customer Owned Banking Code of Practice* (developed by Abacus, now the Customer Owned Banking Association);

(d) Financial Planning Association of Australia's *Code of Ethics and Professional Standards*;

(e) Association of Financial Advisers' (AFA) *Code of Ethics*;

(f) Accounting Professional and Ethical Standards Board's (APESB) standard for the provision of financial planning services, APES 230 *Financial planning services* (applying from 1 July 2014);

(g) Mortgage and Finance Association of Australia's (MFAA) *Code of Practice*; and

(h) National Insurance Brokers Association's *Insurance Brokers Code of Practice*.

459 None of these have direct co-regulatory features, although we note that there is an important link to compensation in that the ASIC-approved external-dispute resolution (EDR) schemes will consider standards set in recognised industry codes or standards when considering the merits of a consumer claim for loss.

460 At the time of their establishment, the *Code of Banking Practice* and the *General Insurance Code of Practice* both substantively filled regulatory gaps and preceded the current licensing and conduct regime in the Corporations Act. These codes have continued to play an important role in setting clear expectations about industry conduct and, in the case of the *General Insurance Code of Practice*, set specific standards in relation to claims handling (a key aspect of the consumer/insurer relationship which is explicitly excluded from ASIC's financial services regime). These codes each significantly cover all of the retail banking and general insurance sector.

461 Conversely, in the financial advice sector there are a number of industry and professional associations operating competing codes, guidelines and/or standards relating to the provision of financial advice and to the professional role of advisers.

462 The ePayments Code (formerly known as the EFT Code of Conduct) provides the only example of a co-regulatory code currently operating in the retail financial services system. It is a voluntary industry code regulating consumer electronic payments—including automatic teller machines, electronic funds transfers at point of sale, debit and credit card transactions (including contactless transactions), online payments, internet banking and BPAY. There are currently 125 subscribers to the Code, which include almost all ADIs and other electronic payment facility providers such as PayPal, Tyro Payments, and a number of online payment platform providers. ASIC became responsible for administering the EFT Code in 1998, and continues to administer the ePayments Code today.

463 Among other rules, the ePayments Code establishes a liability allocation regime for fraudulent and unauthorised transactions and, more recently, a regime to resolve mistaken internet banking payments. These rules play an essential role in promoting consumer protection and consumer confidence in the electronic payment system, as there would otherwise be no specific regulatory regime setting industry standards or protecting consumers in these circumstances. The rules also help Code subscribers' operations by providing a clear, simple and decisive way of resolving disputes when with customers or other subscribers.

464 Some of the pre-requisites for effective self- and co-regulation discussed in paragraphs 439–445 exist in relation to the ePayments Code. This includes a clear incentive for subscribers to comply with the Code in order to promote

consumer confidence, and continued industry investment in the payments system. In this regard, the interests of subscribers are largely homogenous. However, there is no single industry body that has been able to accept responsibility for administering or monitoring compliance with the Code, so this role currently resides with ASIC. Further, the development of both the EFT Code and ePayments Code over the last two decades has taken place with significant regulatory and Government effort and input (including not only from ASIC, but also at various times from the RBA and the ACCC).

ASIC's co-regulatory role with market operators

465 ASIC and market operators have separate and complementary roles in the supervision of the market and of market participants.

466 On 1 August 2010, ASIC took over responsibility for supervision of real-time trading on Australia's domestic licensed markets. This means ASIC is responsible for supervising market participants, market operators and other relevant entities for compliance with ASIC market integrity rules. This new responsibility supplements our responsibility for enforcement of the laws against misconduct on Australia's financial markets and its supervision of AFS licensees and market licensees.

467 Market operators, such as ASX, have retained responsibility for monitoring and enforcing compliance with their operating rules, including listing rules for entities listed on their exchange.

Scope for further self-regulatory or co-regulatory models in the financial services industry

468 ASIC continues to support self-regulatory measures, in particular where these set standards or training requirements that exceed legal requirements.

469 We also acknowledges that industry and professional associations may have legitimate reasons to differentiate their membership and service offerings to clients and that establishing their own codes or standards may be an effective way to do this.

470 However, our experience is that self-regulatory models are rarely an effective or acceptable alternative to explicit regulation in the context of retail financial markets, because the types of pre-conditions for effective self- or co- regulation (set out in paragraphs 439–445) are rarely present in a fully developed state.

471 By way of example, prior to ASIC assuming primary responsibility for regulating consumer credit in 2010, we worked with industry in an effort to improve standards through the development of industry codes. We worked with the mortgage broking industry to improve its existing industry code in

order to address problems identified by our reviews of the industry; however, we found that this was not sufficient to address these issues.

472 Similarly, from about 2005, as the market for reverse mortgages increased significantly, ASIC and others began publicly reporting on the complexity of the products and the significant risks they posed to consumers if used inappropriately or with poor advice. The reverse mortgage industry, responded by implementing a code of conduct—setting minimum product design, conduct and advice standards—with which its members were required to comply.

473 This code did not, however, address all of the risks that had been identified and no compliance body was established to enforce compliance. Accordingly, this was an issue in relation to which law reform was appropriate and there is now tailored regulation of the market, enforced by ASIC under the National Credit Act: see Section J.

474 There have been recent calls from some industry participants for ASIC to have broader co-regulatory powers, including to be able to formally recognise or approve self-regulatory organisations or industry associations and/or to restrict terms of codes. All of these models need to be carefully considered against the type of considerations already discussed—including that, generally, the financial services sector is not an area of low risk to consumers, that in many sectors the industry is diverse and represented by a number of industry bodies, and that in some areas there have been entrenched problems with the quality of products or services being provided.

475 Further, whether or not a co-regulatory model will be more cost-effective will depend on the circumstances in which it is designed and implemented. In particular, this will depend on the level of resources that are devoted to enforcement and ensuring compliance, and the extent to which this is done by industry representative bodies and/or by the regulator.

476 The regulatory effort invested by ASIC in the administration of the ePayments Code demonstrates this point. The consensus-based nature of the Code requires ASIC to consult extensively in formulating any policy and procedural positions for the Code. The most recent review of the EFT Code commenced in 2004 and culminated in the release of the ePayments Code in 2011. The review was extensive and involved comprehensive consultation with various stakeholders, including industry and consumer stakeholders, government agencies, legal profession representatives and dispute resolution schemes.

477 The ePayments Code represents an important progression in consumer protection; however, the Code review experience should also serve as a caution to the presumption that self- or co-regulation will always be more cost effective for government and industry than government regulation.

478 The voluntary nature of the ePayments Code enables some entities that offer electronic payment facilities not to subscribe to the Code. It has been argued that this has contributed to an uneven playing field, due to industry players who subscribe to the Code having to carry more compliance burden than those that do not—a cost to the industry of maintaining a self- or co-regulatory model. Similarly, the advancement and accessibility of technology in recent years has meant some new, smaller players can enter the market quickly, but may fail. This exposes consumers to higher risks and raises questions about the extent to which a self- or co-regulatory model can continue to deliver effective market supervision and regulation.

Competition in the financial system

479 Creating competition in the financial system can deliver very significant benefits to end-users and the economy more broadly.

480 However, competition policy has traditionally been applied cautiously within the financial system. Special features of financial markets and perceived tensions between competition and financial stability have been thought to require a cautious approach to the pursuit of competition.[50]

481 Attitudes towards the role of competition policy in the financial system have begun to change over the past two decades. In particular, views on the relationship between competition policy and financial stability have become more balanced. There is also now some empirical evidence to suggest that regulatory restrictions on competition do not benefit stability.[51]

482 The global financial crisis highlighted the need to reconsider the role of competition policy in the financial system. The Organisation for Economic Co-operation and Development (OECD) has observed that, in response to the global financial crisis, a ‘number of government actions that may harm competition among financial firms have already occurred’.[52] Evidence from previous financial crises suggests that restrictions on competition policy and enforcement can interfere with the process of recovery.[53]

Competition regulation in the Australian financial system

483 An express competition mandate is not part of ASIC’s statutory obligations under s2 of the ASIC Act. Nor do ASIC’s existing statutory objectives provide a sufficient basis to pursue an implied competition mandate.

[50] Organisation for Economic Co-operation and Development (OECD), *Competition and financial markets* (DAF/COMP(2009)11), pp. 33 and 42.
[51] OECD, *Competition and financial markets* (DAF/COMP(2009)11), p. 42.
[52] OECD, *Competition and financial markets* (DAF/COMP(2009)11), p. 54.
[53] OECD, *Competition and financial markets* (DAF/COMP(2009)11), pp. 49–50.

484 In performing its functions and exercising its powers, s2 of the ASIC Act provides that ASIC must act in the interests of the commercial certainty, efficiency and development of the economy, and promote the confident and informed participation of consumers and investors in the financial system. These objectives are commonly regarded as fundamental pre-requisites for ensuring effective competition. However, they are not necessarily synonymous, and tensions and trade-offs may arise.

485 Nonetheless, ASIC fulfils an important role in encouraging competition in the financial system. For example, we led the introduction of competition in exchange markets, including ensuring participant readiness for competition: see paragraphs 500–506. The credit regime administered by ASIC places ultimate importance on consumer protection, while still encouraging competition and product innovation: see paragraphs 515–522.

International approaches to regulating competition in the financial system

486 Several counties incorporate competition considerations within the statutory mandate of their securities regulators.

487 For the most part, these reforms are aimed at discrete sectors of the financial system. As discussed in paragraphs 488–496, only the United Kingdom has adopted a more holistic approach to facilitating competition in the financial system.

United Kingdom

488 In recent years, the United Kingdom has restructured its financial regulatory system to create a twin peaks regulatory framework. From 1 April 2013, the FSA was replaced by a new regulatory framework consisting of the FCA and the PRA.

489 The FCA is responsible for regulating the United Kingdom's financial services industry. The PRA is responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms.

490 The FCA's responsibilities are set out in the *Financial Services Act 2012* (UK) and supporting legislation, and include a competition objective and a competition duty.

Note: The FCA's single strategic objective is ensuring that the relevant markets function well. To support this, the FCA has three operational objectives:

(a) to secure an appropriate degree of protection for consumers (the consumer objective);

(b) to protect and enhance the integrity of the UK financial system (the integrity objective), and

(c) to promote effective competition in the interests of consumers (the competition objective).

Additionally, the FCA has a duty to discharge its functions in a way that promotes effective competition in the interests of consumers, so far as is compatible with the consumer objective or integrity objective.

491 According to the FCA, these provide it with a strong mandate to promote competition in the interests of consumers.[54] The UK Government has said that it views regulatory intervention to promote competition as an urgent task and key priority for the FCA.[55]

492 The FCA has only just begun to apply its competition mandate. Work in the early stages has involved examining existing regulatory requirements (most of which were inherited from the FSA) for anti-competitive effects.

493 An extensive program of market analysis and studies is also underway to determine the state of competition in UK financial markets. The FCA expects to use its regulatory powers to address any competition weaknesses or failings identified as part of this program.

494 For example, the FCA's recent work has included a thematic review of UK market for annuities.[56] This included an analysis of competition forces, and concluded that many consumers could benefit from shopping around rather than simply taking up an annuity from their existing pension provider at retirement (as many UK consumers do). The FCA has committed to undertake further market study to understand what barriers to competition exist in the annuities market, which could inform further work—including targeted regulatory interventions, if necessary.

495 More recently, there have been further reforms in the United Kingdom to provide the FCA with formal competition enforcement power, with effect from April 2015.

Note: The *Financial Services (Banking Reform) Act 2013* (UK) received Royal Assent on 18 December 2013. This Act gives the FCA new competition law powers which it will exercise concurrently with the UK Competition and Markets Authority, the United Kingdom's new unified competition regulator.

496 The PRA also has a competition objective among its regulatory responsibilities. The competition objective is subordinate to its general objective of ensuring the safety and soundness of the firms it regulates (and to its insurance objective). However, it means that the PRA will be required to act in a way that advances competition when taking action to pursue its general objective and insurance objective. The PRA will also be expected to

[54] FCA, *Promoting effective competition*, webpage, 9 September 2013, www.fca.org.uk/about/what/promoting-competition.
[55] Rt Hon Greg Clark MP, *Speech by the Financial Secretary to the Treasury, Rt Hon Greg Clark MP; Journey to the FCA*, speech, 16 October 2012.
[56] FCA, *Thematic review of annuities* (TR 14/2), thematic review, February 2014, www.fca.org.uk/static/documents/thematic-reviews/tr14-02.pdf.

review the prudential regime to consider changes that might further its competition objective.

Regulatory impediments to competition

497 Government regulation has been acknowledged as a potential impediment to effective competition. This issue is sometimes regarded as a greater threat to market access than anti-competitive conduct by private participants.[57] Improperly designed or careless regulatory responses can result in significant negative consequences for the market, market participants and, ultimately, investors. This problem is more acute in global financial markets. Each regulatory regime that must be accommodated increases the compliance burden on businesses and the potential for regulatory inconsistency.

498 The challenge for securities regulators is to design policy responses that balance the need for stability, fair and efficient markets, and consumer protection without inappropriately altering the conditions of access to financial markets or creating barriers to entry and other competition-related impediments.

Implications of changing competitive environments

499 We have highlighted examples of financial sectors that have experienced changing competitive environments in paragraphs 500–536, and our observations of these changes.

Competition in exchange markets

500 The introduction of competition in exchange markets represents one of the most significant structural changes to Australia's financial system in recent years. Since its formation, ASX has held a virtual monopoly over exchange market services. In mid-2011, Chi-X Australia Pty Ltd (Chi-X) was granted a licence to operate an Australian financial market and commenced operation in October 2011 as an alternative trading venue for ASX-listed securities.

> Note: Prior to the introduction of competition, responsibility for the supervision of markets was transferred from ASX to ASIC. In April 2011, ASIC published market integrity rules to provide a framework for competition in exchange markets and to regulate the operation of Chi-X.

501 Prior to the introduction of competition in exchange markets, the Government stated that:

[57] Joint Group on Trade and Competition, *International options to improve the coherence between trade and competition policies* (COM/TD/DAFFE/CLP(99)102/FINAL), OECD, 10 February 2000, p. 2.

> competition between financial markets operating in Australia is an important step in ensuring that Australia's financial markets are innovative and efficient, now and into the future.[58]

502 Following the Government's announcement, ASX substantially reduced fees in areas that would be subject to competition. We attribute this to the threat of competition. Trade reporting fees have continued to be contested, resulting in significant fee reductions and delivering reduced costs to market participants.

503 Competition in exchange markets has helped to deliver new trading technology and innovative order and trade types. For example, ASX has launched Centre Point, which has captured a 5% market share, the PureMatch order book and has trialled intra-day auctions as an initiative to improve liquidity. Chi-X has introduced market-on-close orders and hidden orders in the central limit order book. These developments have benefited investors by providing new ways of transacting and, in some circumstances, offering better prices.

> Note 1: ASX Centre Point orders offer execution at the prevailing mid-point of the national best bid and offer. Centre Point orders can only interact with other Centre Point orders or ASX sweep orders. ASX PureMatch is an alternative order book established by ASX to trade a subset of ASX-listed securities and targets investors and participants who are latency sensitive by offering a faster operating platform. The intra-day auction trial involved participating securities conducting scheduled auctions throughout the day to encourage liquidity to pool around auction periods with the aim of increased turnover.

> Note 2: Chi-X market-on-close orders can only match against other market-on-close orders. They are available throughout the trading day yet the reference price is only determined by the ASX closing auction. Chi-X hidden orders are non-transparent orders that can interact with all Chi-X orders, both lit and other hidden orders.

504 ASIC appreciates that, at a practical level, the regulatory changes that accompanied the introduction of competition in exchange markets had a significant impact on the day-to-day operations of many businesses. Competition has also fragmented liquidity across the two markets, potentially making liquidity harder to find.

505 A report recently concluded that:

> [w]ith no change in market integrity and a positive change in market efficiency (both transaction costs and price discovery) [...] the introduction of competition has improved the quality of Australian equity markets. More specifically, the implicit benefits of these costs far outweigh the costs of

[58] The Hon Chris Bowen MP, then Minister for Financial Services, Superannuation and Corporate Law, Media Release No. 032, *Government announces competition in financial markets*, 31 March 2010, http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/032.htm&pageID=&min=ceba&Year=&DocType=0.

competition, at least as compared to the monopoly provision of secondary securities market trading.[59]

506 The same report said that, for market participants alone, the net benefits of exchange market competition (e.g. reduced transaction costs and market spreads minus the costs associated with implementation) have been estimated at between $36 million and $220 million in the first year after the introduction of exchange market competition.[60]

Competition in listing markets

507 ASIC is currently observing increased competition among market operators seeking to participate in the listing or quoting of financial products. Australia has four financial markets that list or quote financial products for trading on their markets:

(a) ASX is the largest and most established exchange in Australia and is considered to be Australia's primary listing market;

(b) National Stock Exchange of Australia Limited (NSX) and SIM Venture Securities Exchange Limited (SIM VSE) operate smaller markets than those operated by ASX and generally attract smaller entities; and

(c) Asia Pacific Exchange Limited (APX) recommenced trading on its market in March 2014 and is seeking to establish itself in the emerging markets area.

508 In Australia, the responsibility for setting and maintaining listing rules resides with the listing market. However, significant listing rules, such as those relating to continuous disclosure, are enforced by ASIC under the Corporations Act. ASIC also has a role in reviewing the performance of an exchange in maintaining fair, orderly and transparent markets.

509 ASIC has worked with ASX over many years to ensure that the ASX Listing Rules reflect the requirements that we think are important to maintaining market integrity. These include:

(a) rules regarding periodic and ongoing disclosure to ensure that listed entities provide reliable and timely information to the market. Examples of specific disclosure rules include the continuous disclosure requirements for all listed entities and specific disclosure requirements for mining, oil and gas companies; and

(b) rules regarding changes in capital and new issues that restrict a company's ability to issue new shares. Under these rules, companies must either offer shares to existing shareholders on a pro rata basis or

[59] M Aitken, H Chen and S Foley, *How beneficial has competition been for the Australian equity marketplace?*, working paper, 2013 http://www.finance.uts.edu.au/research/seminars/131023.pdf.
[60] M Aitken, H Chen and S Foley, *How beneficial has competition been for the Australian equity marketplace?*, working paper, 2013 http://www.finance.uts.edu.au/research/seminars/131023.pdf.

obtain shareholder approval (unless otherwise exempt), in order to avoid unfairly diluting the interests of shareholders.

510 Since its advent, ASIC has also worked with APX to ensure that its listing rules reflect the similar requirements.

511 As competition in listings markets increases, market operators are seeking to distinguish themselves from one another with different standards. At present, fundamental listings principles or minimum listings requirements are not prescribed by legislation or regulation. Consequently, there is some scope for market operators to design their own listings requirements.

512 As well as potential for confusion, the existence of separate listing requirements for different markets creates opportunities for arbitrage by entities seeking access to the least onerous listing requirements. We consider that competition for listings could lead to deterioration in listings standards for Australian financial markets, and highlights the need for greater consistency in the listing requirements that apply across these markets.

513 In most international jurisdictions, the various exchanges are also responsible for setting their own listing rules and requirements. However, some jurisdictions (such as the United States, Canada and Hong Kong) give their regulators more power to approve amendments to existing listing rules. This assists regulators in those jurisdictions to ensure greater consistency across their exchanges.

514 In a different approach, the United Kingdom has established a central listing authority known as the UK Listing Authority, which forms part of the FCA. The UK Listing Authority is responsible for operating the UK listing regime, including setting, monitoring and enforcing the listing rules.

Securitisation and the consumer credit market

515 Australia’s non-bank lending sector began emerging in earnest in the early 1990s. Largely relying on a funding model involving residential mortgage-backed securities (a form of securitisation), these lenders distributed their products through brokers. To a limited extent, banks began adopting a similar funding and distribution model in response to increasing competition from non-bank lenders. For consumers, this meant easier access to credit and lower borrowing costs.

516 The shift away from traditional models of lending resulted in an increase in the number of intermediaries (e.g. mortgage brokers and finance brokers) as new entities have required alternative distribution channels to compete with networks owned by ADIs. Many consumers use brokers to select and obtain a loan that suits their specific circumstances. This not only assists the consumer obtaining the loan, but can also benefit other consumers, through

market competition, by ensuring that business is directed to credit providers whose loans better meet consumers’ requirements.

517 The period leading up to the global financial crisis was characterised by strong competition among lenders for market share and high levels of available funds to lend. Lenders competed with one another using a mixture of increasing commission payments, product innovation and relaxed lending standards on some products. Resulting problems in this market were exacerbated by poor standards of conduct among under-regulated brokers, and included the churning of consumers among products to increase commissions, and high exit fees preventing consumers from exercising choice. These problems were sufficiently significant to require new regulation to address them: see Section J.

518 Subsequent events have shown that some loans made during this period were unaffordable for the borrowers involved. The lending was, at least in that sense, excessive.

519 Before 1 July 2010, consumer credit was primarily regulated by the states and territories under the Uniform Consumer Credit Code (UCCC). The UCCC was developed before non-bank lending, securitisation and the use of brokers became common features of the residential mortgage market. As a result, it did not address many of the issues arising from these developments and, most particularly, it did not regulate the intermediary and advice role played by brokers.

520 In 2010, licensing and responsible lending obligations were introduced for lenders and intermediaries under the National Credit Act and primary responsibility for consumer credit regulation was transferred to ASIC: see Section J. These reforms have gone a long way to addressing many of the issues that were prevalent in the credit industry before 2010.

521 Data collected by APRA shows that the responsible lending obligations have had a positive impact on the credit industry.[61] For example, since legislation implementing the credit reforms was first introduced and read into Parliament on 25 June 2009, the amount of new approved low doc loans issued by ADIs[62] declined 89.52% from approximately $4.8 billion on 30 June 2009 to $0.5 billion on 30 September 2013.[63] As a percentage of all new household loans approved per quarter, the proportion of low doc loans fell from 6.95% to 0.66% over the same period.

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[61] APRA, *Quarterly authorised deposit-taking institution property exposures: September 2013*, 26 November 2013.
[62] By those ADIs with greater than $1 billion of residential term loans between March 2008 and September 2013 (on average, capturing data on 26 entities per quarter).
[63] On the assumption that the introduction of the bill itself may have resulted in some behavioural modification and reduction in low doc loans by ADIs as they adjust their compliance frameworks before the requirements fully commenced on 1 January 2011.

Note: It is possible that the number of loans that are truly ‘low doc’ is even lower, as some loans include a verification component but are reported to APRA as low doc due to lenders’ historical naming conventions.

522 The state of competition in the consumer credit industry remains dynamic. The period after the global financial crisis saw a marked reduction in non-bank lending activity. A number of non-bank lenders were unable to access the same level of funds through securitisation. Banks became increasingly active in the mortgage broking industry through outright ownership or significant shareholdings in some of the larger mortgage broking entities. With non-bank lenders now re-entering the mortgage market, competition for borrowers again appears to be increasing.

Relationship between financial literacy and competition

523 In its 2008 report, *Review of Australia’s consumer policy framework*, the Productivity Commission found that competition policy forms part of a range of economic policies aimed at improving consumer wellbeing, both macroeconomic and microeconomic.[64] These include policies promoting productivity and education, as well as fair trade practices.

524 Financial literacy is critical to increasing competition among financial services providers. Financially literate investors and financial consumers are more likely ask questions of providers and shop around before making major financial decisions. By demanding products that are more responsive to their needs, they drive product innovation and market efficiency (demand-driven competition). In addition, financially literate investors and financial consumers are more aware of their ability to swap products and providers if they are dissatisfied with their performance. Businesses must work harder to meet the needs of engaged consumers such as these and to differentiate themselves from their competitors.

525 Conversely, low levels of financial literacy can exacerbate competition problems. A lack of understanding about the various financial products and providers available (including the features of those products and their risk profiles), low levels of confidence about financial decision making, and behavioural biases such as inertia lead to low levels of switching rates. In these circumstances, businesses do not have sufficient incentives to improve their performance in order to retain customers.

526 Investors and financial consumers must be freely able to exercise informed choice in order for financial literacy to have a positive and tangible impact on competition. An understanding of the investors and financial consumers’ financial requirements accompanied by trustworthy sources of information are fundamental pre-requisites to the exercise of informed choice.

[64] Productivity Commission, *Review of Australia’s consumer policy framework*, Inquiry Report No. 45, April 2008, pp. 4–7.

527 There are significant inherent information asymmetries between investors and financial consumers and providers. Seeking financial advice is one way investors and financial consumers can bridge this gap. However, even with advice, there may be limitations on investors' and financial consumers' ability to make an informed choice. For example, vertical integration of advisers and product manufacturers may mean that product recommendations are subject to some inherent conflicts (e.g. because a financial adviser's adherence to an approved product list may limit the consumer's investment options).

528 In recent years, there has been a proliferation in the number of online tools designed to enable consumers to better understand their financial circumstances. Comparison websites can be a useful educational tool for consumers. By increasing the likelihood that plans are converted into action they may stimulate competition among providers. However, they can have significant limitations and may mislead consumers if they are not designed responsibly: see Section H for further discussion of some potentially poor design features of comparison websites.

> Note: ASIC imposes conditions on providers of generic financial calculators to ensure that consumer protections are maintained in the provision of online advice: see Class Order [CO 05/1122] *Relief for providers of generic calculators*.

Vertical integration and the financial advice industry

529 Vertically integrated businesses, which combine product manufacturers with advice groups, have always been a feature of the financial advice industry. Vertical integration is common in the financial system, particularly in the banking and funds management industries.

530 From a business perspective, one of the perceived advantages of a vertically integrated business structure is that the advice arm of the group can drive sales for the aligned product manufacturer. Volume rebates traditionally paid from platform operators to advice groups, banned under FOFA, can also be brought within the corporate structure. For investors and financial consumers, the ease of having a range of financial and investment needs met by one entity may be appealing. However, the conflicts of interest inherent in vertically integrated structures can impact on the progress of effective competition.

531 Vertically integrated advice groups use and maintain an approved product list. Aligned advisers select products to recommend to their clients from the approved product list. Aligned advisers are more likely to offer (or may only offer) products issued by an integrated product manufacturer on their approved product list. As discussed in paragraph 527, this may restrict an investor's or financial consumer's ability to make an informed choice.

532 There is no requirement in Australia for advisers to offer independent advice, or for advice groups to be structurally separate from product manufacturers. While required to act in the best interests of clients when providing personal advice, advisers are not required to review all products available in the market before making a recommendation and are not restricted from advising on a limited range of house products under an approved product list.

> Note: The AFS licensing obligations include a requirement to manage conflicts of interest: see Regulatory Guide 181 *Licensing: Managing conflicts of interest* (RG 181). Some AFS licensees that are also regulated by APRA may also be required to meet APRA's prudential standards for managing conflicts of interest.

533 Financial advisers may invest clients' money through an investment platform. Platform operators may offer significant incentives (through retention payments and ownership structures) to entice dealer groups to list that platform on their approved product list. New platform providers may struggle to compete with these incentives and may experience difficulty having their platforms listed on approved product lists as a result. Dealer groups that want to operate as independent groups may struggle to compete against aligned dealer groups that are receiving payments and other assistance.

534 Superficially, at least, the platform may appear to offer a wide variety of products. However, entry to the platform is controlled by the platform operator. Products from preferred providers or products that offer superior returns may be listed in place of those that are better suited to the client's needs. Preferred products may be cross-subsidised through other parts of the platform operator's business, making it difficult for the consumer to discern the true cost. Beyond the evident consumer welfare detriment, this may constitute a barrier to entry for alternative product manufacturers and platforms.

535 The inherent conflict of interest created by vertical integration may not be readily apparent to clients, particularly if the product manufacture and advice parts of the business operate under separate licences and business names. Better informing clients about the nature of vertically integrated business models and their implications for financial decision making will go some way to increasing consumers' understanding of these issues. This may be a prominent, simple statement about the relationship of the adviser to the issuer and the limited range of products that the adviser is able to recommend.

536 In our submission to the Ripoll Inquiry, we advocated for measures to provide better disclosure to investors about relationships between advisers and product issuers, stating:

> Currently disclosure about relationships with product issuers tends to be buried in the fine print of a licensee's [Financial Services Guide] and there

is no legislative requirement for a financial adviser's marketing material (as distinct from FSGs and Statements of Advice (SOAs)) to disclose the association with a product issuer. Many advisers do not disclose this relationship on their website. By the time a potential client receives an FSG or SOA, they may have already gone a long way down the path to making a decision to use the services of the adviser.

F Financial markets

Key points

Financial markets are central to the growth and prosperity of an economy. They have the primary role of facilitating the raising of capital and the efficient allocation of resources and risk between parties.

Financial markets are changing more rapidly than ever before, due to technological change, increasing competition, regulatory change and globalisation.

These changes have driven substantial growth in the markets and productivity improvements, while creating new challenges for regulators globally and in Australia.

537 Financial markets play a central role in the growth and prosperity of any economy. They have the primary role of facilitating the raising of capital and the efficient allocation of resources and risk between parties.

538 Markets consist of:

(a) financial market infrastructure providers (e.g. ASX,[65] ASX 24 and Chi-X);

(b) markets participants (e.g. UBS, JBWere);

(c) other participants (e.g. securities dealers); and

(d) entities that list or quote their products on financial market infrastructure and investors who invest in them (e.g. retail and institutional investors).

Note 1: Market participants enter orders directly into the market and are participants of a licensed financial market.

Note 2: The term 'securities dealers' is used to describe AFS licensees who are not market participants but who facilitate securities trading on licensed markets for clients through an arrangement with a market participant. Securities dealers may also be known as 'white-label' or 'indirect' brokers, shadow brokers, non-broker brokers or indirect market participants.

539 There are several types of markets, including:

(a) equity markets;

(b) derivatives (including futures) markets; and

(c) debt markets.

[65] ASX Group (ASX) is an umbrella brand developed to reflect the role of ASX Limited as the holding company of a group with the following subsidiaries: Australian Securities Exchange, which encompasses ASX and ASX 24; ASX Clearing Corporation, which encompasses ASX Clear and ASX Clear (Futures); ASX Settlement Corporation, which encompasses ASX Settlement and Austraclear; and ASX Compliance.

540 ASIC is responsible for regulating Australia's financial markets and one of its key priorities is to promote fair and efficient markets. ASIC regulates:

(a) listing and trading services;

Note: Listing services facilitate the public raising of capital by corporate entities through the offer of securities to investors. This activity traditionally takes place on licensed markets that are accessible, making listed securities available to retail investors as well as wholesale investors. Listing markets may also provide a venue for the admission of financial products issued by suitable third-party entities, such as warrants and exchange traded funds, which are also made available to retail and wholesale investors alike. However, there has been increasing movement to markets that are not traditional listing markets through, for example, exempt professional markets and the growth of markets like those offered by dark pools.

(b) clearing and settlement facilities (in conjunction with the RBA);

Note: Clearing and settlement facilities provide a regular mechanism for parties to transactions in financial products to meet obligations to each other.

(c) derivative trade repositories;

Note: A derivative is a risk transfer agreement, the value of which is derived from the value of an underlying asset. The underlying asset could be an interest rate, a physical commodity, a company's equity shares, an equity index, a currency, or virtually any other tradable instrument on which parties can agree. A derivative trade repository is a facility to which information about derivative transactions or positions relating to derivative transactions can be reported.

(d) market participants;

(e) securities and derivatives dealers; and

(f) fund managers.

541 Financial markets globally—and in Australia—are undergoing a period of rapid change. This change is occurring across the entire market from capital raising through to post-trade services.

Note: Post-trade services are services during which the details of trades are reported, confirmed, reconciled, cleared and settled. During clearing and settlement, payment occurs and ownership is transferred from the seller to buyer.

542 This change is occurring primarily because of:

(a) new technology;

(b) increasing competition;

(c) the impact of regulation (particularly after the global financial crisis);and

(d) globalisation.

Note: In response to changes in financial markets, including technological innovation and globalisation, Treasury is currently conducting a public review of the existing market licensing regime.[66] One of the objectives of the review is to design a more

[66] Treasury, *Australia's financial market licensing regime: addressing market evolution*, options paper, November 2012.

flexible and effective regime that may provide effective regulation of financial market innovations—for example, dealing with increased use of dark pools as a mechanism for trading securities.

Financial markets infrastructure

543 Australia's financial market infrastructure currently consists of:

(a) 18 licensed financial markets (including six overseas financial markets);

(b) six licensed clearing and settlement facilities;

(c) 18 dark pools;

(d) 25 professional trading platforms (four of which are also licensed financial markets); and

Note: In this submission, we refer to professional trading platforms as markets with the following characteristics:

- users are professional investors who participate in the market on their own behalf or on behalf of other professional investors;
- only financial products that are not available for trading on public markets are traded on the market; and
- the operator (or its associated entity) does not operate a clearing and settlement facility for the market.

(e) eight prescribed derivative trade repositories.

Markets growth

544 The size of Australia's markets has grown considerably from $30.9 trillion in 1996–97 to $135.3 trillion in 2012–13: see Table 14. The size of the OTC derivatives markets in Australia has also grown strongly over this period from $21.8 trillion to $83.4 trillion. The growth in trading on the major derivative market (ASX 24) has increased from $8.7 trillion in 1996–97 to $49.9 trillion in 2012–13. At the same time the growth in the primary equities market (ASX) has increased from $309 billion in 1996–97 to $2 trillion in 2012–13.

Note: The dollar values mentioned in this section have not been adjusted for inflation.

545 In order to more accurately represent the change in the size of the financial market over the past 15 years, market turnover as a multiple of gross domestic product has risen from 55 to 89 times (a growth of 62%).

Table 14: Annual Australian financial market turnover ($ billion)

	1996–97	2007–08	2012–13
OTC markets	**21,849**	**72,149**	**83,397**
Foreign exchange	15,320	45,837	42,403
Foreign currency options	334	745	1,274
Government debt securities	1,387	716	1,778
Non-government debt securities	62	637	777
Repurchase agreements	2,413	3,885	7,864
Forward rate agreements	518	5,833	5,937
Swaps	918	7,945	19,389
Interest rate options	71	425	475
Credit derivatives	—	255	229
ASX 24	**8,712**	**41,496**	**49,938**
Futures	7,396	40,850	49,460
Options	1,316	646	478
ASX	**309**	**2,199**	**2,013**
TOTAL	**30,870**	**98,591**	**135,348**
Market turnover as a multiple of GDP	55	84	89

Note: Totals may not add due to omission of some small contract categories.

Source: AFMA, *Australian financial markets report*, 2001, 2012 and 2013; and RBA, *Gross domestic product—Expenditure components—G11*, statistics table.

Growth of markets: ASX Group

546 The dominant exchange market group in Australia in terms of overall activity is the ASX Group. ASX Group is one of the world's top 10 listed exchange groups as measured by market capitalisation. ASX Group functions as a licensed market operator and licensed clearing and settlement facility provider.

Note: On 14 October 1998, the ASX demutualised and self-listed. ASX was the first exchange in the world to list on its own market. ASIC assumed supervision of ASX as a listed entity, overseeing its compliance with the listing rules.

547 As at 30 June 2013, there were 1,989 companies listed on the ASX with quoted securities. In 2012–13 financial year, companies listed on ASX alone raised a total of $42 billion in capital through primary and secondary

issuance. This compares to a total of 1,198 companies with listed equities and a total capital raising of $16 billion in 1996–97.

Growth of markets: Derivatives markets

548 Derivatives markets are Australia's largest financial markets. The major futures market in Australia (ASX 24) has experienced strong growth in turnover during the past 15 years. Turnover on ASX 24 (futures and options) has risen from $8.7 trillion in 1996–97 to $49.9 trillion in 2012–13.

549 As at 30 June 2013, Australian banks had OTC derivatives total notional outstanding[67] of US$12.2 trillion,[68] of which:

(a) almost two-thirds were single-currency interest rate derivatives;

(b) 10% were cross-currency swaps with an Australian dollar-denominated leg. Almost 95% of these cross currency swaps had floating Australian dollar legs, reflecting the widespread use of these derivatives to hedge offshore funding.

550 The most substantial change in Australian OTC derivatives markets recently has been the increased use of CCPs for interest rate derivatives. For example:

(a) Australian participants have increased their use of major global CCP LCH.Clearnet Limited for the clearing of OTC derivatives from essentially nil at the end of 2011 to US$1.8 trillion in February 2014.[69]

Note: LCH.Clearnet Limited is a London-based CCP that commenced operation in Australia in July 2013.

(b) Australian-dollar interest rate derivatives cleared by CCPs have increased from US$163 billion as at 31 January 2007 to US$3.9 trillion as at 28 February 2014.[70]

551 We anticipate that further OTC derivatives reforms, in particular the possible implementation of a requirement to centrally clear certain OTC derivatives transactions (see paragraphs A–256) will result in further substantial increases in the volumes of cleared transactions.

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[67] Total notional outstanding refers to the total face value of all currently open OTC derivatives.
[68] APRA, ASIC and RBA, *Report on the Australian OTC derivatives market*, 3 April 2014, Table 2, www.cfr.gov.au/publications/cfr-publications/2014/report-on-the-australian-otc-derivatives-market-april/index.html.
[69] APRA, ASIC and RBA, *Report on the Australian OTC derivatives market* 3 April 2014, Graph 7, www.cfr.gov.au/publications/cfr-publications/2014/report-on-the-australian-otc-derivatives-market-april/index.html.
[70] APRA, ASIC and RBA, Report on the Australian OTC derivatives market, 3 April 2014, Graph 6, www.cfr.gov.au/publications/cfr-publications/2014/report-on-the-australian-otc-derivatives-market-april/index.html.

Clearing of OTC transactions

Prompted by global and regulatory decisions, as well as client demand following risks identified from the global financial crisis, central clearing of OTC transactions is a key growth area in Australia and overseas.

In Australia, ASX and LCH.Clearnet are competing in offering clearing services for the OTC market, with both authorised to commence their services in July 2013. ASIC expects that other global CCPs may also look to provide clearing services to the Australian market.

Key developments

Technology

552 Technological developments have driven substantial productivity improvements in global markets by, among other things:

(a) automating company announcements, trading suspensions and consolidation of market data; and

(b) enhancing the capacity, accuracy and speed of order transmission and execution.

553 Technological developments have also created many challenges. For example, globally:

(a) there have been larger and more widespread trading disruptions—for example, resulting from trading system failures and aberrations in computer algorithms that are routing and executing orders without human intervention;

(b) there has been considerable growth in cybercrime, which in some cases is amplified by the speed of systems; and

(c) system connectivity and data management are a challenge for all. Market users and regulators alike need to process and store massive volumes of messages and invest in system capacity, security to protect confidential information and make business continuity arrangements.

Disruptions to services

554 Advances in technology have meant that trading venues have become technology dependent and more susceptible to larger and more widespread trading disruptions. Recent cases of technical problems overseas (such as the Facebook initial public offering, where delays in trading created confusion over individual trades) illustrate the risks and the inherent systemic vulnerability if systems do not function properly. These risks include potential losses for investors and the undermining of investor confidence more generally.

555 The impact of a significant operational shock or disruption to a systemically important central counterparty could potentially extend beyond the markets cleared and its participants, and affect the stability of the financial system and the broader economy.

Note: Operational shocks to a CCP or a systemically important payment facility could be events such as:

- a non-trading related financial loss incurred by one of ASX Group's facilities that consumed the CCP's or settlement facility's equity and that of the ASX Group which would result in there being no clearing house for the ASX market; or
- the corruption of the ASX CHESS system, which is used by ASX Clear (CCP) and ASX Settlement (settlement facility) as the electronic sub-register for equity share holdings in Australia. The unavailability of CHESS would be a significant disruption to the Australian equity market, retail investors and large institutional investors such as fund managers and banks.

556 To mitigate against such a risk, the *Principles for financial market infrastructures* were developed and implemented by members of the Committee on Payments and Settlement System (CPSS) and IOSCO, which includes Australia. The *Principles* set out new international standards for systemically important payment systems, central securities depositories, securities settlement facilities and central counterparties, and include standards for the management of general business and operational risks. The *Principles* have been adopted in Australia by the RBA and ASIC.[71]

Dark liquidity

557 'Dark liquidity' refers to buy and sell orders that are not visible to the rest of the market (dark trades), although the trades are typically published immediately after they take place. While the proportion of total trading that is occurring 'in the dark' has remained fairly constant, the nature of this trading has changed.

558 Advances in technology have made it easier to trade away from central exchange order books. This has resulted in a proliferation of dark trading venues—as at March 2014, there were 18 dark venues registered with ASIC.[72] Trade on these venues is mostly in the 200 largest, and most liquid, securities.

Note: A 'dark pool' is a system that enables trading to occur away from lit exchange markets. A crossing system is a dark pool that is operated by a market participant (a participant of a licensed market, with permission to directly access the market to trade on behalf of their clients and/or themselves).

559 In 2012 and 2013, concerns were raised in the market about the impact of dark liquidity on market integrity and quality. The concerns were centred on

[71] See http://asic.gov.au/asic/asic.nsf/byheadline/Implementing-the-CPSS–IOSCO-Principles-for-financial-market-infrastructures-in-Australia?openDocument.
[72] Information Sheet 178 *Dark liquidity and high-frequency trading* (INFO 178).

the idea that the nature and use of dark liquidity was changing, and that these changes were affecting the prices of securities. There were also questions about the fairness of dark venues for investors, with concerns that they are not regulated as markets and ‘free ride’ on the pricing and information set on lit exchange markets.

560 ASIC established a taskforce in 2012 to undertake an in-depth review of dark liquidity and dark pools. On 18 March 2013, ASIC released Report 331 *Dark liquidity and high-frequency trading* (REP 331) and Consultation Paper 202 *Dark liquidity and high-frequency trading: Proposals* (CP 202), which examine the impact of dark liquidity and high-frequency trading on Australia’s financial markets.

Competition

561 Competition in the Australian market is intensifying at every level of our market structure—from capital raising and secondary trading through to post-trade services. There is also more cross-border competition and integration. This change is largely driven by developments in technology that enable new entrants to compete at a fraction of the cost of incumbents, as well as regulatory decisions that foster competitive settings.

Note: Secondary trading refers to selling and buying securities and assets from other investors, rather than from issuing companies themselves.

562 The impact of this change is especially pronounced in the services provided by financial market infrastructure operators in Australia.

563 On the cash equity trading side, October 2011 (when Chi-X commenced operations) saw the introduction of competition in trading of ASX securities.

Impact of exchange market competition in equities

The introduction of exchange market competition in equities required market operators, market participants, investors, issuers and ASIC to adapt to a multi-market environment.

This has included acquiring the tools and developing processes to identify and access liquidity across multiple markets. Market data from multiple sources must be collected and consolidated to create a single view, and ASIC needs to supervise activity across all markets

564 Competition has also intensified as markets launched new order types, order books and reporting facilities and dark pools continued to proliferate and evolve. Additionally, a number of players in the industry have either commenced activity in—or keenly signalled their intention to commence activity in—other market infrastructure related areas including:

(a) listings;

(b) the admission of other products to trading (including exchange-traded derivatives);

(c) post-trade infrastructure.

Professional trading platforms

565 There has been significant growth in the number of professional trading platforms in operation in Australia since the 2000s, with 25 such markets currently in operation. Four of these markets currently hold an Australian market licence. These licences were mainly granted by the Minister prior to 2007, after which a general approach of exempting professional trading platforms from the requirement to hold an Australian market licence was adopted. Increasingly, these markets are looking for opportunities to compete directly with public exchanges.

566 The current market licensing regime is limited in its ability to accommodate new developments, such as the further growth of professional trading platforms. Under the existing regime, only one category of financial market licence (with the same regulatory obligations) applies to all facilities that fall within the definition of financial markets under the Corporations Act—notwithstanding that the definition of financial markets captures facilities as diverse as:

(a) dark pool trading systems operated by market participants associated with existing exchange markets;

(b) markets that facilitate investment through crowd funding by retail investors; and

(c) electronic platforms that permit trading on a global basis in complex derivatives between wholesale investors.

If a market wanting to operate in Australia cannot meet all the requirements for a licensed market, the only other option available to it under the current regime is for the Minister to issue an exemption.

567 Limitations on the ability of the existing market licensing regime to address market evolution have prompted Treasury to commence a separate review of the financial markets regulatory regime in consultation with industry and ASIC. One of the aims of the review is to develop a more flexible licensing framework for financial markets that facilitates:

(a) more effective competition between markets; and

(b) more effective regulation of financial market innovations—for example, dealing with increased use of dark pools as a mechanism for trading securities.[73]

[73] Treasury, *Australia's financial market licensing regime: addressing market evolution,* options paper, November 2012.

Mergers between financial markets

568 In 2006, following developments among international exchanges (such as the merger of the New York Stock Exchange and Euronext), ASX and Sydney Futures Exchange merged. ASX still operates separate financial markets for derivatives and equities; however, they are now owned by a single holding company.

569 In October 2010, ASX and Singapore Exchange Limited announced a merger proposal. The proposal was subject to various conditions, including foreign investment approval from the Treasurer under the *Foreign Acquisitions and Takeovers Act 1975*. In April 2011, the Government declined the request for approval under this Act and rejected Singapore Exchange's bid for the ASX on national interest grounds

CCP clearing services

570 There are currently seven licensed clearing and settlement facilities operating in Australia, four of which are part of the ASX Group. ASX is the only licensed provider of clearing and settlement services to the market for ASX-listed securities. Transactions executed on Chi-X are cleared through ASX's Trade Acceptance Service on ASX Clear, ASX Group's CCP for cash equities. LCH.Clearnet Limited, a London-based CCP, commenced operation in Australia in July 2013 and is licensed to operate two facilities.[74]

> Note: ASIC shares oversight of licensed clearing and settlement facilities with the RBA. ASIC is responsible for ensuring that licensed clearing and settlement facilities provide their services in a fair and effective manner.[75]

571 In December 2012, the Council of Financial Regulators recommended that competition for clearing and settlement services be deferred for a period of two years.[76] The Treasurer accepted the Council's recommendations on 11 February 2013.[77]

572 As a condition of that decision, ASX has established the *Code of Practice for Clearing and Settlement of Cash Equities in Australia*, under which ASX is obliged to provide its services to the wider market, including competing trading platforms.[78] Conditions of the Code of Practice include the

[74] IMB Limited is also licensed to operate a facility for the purposes of a limited post-trade service that is not considered systemically important.

[75] Under s821A(a) of the Corporations Act, a clearing and settlement facility licensee must, to the extent that it is reasonably practicable to do so, do all things necessary to ensure that the facility's services are provided in a fair and effective way.

[76] Council of Financial Regulators, *Competition in clearing Australian cash equities: Conclusions*, report, December 2012. ASIC is a member of the Council.

[77] The Hon Wayne Swan, then Treasurer, Media Release No. 022, *Clearing and settlement in the cash equity market*, 11 February 2013, http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2013/022.htm&pageID=&min=wms&Year=&DocType=0

[78] ASX, *Code of Practice for Clearing and Settlement of Cash Equities in Australia: ASX Ltd, ASX Clear Pty Ltd and ASX Settlement Pty Ltd*, 9 August 2013, www.asx.com.au/cs/documents/Code_of_Practice_9Aug13.pdf.

establishment of a formal and permanent user group, and transparent and non-discriminatory pricing (including the publication of the full range of fees for ASX's unbundled clearing and settlement services).

573 In March 2014, the Council of Financial Regulators released a paper which provided further guidance on the application of the regulatory influence framework (issued by the Council in July 2012) to CCPs in various Australian financial markets. The paper includes guidance on ASIC and the RBA's likely approach to location requirements for applicants seeking a clearing and settlement facility licence.[79]

574 In other jurisdictions where competition in clearing is being considered or facilitated, there are a number of challenging commercial and regulatory issues including:

(a) possible interoperability between facilities; and

(b) ensuring an adequate regulatory framework to support wider issues in respect of systemic risk.

Globalisation

Overseas financial markets

575 Since the Wallis Inquiry, a framework for the licensing of overseas markets operating in Australia has been established. This has reduced the regulatory barriers between national markets and facilitated the provision of financial facilities, services and products across borders.

576 ASIC regulates foreign providers of financial facilities, services and products that operate in Australia. ASIC has developed principles to guide its decision making relating to the granting of relief to foreign providers from certain Australian regulatory requirements in the Corporations Act. One key principle is that the foreign provider is subject to a sufficiently equivalent overseas regulatory regime.

577 Recognising overseas regulatory regimes reduces the regulatory barriers between national markets and facilitates the provision of financial facilities, services and products across borders.

578 Licences to operate in Australia have been granted to a number of the world's largest overseas derivatives exchanges, including ICE Futures Europe, the London Metal Exchange Limited, Eurex Frankfurt AG, Chicago Mercantile Exchange Inc., and the Board of Trade of the City of Chicago Inc.

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[79] RBA, APRA, ASIC and Treasury, *Application of the regulatory influence framework for cross-border central counterparties*, March 2014, www.cfr.gov.au/publications/cfr-publications/2014/pdf/app-reg-influence-framework-cross-border-central-counterparties.pdf.

579 Overseas licensees are typically able to list any type of new derivatives on their markets and have the potential to provide a range of additional investment opportunities for Australian investors.

580 While the overseas licensing regime relies in general terms on the equivalence of regulation, it is possible that direct listing of the same or equivalent contracts by overseas licensees could give rise to market arbitrage issues (e.g. inconsistent or lower standards). Ultimately, consideration and care should be given to whether our regime places Australian licensed exchanges, and Australian markets more broadly, on a level playing field, particularly in relation to products that are traded on those markets and that are strongly connected to the investment and risk management operations of domestic investors and institutions.

581 Importantly, Australia's current regulatory settings only provide for frontline ASIC supervision of trading on licensed domestic markets. Consideration needs to be given to the appropriateness of having the same products traded on both domestic and international markets, with ASIC only having direct frontline supervision of the trading activity that takes place on licenced domestic markets.

G20 OTC derivatives reform

582 In the wake of the global financial crisis, G20 leaders committed to a series of key reforms of OTC derivatives markets, as part of a broader program to make financial markets safer and financial institutions more resilient. The key reforms require:

(a) all OTC derivative transactions to be reported to databases known as trade repositories;

(b) all standardised OTC derivatives transactions to be centrally cleared through clearing houses; and

(c) all standardised OTC derivatives transactions to be traded on exchanges or electronic trading platforms, where appropriate.

583 The objectives of these reforms were to improve transparency in the derivatives markets, mitigate systemic risk and protect against market abuse.

584 The global nature of OTC derivatives markets requires that ASIC's implementation of the G20 OTC derivatives reforms be consistent with international requirements. This is to ensure that our regime is recognised by the US Commodity Futures Trading Commission and the European Securities Markets Authority.

585 To date, both the European Securities and Markets Authority and the US Commodity Futures Trading Commission have made positive assessments of various aspects of Australia's OTC derivatives reforms. These positive

assessments have the potential to significantly benefit the major Australian banks and providers of market infrastructure.

586 We estimate positive findings of regulatory equivalence have the potential to result in costs savings of $60 million a year on an ongoing basis to Australian financial institutions and infrastructures, and to allow Australian businesses to access EU and US markets on a level playing field with their foreign competitors.

Regulation and innovation

587 The regulatory landscape has evolved so far to facilitate competition in equity trading services, to lower barriers to cross-border activity and to respond to the global financial crisis. Regulatory interventions have been instrumental in significant changes to market structure, but they also provide opportunities for the industry to innovate by, for example, improving service range and quality, technological capability and the products admitted for trading.

588 These innovations may involve changes that raise market integrity concerns or affect the market's key stakeholders. The commercial realities of innovation mean that it is typically driven by stakeholders who stand to benefit from that change or initiative, and where the externalities of that change for the wider market are usually of limited consideration for the proponent.

589 Regulators need to consider the effect of these types of innovations on the fair and efficient operation of the whole market and the wider set of market users, particularly entities that use markets to raise capital for the efficient operation of their business and retail investors who invest in those entities and manage risks. Regulators must also be mindful that the cumulative effect of incremental changes may have unintended consequences—and that those incremental changes may be difficult to unwind.

590 Another concern for regulators is that a number of changes are being introduced outside of operating rules without any platform for formal regulatory influence and input; for example:

(a) fee changes (which alter trading behaviour);

(b) changes to a market's trading hours;

(c) introduction of new order types, securities and users;

(d) changes to core systems and technology (including order entry, routing and execution); and

(e) changes that affect ASIC market surveillance.

Responsibility for market supervision

591 In August 2009, the Government announced its decision to transfer the responsibility for supervision of domestic licensed financial markets from market operators to ASIC. Responsibility for market supervision was transferred to ASIC on 1 August 2010.

592 The Government's decision was designed to create one whole-of-market supervisor, and thereby streamline supervision and enforcement. The Government described this decision as the first step towards considering competition between exchange markets for trading in ASX-listed securities.

593 Prior to the transfer of market supervision to ASIC, each market operator was responsible for supervising secondary trading on their own markets and the conduct of their participants (for compliance with their market's operating rules, as well as some conduct of their business obligations).

594 After the transfer of supervision, ASIC took over the responsibility of real-time supervision of trading on certain domestic licensed financial markets and additional responsibilities, including:

(a) undertaking real-time market surveillance and post-trade analysis to detect market misconduct;

(b) making market integrity rules and monitoring compliance by market operators and market participants; and

(c) administering the disciplinary framework for breaches of the market integrity rules (which includes the Markets Disciplinary Panel, enforceable undertakings, and infringement notices).

Note 1: Market operators are required to pay fees to ASIC for undertaking real-time market surveillance. The Corporations (Fees) Regulations 2001 provide details of the fees payable by market operators for ASIC undertaking real-time market surveillance. The regulations include the dates, amounts and other points of reference by which fees will be levied.

Note 2: The Markets Disciplinary Panel is the forum for disciplinary action against participant and market operators for alleged breaches of the market integrity rules. It is a peer review body, consisting of part-time members with relevant market or professional experience.

Market participants

595 There are currently approximately 130 market participants across Australia's seven licensed exchanges. Many market participants participate in multiple exchanges. There are approximately 800 securities dealers who actively providing services similar to market participants under their AFS licence.[80]

[80] *ASIC annual report 2012–13*. These figures reflect the position over the 2012–13 financial year.

Supervision of market participants

596 ASIC supervises market participants and securities dealers to ensure they comply with the Corporations Act and meet their obligations as AFS licensees (to the extent than a market participant holds an AFS licence) and under the market integrity rules (for market participants). In addition, ASIC supervises equities and derivatives markets for instances of conduct that might disrupt market integrity. This includes market manipulation, insider trading, breaches of the continuous disclosure obligations and abnormal algorithmic trading.

597 ASIC monitors the capital of trading-only participants. For market participants that are also clearing participants, ASX Clear sets and monitors their capital requirements under ASIC's supervision.

598 Market participants are also subject to:

(a) the operating rules of the markets of which they are a participant; and

(b) for participants of certain markets, the ASIC market integrity rules related to that market.[81]

599 Securities dealers are not subject to ASIC market integrity rules or the operating rules of a market, but must comply with the Corporations Act and their AFS licence obligations.

Key developments

Technology

600 Market participants are increasingly reliant on technology in all parts of their operations, such as automated order processing and back office functions.

> Note: 'Back office' functions for market participants include activities such as the booking and settlement of trades and position keeping.

Crossing systems

601 Technology has enabled market participants to internalise all trades no matter how small, resulting in lower market impact costs and a substantial fall in average trade size. Market participants have developed crossing systems with automatic internalisation (i.e. the internal execution of the trades received from clients). Previously, market participant internalisation was conducted manually for very large value trades, where executing on-market would cause excessive volatility and market impact costs.

[81] The market integrity rules currently apply to market operators and market participants. Regulations would be required to extend the jurisdiction of the market integrity rules to additional classes of person.

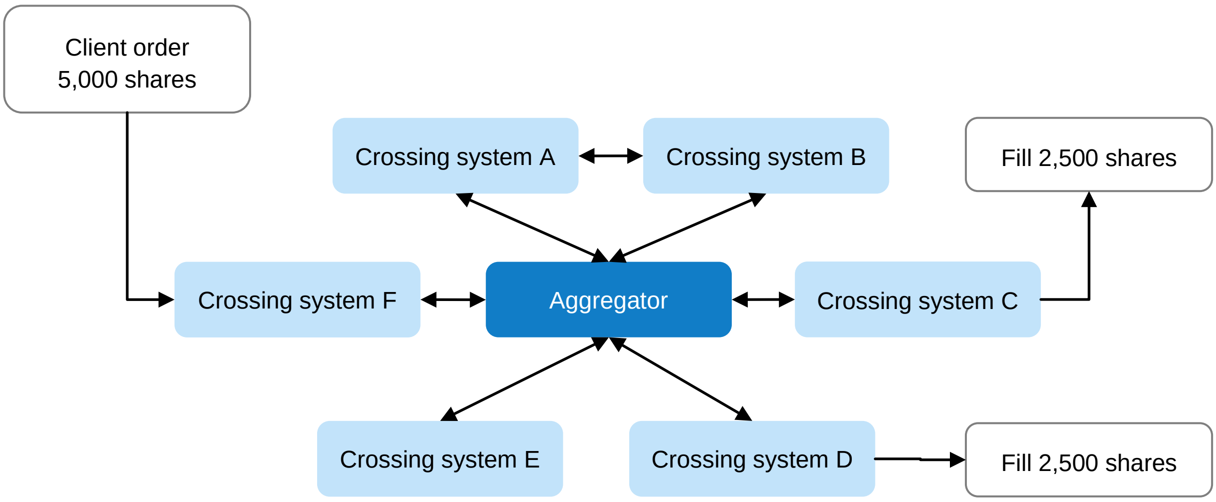
602 Technology has also played a critical role in improving the efficiency of market participants matching client order flow and directing client orders to the venue offering the best outcome for their clients.

603 Market participants have adopted technology to internally match client order flow. The first crossing system was launched in Australia in 2005. The number of crossing systems has risen from five in 2010 to 18 in April 2014. These crossing systems are operated by 15 separate market participants.

Aggregators

604 Crossing systems are becoming more interconnected and 'market-like'. Aggregators can provide links between crossing systems: see Figure 5. Aggregators receive and transmit orders from and to other crossing systems, providing clients with access to more sources of liquidity.

Figure 5: Links between aggregators and crossing systems



605 This means that many crossing systems are becoming multilateral and are no longer just a facility operated by one market participant for matching their own client orders. It raises questions about what duty a crossing system operator owes, or should owe, to other users of its facility and their clients. The obligation to take reasonable steps to obtain the best outcome for clients (i.e. the best execution obligation) is a bilateral obligation and typically limited to direct clients.

606 Some industry commentary suggests that the use of aggregators may increase the risk of adverse selection and information leakage—that is, they may lead to a worse price outcome because some information about orders may be determined by others as orders pass through more venues. Furthermore, it was suggested that it is difficult for clients to control and monitor whether their instructions are being met (e.g. regarding the types of

counterparties they wish to interact with) because they are one or more steps removed from the execution process.

High-frequency trading

607 While market participants have embraced the use of technology in fulfilling client orders, so too have clients adopted technology in deploying trading strategies and improving the speed with which they can trade. High-frequency trading behaviours now represent 32% of total trades on the market and 46% of total orders: see REP 331. REP 331 found that between May and June 2012, high-frequency traders accounted for less than 1% of total traders in our market, yet they were responsible for large volumes of activity.

608 The proportion of turnover conducted by high-frequency traders has increased from an estimated 10% in 2010[82] to 27% in 2012: see REP 331. In spite of this growth, REP 331 found that the Australian market has substantially less high-frequency trading than other markets; in the United States and Europe its contribution to turnover was estimated to be over 50% and 36% in 2012, respectively.

Automation and sophistication of trading technology

609 One of the most significant recent developments in Australian and global markets has been the dramatic growth in automated electronic trading. A growing number of market participants offer automated order processing to their clients (through direct electronic access systems). [83]

Table 15: Features of electronic trading

Algorithmic programs	Automated strategies using programmable logic or system-generated orders (rather than human-generated orders) based on a set of predetermined parameters, logic rules and conditions. These include algorithmic trading, automated order generation and high-frequency trading.
Automated order processing	Automated order processing is an existing concept in the Australian market. It is the process by which orders are registered in a market participant's system, which connects it to a market. Client or principal orders are submitted to an order book without being manually keyed in by an individual (referred in the rules as a 'DTR').[84] It is through automated order processing (AOP) systems that algorithmic programs access our markets.

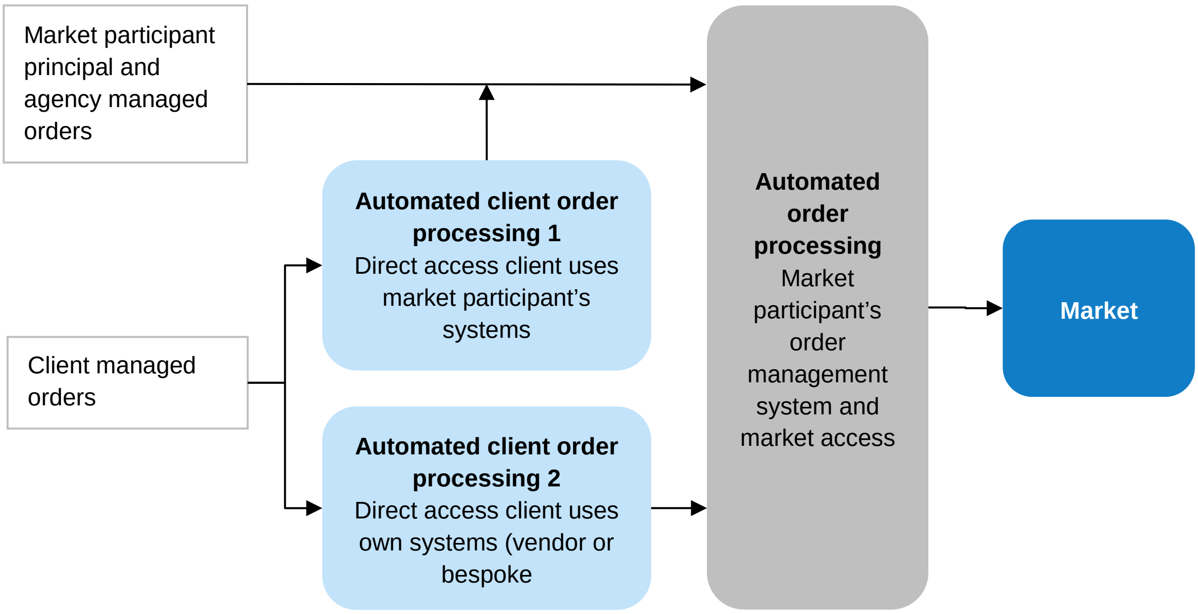
[82] ASX, *Algorithmic trading and market access arrangements*, 8 February 2010, www.asx.com.au/documents/media/20100211_review_algorithmic_trading_and_market_access.pdf

[83] Approximately 75% of market participants have automated order processing certification as at August 2011, compared with 42% in 2006: ASIC data. See also ASX, *Algorithmic trading and market access arrangements*, 8 February 2010, www.asx.com.au/documents/media/20100211_review_algorithmic_trading_and_market_access.pdf.

[84] 'DTR' is defined in Rule 1.4.3 of the ASIC Market Integrity Rules (ASX Market) 2010 and Rule 1.4.3 of the ASIC Market Integrity Rules (Chi-X Market) 2011 to mean a representative of the trading participant who has been authorised by the trading participant to submit trading messages to the trading platform on behalf of the trading participant.

	Where automated order processing is used by clients, the process is defined in the ASIC Market Integrity Rules (ASX Market) 2010 and ASIC Market Integrity Rules (Chi-X Market) 2011 as 'automated client order processing'. This same process is commonly referred to by IOSCO as 'direct electronic access'.
Direct electronic access—also known as 'automated client order processing' in Australia	Direct electronic access is the process by which an order is submitted by a client, agent or participant representative, into a market participant's AOP system directly without human intervention. Clients may either use the market participant's order management system and algorithmic programs to manage and generate orders, or their own systems or programs that are connected to the participant's AOP system. Direct electronic access enables a client to access a market without being a direct market participant and without being directly bound by the operating rules of the market they are accessing.

Figure 6: Automated order processing and direct electronic access



610 With the developments in technology, the manual entry of orders has declined drastically. ASIC estimated in REP 331 that approximately 99.7% of all equity market orders in 2013 are now transacted by automated order processing. Similarly, all ASX 24 participants access the market using an automated order electronic interface.

611 Over the past few years, ASIC has consulted on and introduced rules and guidance to ensure that these controls fully address emerging risks, as well as to align our regime with the IOSCO principles[85] and international best practice (taking into account the distinguishing features of the Australian market).

[85] Technical Committee of IOSCO, *Principles for direct electronic access to markets* (IOSCOPD332), IOSCO, 12 August 2010.

612 ASIC's market integrity rules for the ASX and Chi-X markets require market participants to ensure that all orders that are submitted through AOP systems to ASX or Chi-X are appropriately filtered and monitored to prevent manipulative trading and do not interfere with the efficiency and integrity of the market.

613 Market participants are responsible for identifying and implementing controls to manage their risks, including maintaining organisational and technical resources to comply with the market integrity rules.

614 Regulatory Guide 241 *Electronic trading* (RG 241) outlines ASIC's expectations of market participants in relation to automated order processing.

Service providers (vendors)

615 There are a number of domestic and foreign service providers operating in Australia that provide front, middle and back office systems, market data, and trading systems and services. Given the increased reliance on technology, these major service providers are critical to the operation of our market.

616 Market participants and market operators rely heavily on key vendors to perform core business operations in the financial markets.[86] The functions performed by key vendors are technology-based:

(a) *Data vendors* provide data inputs into buy- and sell-side algorithms, portfolio pricing systems, transaction cost analysis, and benchmarking, among other things. The data is typically exchange generated pricing data and/or related to an index.

(b) *Middle and front office vendors* provide front and middle office functionality, such as order processing, risk monitoring, algorithmic trading and portfolio management services. These functions have the capacity to affect market integrity, given the nature of front office functions such as order management systems and execution management systems.

(c) *Back office vendors* perform 'back office' tasks such as booking and settlement of trades and position keeping. The outsourcing of 'back office' functions to vendors has typically been driven by a desire for lower cost operating models and, as such, this outsourcing often includes a degree of 'off-shoring' by the market participants and/or vendors.

(d) *Exchange and clearing vendors* help market operators and their participants conduct their day-to-day operations.

[86] Clearing and settlement facilities may also rely on vendors to perform key functions. Outsourcing by clearing and settlement facilities is currently regulated by the RBA under the Financial Stability Standards.

617 The functions performed by the key vendors have the capacity to affect the integrity of financial markets. However, there is limited regulatory visibility or oversight of these vendors. The law places the onus on the licensees to ensure that the technology is appropriate for its operations. There are also very few (almost negligible) regulatory requirements that cover business continuity requirements for market participants.

618 We expect market participants to consider the risks posed by vendor activities (including system malfunctions and failures) to their operations. However, market participants may not always consider the broader risks of disruption to the fair and orderly operation of Australia's financial markets posed by vendor activities. For example, a major system failure or malfunction by a key back office vendor could have widespread ramifications for the ability of multiple market participants to settle trades for that period.

> Note: Market participants may not necessarily be in a position to adequately mitigate the broader risks of disruption to the fair and orderly operation of Australia's financial markets either.

619 It is also unclear to what extent market participants and market operators can adequately mitigate and manage their operational risks when they rely on vendors to perform significant business operations (both through outsourcing and off-shoring).

UK and IOSCO approach to outsourcing

In the United Kingdom, the FCA requires market participants to have controls around any outsourcing activity that relates to 'critical or important functions and investment services and activities' to address these risks. The FCA also imposes obligations on market operators to ensure any party performing functions on its behalf is fit and proper and able to perform that function. The FCA imposes expectations on market operators in relation to risk identification and management. The market operator remains responsible for the function.

IOSCO has published *Principles on Outsourcing of Financial Services for Market Intermediaries* (February 2005) and *Principles on Outsourcing by Markets* (July 2009). These principles seek to ensure that market intermediaries, such as market participants and market operators, are conducting appropriate due diligence, monitoring, and risk management of vendors.

Globalisation

620 Australia's financial markets are interconnected with financial markets in countries around the world. This means that regulatory, economic and political developments in other countries can affect Australia's financial markets and the real economy.

621 The impact of the global financial crisis emphasised the interdependent relationship between the Australian and the global financial markets. For

example, during the global financial crisis ASIC banned short selling in major part due to the implications arising from activities in other regions of the world.

622 The global nature of financial markets presents a number of challenges for ASIC in our efforts to identify and prosecute market misconduct, including structural and jurisdictional issues. These issues affect how quickly ASIC can identify the ultimate holders of securities when trading via numerous jurisdictions. Speed is critical, given that electronic fund transfers mean the proceeds of illegal transactions may move into non-cooperative jurisdictions well ahead of ASIC completing its inquiries.

Structural issues

623 Financial products are now more likely to be traded simultaneously on several markets or trading facilities around the world. This provides greater opportunity for manipulative practices to be employed between markets for a single product. It also complicates the process of ascertaining whether price movements are the result of legitimate supply and demand forces or arise from manipulation.

624 The trend towards clients trading through a layered market structure involving market participants and securities dealers also makes it difficult to identify the underlying client involved in an instance of market misconduct. Multiple subsidiaries may be involved in setting up a client's account and executing trades, so no one entity has a full picture of a client's interests and behaviour to identify potentially manipulative conduct.

Jurisdictional issues

625 Activities by participants in one market increasingly have repercussions for other financial markets. This can give rise to jurisdictional issues when the conduct in question breaches financial services laws in another country.

626 Australian law may have limited application when Australian local market participants act as intermediaries for overseas brokers, who fall outside our jurisdiction, or where records are retained by key vendors whose operations are located outside of Australia. Complicating matters, client records and trading records needed to establish misconduct may be located off-shore.

627 Jurisdictional limitations necessitate a high degree of cooperation between securities regulators to investigate and prosecute market manipulation: see paragraphs 363–364.

Regulation and innovation

Advanced surveillance capabilities

628 With the increased volumes and speed of trading there is an increased need for more sophisticated surveillance systems relying on technology.

629 ASIC has developed and uses Markets Analysis and Intelligence (MAI), an advanced surveillance system, to stay abreast of technological developments in financial markets. MAI is built around algorithmic trading technology, and gives ASIC the ability to analyse trade data for patterns and relationships. MAI provides sophisticated data analytics to identify suspicious trading in real time and across markets, as well as greater levels of detection of insider trading. This enables ASIC to better detect, investigate and prosecute trading breaches.

> Note: MAI is purpose built and designed to handle the dynamism of financial markets (i.e. to handle increases in high-frequency trading and algorithmic trading). The new system enables ASIC to interrogate very large data sets and monitor market activity, consistent with the increased use of technology in day-to-day trading.

Securities dealers

630 The regulatory framework that applies to market participants is substantially different to that which applies to securities dealers, even though market participants and securities dealers play similar roles within our financial markets. In particular, ASIC does not have the power to make market integrity rules that apply to securities dealers.

631 Market integrity rules impose a range of specific obligations to protect the integrity and efficiency of licensed markets. In many cases, the risks that are addressed by ASIC’s market integrity rules may arise from the operations of both market participants and securities dealers.

632 From a retail client’s perspective, a securities dealer’s services may be indistinguishable from those of a market participant. Clients place trades with securities dealers in a very similar manner to market participants and securities dealers may also offer other services such as managed discretionary accounts.

633 Because the market integrity rules cannot apply to securities dealers, ASIC has no power to take administrative action against securities dealers through the Markets Disciplinary Panel. Decisions of the Markets Disciplinary Panel have a high level of recognition and impact in the markets. Although remedies under the Corporations Act may be available against securities dealers, the inability to refer securities dealers to the Markets Disciplinary Panel deprives ASIC of an important and effective regulatory mechanism.

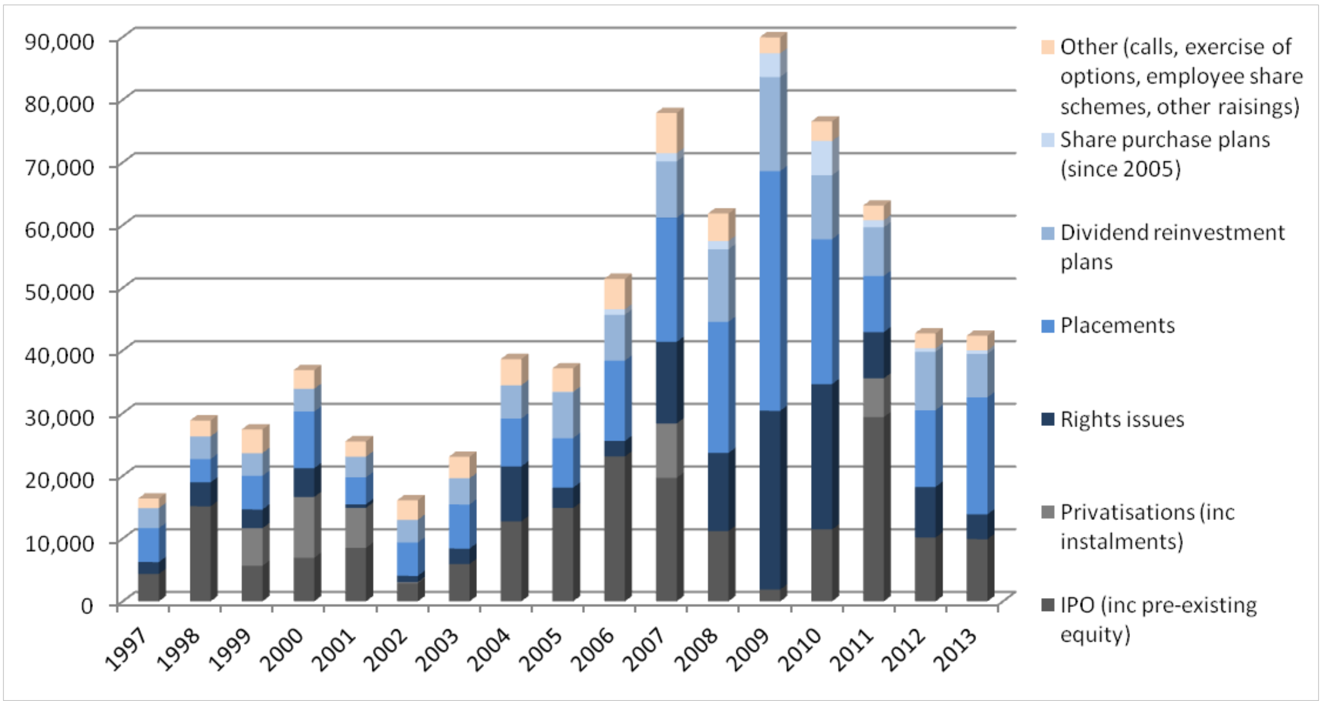
Equity market financing

634 Equity markets facilitate the issuing and trading of equity (i.e. shares), allowing companies to raise funds to conduct their business and investors to own a part of a company, with the potential to realise gains based on the future performance of the company or from trading the shares. Equity markets are an important part of the economy as they allow a company to acquire funds without incurring debt.

635 Australia enjoys a robust equity market that compares favourably with international markets in terms of comparative size and capacity to raise capital.

636 Since the Wallis Inquiry equity markets have continued to provide an important source of funding for Australian companies and economic growth. Figure 7 shows the total value of securities quoted on ASX in connection with both initial public offerings and secondary capital raisings between the 1997 and 2013 financial years by method of raising.

Figure 7: Value of initial public offering and secondary capital raised on ASX (financial years 1997–2013) ($m)



Source: AFMA Australian Financial Markets Reports 2001–2013 (based on ASX data).

637 Secondary capital raisings by listed entities played a particularly important role in securing funding for domestic companies during the global financial crisis, a time of dramatically tightening conditions and uncertainty in wholesale debt and credit markets. Australia's relatively flexible framework regarding the method of raising secondary capital has been cited as a

significant contributor to the ability of equity markets to address capital needs during this period.

638 Throughout the crisis there was significant use of share placements due to their speed and certainty as a fundraising method in volatile conditions. There was also a corresponding increase in contemporaneous share purchase plan offerings as companies sought to address the inability of existing retail holders to participate in placements. As a result, the experience of the global financial crisis generated some public debate over issues of fairness in equity fundraising.

Note: A share purchase plan is a plan under which existing shareholders of a listed company are invited to subscribe for further shares up to a maximum monetary limit. These plans give existing members a convenient means of obtaining additional shares that are priced at a discount to the market price. ASIC has given relief to allow share purchase plans to be offered without a prospectus.

Key developments

639 As foreshadowed in the Wallis report, the growth of superannuation assets arising from Australia's compulsory superannuation scheme has had a substantial impact on domestic equity markets. A significant proportion of superannuation contributions and, as a result, Australia's $1.6 trillion pool of superannuation assets, has been allocated to equities issued to fund the growth of domestic enterprises.

640 SMSFs allocate on average one-third of total assets to Australian shares while superannuation fund default investment strategies (representing more than 43% of the superannuation assets of entities with more than four members) allocate on average 26.5%—making Australian shares the largest overall asset class for superannuation.[87]

641 Evidence suggests that direct household investment in equities is also relatively high by international standards, with over 34% of the Australian adult population directly owning shares in 2012. Overall direct investment by households in Australian listed equities account for approximately 15% of the market, with domestic institutions owning slightly more than 40% and overseas investors slightly less than 45%.[88]

642 Other notable developments affecting equity capital raising since the Wallis Inquiry and the global financial crisis include:

(a) innovation in capital raising methods—principally the introduction of accelerated rights issue models that combine the speed of institutional placements with the fairness of pro rata participation;

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[87] APRA, *Annual superannuation bulletin*, June 2013; ATO, *Self-managed super fund statistical report—September 2013*, 21 November 2013.

[88] ASX, *2012 Australian share ownership study*, April 2013; ABS, *Australian national accounts: Financial accounts, Sep 2013* (ABS Cat No. 5232.0), 30 September 2013.

(b) increased institutional and retail shareholder activism—including the emergence of proxy advisers, new shareholder groups, and a generally heightened awareness of shareholder rights and issues such as fairness in capital raising;

(c) increased access to equity markets by companies with exposure to business operations or assets in overseas jurisdictions, or which are subject to the laws of other jurisdictions with differing systems and levels of property and governance protections, geopolitical risk and regulatory oversight;

(d) improved regional linkages with the commencement of mutual recognition of Australian and New Zealand security offerings from December 2007; and

(e) more recently, the increase in offerings of complex securities with equity characteristics: see paragraph 658.

Regulation and innovation

643 The increased share of household wealth linked to equity markets underscores the importance of ensuring investors are adequately informed when making investment decisions and have confidence that markets operate fairly and efficiently. A high standard of integrity in the financial markets on which equity is quoted is vital to maintaining confident investor participation in the market and, in turn, enabling business to reliably access equity capital at the lowest possible cost.

644 A number of regulatory requirements in the Corporations Act and market listing and integrity rules aim to ensure market confidence and integrity. Some of these include:

(a) the continuous disclosure obligations of issuers—which requires the prompt disclosure of information that may influence investors;

(b) the takeover provisions—which, among other things, ensure equal participation by all shareholders in the benefits offered under control transactions; and

Note: A control transaction is a transaction under which control of an entity may materially change—for example, a takeover bid, a scheme of arrangement or a large share subscription or purchase approved by shareholders. A person acquiring control will often be expected to pay a premium for doing so to the benefit of existing holders.

(c) the general corporate governance regime in the Corporations Act and market listing rules—which sets out rules and penalties relating to matters such as related party transactions and financial reporting.

645 Flexibility in the conduct and disclosure framework regulating equity offerings has enabled ASIC to respond to market developments and innovations in the interests of both upholding standards to maintain the integrity of markets and—through the use of ASIC's case-by-case and

general exemption and modification powers—removing unnecessary regulatory obstacles in order to promote more cost-effective regulation and innovation. This has also been supplemented by legislative amendments. Table 16 sets out a number of these developments.

Table 16: Corporations Act changes relating to equity capital offerings

Date	Development
March 2002	ASIC class order relief facilitates placements by enabling on-sale of securities under a 'cleansing notice' or where a prospectus has been lodged in relation to the same class (subsequently incorporated into the legislation in s708A in 2004): Superseded Class Order [SCO 02/272] *Secondary sale of securities: section 707(3) and section 707(4)*.
July 2004	Legislative amendments enable ASIC to stop, and require amendments to, prospectuses that are not 'clear, concise and effective': s715A and s739(1).
June 2007	Rights issue offers for quoted securities are able to be made under a cleansing notice (rather than requiring a prospectus): s708AA. The amount that can be raised under offer information statements is also lifted from \$5 million to \$10 million.
May 2008	ASIC class order relief facilitates accelerated rights issues by allowing them to be made under the cleansing notice regime without a prospectus: Class Order [CO 08/35] *Disclosure relief for rights issues*.
June 2009	ASIC puts in place a number of further measures to enhance capital raising: • increasing the amount that can be raised from each share or unit holder under share purchase plans from \$5,000 to \$15,000; and • enabling listed managed investment schemes to make placements at a discount of more than 10% to the current unit price without member approval; • incorporating an exception to the takeover provisions for accelerated rights issues; • setting new policy to enable individual ASIC relief: – allowing use of a cleansing notice to permit on-sales where an entity has been suspended for more than five days; – providing an exemption from the takeover prohibitions in connection with shortfall facilities and the underwriting of dividend reinvestment plans; and – exempting, in appropriate cases, offerors under non-renounceable rights issues from the procedure in s615 (which requires the appointment of a nominee to sell securities that would otherwise be offered to foreign holders).
March 2010	Changes to ASIC's share purchase plan class order relief facilitate electronic payment and access by underlying owners holding through custodian arrangements—making share purchase plan offers more widely available.
July 2013	ASIC extends takeovers relief to facilitate accelerated issues incorporating retail rights trading.

646 ASIC has also sought to address emerging regulatory challenges within the existing regulatory framework. We have issued a number of reports on regulatory developments and guides designed to improve and maintain standards in disclosure and assist with compliance, including recently:

(a) Report 365 *Hybrid securities* (REP 365);

(b) Report 368 *Emerging market issuers* (REP 368); and

(c) Regulatory Guide 228 *Prospectuses: Effective disclosure for retail investors* (RG 228).

Debt market financing

647 In contrast to the equity markets, debt markets allow debt instruments to be traded (i.e. instruments that require a fixed interest payment to the holder). Debt markets provide a mechanism for companies to retain funding that does not dilute their equity.

648 Australia's corporate bond market has been active since the early 20th century. As at June 2013, in the Australian retail market, $300 million of corporate bonds were on issue. In the international wholesale market, Australian corporate entities had bonds worth $612.4 billion on offer.[89] While securities including bonds are offered in Australia, corporate bonds represent only 0.1% of the total fixed interest securities listed on the ASX and only 0.8% of the total private sector fixed interest securities listed on the ASX (see Table 17–Table 18).

Table 17: ASX listed fixed interest securities (as at June 2013)

Type of fixed interest	Number issued	Market capitalisation ($m)	Share of capitalisation (%)	Share of private sector fixed interest securities (%)
Private sector securities	*78*	*37,600*	*11.9*	*100.0*
Corporate bonds	4	300	0.1	0.8
Hybrids	33	22,200	7.0	59.0
Convertible notes	17	1,800	0.6	4.8
Floating rate notes	24	13,300	4.2	35.4
Government securities	*23*	*277,500*	*88.1*	*N/A*
Commonwealth Government Securities	23	277,500	88.1	N/A

Source: ASX

[89] Bank for International Settlements, *BIS Quarterly Review*, December 2013, www.bis.org/publ/qtrpdf/r_qt1312.htm.

Table 18: Securities terminology

Corporate bonds	Debt instruments issued to an investor in exchange for a loan. The issuer pays interest at regular intervals and returns the principal investment at maturity.
Hybrid securities	Instruments from well-known companies, banks and insurers which have 'equity-like' and 'debt-like' characteristics and risks. Hybrids are often highly complex and may include terms and conditions that allow the issuer to redeem early, suspend the interest payments when they choose, or convert the securities into ordinary shares.
Convertible notes	A type of hybrid security that allow the investor to redeem the note by conversion to ordinary shares at specified times. It carries similar risks to hybrids.
Floating rate notes	Offer a fixed margin above a determined floating rate (e.g. the bank bill swap rate) which is reset for each payment period (e.g. quarterly, half-yearly).
Commonwealth Government Securities	Instruments issued by the Commonwealth Government that provide an agreed interest rate for the term of the investment and the return of the investor's investment at the end of the term.

Corporate bond market

649 The development of a deep and more liquid corporate bond market has the potential to assist issuers (by allowing them to diversify funding sources) and investors (by providing them with access to direct investment in fixed interest securities).

650 The report *Australia as a financial centre—Building on our strengths* (Johnson report) found that the domestic corporate bond market was a relative weakness in an overall strong financial system. Factors that discouraged domestic bond issuance in Australia were considered largely structural:

(a) large banks have provided a significant proportion of the non-financial corporate sector's borrowing needs; and

(b) companies can access the much more liquid corporate bond markets in European Union and United States, but access is difficult and expensive for smaller and lower credit rated Australian companies.

651 Other impediments that have been cited include:[90]

(a) concerns around the limitations on retail investors' ability to adequately assess and price credit risk;

[90] K Davis, *Funding Australia's future: From where do we begin?*, Australian Centre for Financial Studies, July 2013, http://fundingaustraliasfuture.com/fromwheredowebegin.

(b) tax arrangements that are neutral or favour equity investments over debt, such as the availability of franking credits; and

(c) the existence of deposit insurance for large-scale retail bank deposits.

652 Access was also an issue for investors, as there was very limited choice in the bond market with only a small number of corporate bonds available. The bond market was dominated by the banking sector. Further, there was little development of a secondary market to trade in corporate bonds or their derivatives, restricting the liquidity of the bond market.

Key developments

Regulation and innovation

653 The Australian Government has sought to stimulate the corporate bond market by removing some regulation around simple corporate bonds. Sometimes called 'vanilla' corporate bonds, these are generally considered low risk and have straightforward terms and conditions. Without legislative change or ASIC relief, issues of corporate bonds would require full prospectus disclosure under Ch 6D of the Corporations Act.

654 Class Order [CO 10/321] *Offers of vanilla bonds* provides relief to facilitate offers of corporate bonds by listed entities:

(a) to allow certain offers of vanilla corporate bonds to be made under a vanilla bonds prospectus, which has a similar level of detail to a transaction-specific prospectus;

(b) to permit vanilla bonds to be offered under a two-part vanilla bonds prospectus; and

(c) so that offers of vanilla bonds under a vanilla bond prospectus or a two-part prospectus will not be subject to an exposure period if the bonds are in the same class as existing quoted bonds but for differences in the term, interest rate and interest payment dates.

655 Further, ASIC has provided relief in Class Order [CO 10/322] *On-sale for convertible notes issued to investors* so that quoted securities that are issued on the conversion of convertible notes may be on-sold to retail investors if the convertible notes were issued to institutional investors under a cleansing notice containing prospectus-like disclosure. Regulatory Guide 213 *Facilitating debt raising* (RG 213) was issued to provide guidance on the operation of these class orders.

Note: Since [CO 10/321] came into effect, only two bond issues have been made utilising the class order disclosure relief.

Proposed legislative changes

656 The Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013 (Simple Corporate Bonds Bill) was introduced into Parliament in March 2013, and received bilateral support in May 2013, before lapsing on 5 August 2013 when Parliament was prorogued.

657 The Simple Corporate Bonds Bill:

(a) contemplates investors receiving a two-part disclosure document for vanilla (simple) corporate bonds that is supplemented by continuous disclosure announcements rather than containing all relevant information;

(b) allows ASIC to exclude particular issuers from using a two-part document to offer vanilla corporate bonds where they have not met certain disclosure or reporting requirements;

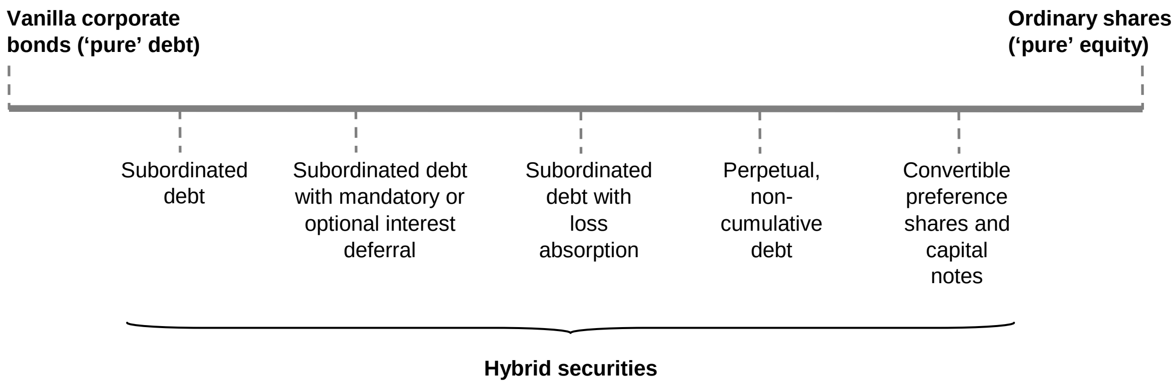
(c) makes changes to the civil liability provisions that apply to offers of vanilla corporate bonds; and

(d) clarifies the application of the ‘reasonable steps’ defence to misleading and deceptive statements and omissions in disclosure documents—these changes apply to all disclosure documents, and are not limited to offers of simple corporate bonds.

Hybrid securities

658 Hybrid securities combine characteristics of both equity (e.g. ordinary shares) and debt (e.g. vanilla corporate bonds) and can be difficult for retail investors to understand. Legally, hybrid securities are considered a debenture or a share and are known by a variety of names, including subordinated notes, capital notes and convertible preference shares. Figure 8 outlines a how hybrids fit into a spectrum of equity and debt.

Figure 8: Hybrid securities on a spectrum between ‘pure’ debt and ‘pure’ equity



659 There has been a retail market for hybrid securities in Australia for several decades. Following reduced activity during and immediately after the global

financial crisis, developments in equity credit criteria and prudential standards have both prompted a strong increase in hybrid issuance, with offers of ASX-listed hybrid securities used to raise more than $18 billion between November 2011 and June 2013.

660 Hybrid securities have been an area of focus for ASIC since November 2011. In August 2013, ASIC published REP 365, which discusses recent offers of hybrids in Australia.

661 Hybrid securities pose a number of regulatory challenges for ASIC, including that:

(a) there is generally a lower level of investor understanding, due to the complexity (and heightened risk profile) of hybrid products. There is difficulty in ensuring the complexity of the securities are explained while maintaining a clear, concise and effective disclosure document—testing the limits of a disclosure-based regime;

(b) hybrid offers are often heavily promoted by issuers and financial advisers—introducing the potential for the sales message to detract from balanced prospectus disclosure; and

(c) notwithstanding the risks, investors may nonetheless be attracted to the higher yield on offer and the fact the products are issued by major banks and corporate entities that are household names and trusted brands.

662 ASIC has engaged with both investors and issuers of hybrid securities to ensure the current regime operates successfully. Some of the actions we have taken include:

(a) providing investor warning and education through media releases and our MoneySmart website, including a self-assessment tool for potential investors to test their knowledge of hybrid securities;

(b) working with issuers and their lawyers to improve the standard of disclosure, by reviewing and commenting on draft prospectuses before lodgement with ASIC; and

(c) undertaking a targeted review of 'selling methods' to encourage the appropriate use of non-prospectus documents as part of the sales process.

663 We also propose to undertake further work which will include:

(a) investigating any reports of problematic conduct by brokers;

(b) reviewing advertisements and other promotions of hybrids;

(c) considering naming conventions for hybrid instruments to ensure accuracy; and

(d) continuing to engage with issuers of hybrid securities and their lawyers to further improve prospectus disclosure.

G Systemic risk in markets

Key points

Systemic risk is the risk of disruption to the flow of financial services that is caused by an impairment of all or parts of the financial system. It has the potential to have serious negative consequences for the financial system and the real economy.

The potentially widespread effects of systemic risk are an inevitable corollary of today's integrated markets and the speed of transactions in the financial system.

Since the global financial crisis, both international standard setters and regulators have implemented new regulatory systems and regulation to pre-emptively address systemic risks, such as shadow banks.

664 Systemic risk is broadly defined as 'the risk of disruption to the flow of financial services that is caused by an impairment of all or parts of the financial system and has the potential to have serious negative consequences for the real economy'.[91]

Oversight of systemic risk in Australia

665 The Wallis Inquiry recognised that regulation would need to address the potential for systemic risk—where a breach of an intense financial promise would result in a risk of losses to third parties and consequently systemic instability, particularly from financial contagion. This systemic risk led the Wallis Inquiry to recommend that prudential regulation be imposed where there was an intense financial promise in an underlying financial product or service.

666 Consistent with the Wallis Inquiry's recommendations, Australia's current prudential framework addresses systemic risk from sectors and entities where the intensity of the financial promise from the entity is considered high.

667 As a result, APRA regulates ADIs and insurers with intensive prudential measures, focusing on preventing the failure of an individual institution. While APRA can exercise its prudential powers to address systemic risks more broadly under a financial stability objective, APRA's oversight and

[91] FSB, IMF, and Bank of International Settlements, *Guidance to assess the systemic importance of financial institutions, markets and instruments: Initial considerations: Report to the G-20 finance ministers and central bank governors*, October 2009.

regulatory powers, such as the power to direct an entity to address particular systemic risks, are limited to its regulated population.

668 The RBA has a financial stability mandate and regulatory oversight of payment systems (including considering their systemic risk), but it does not have an ongoing role in supervising and addressing systemic risks in particular entities or sectors.

669 ASIC, as a conduct and disclosure regulator, does not have a general mandate to identify systemic risk or impose prudential regulation on its regulated population.

Addressing systemic risk since the financial crisis

670 Following the global financial crisis, some commentators looking back on its causes and origins have concluded that pre-crisis regulation placed too much reliance on regulation applying at an entity level at the expense of a system-wide approach.[92] In focusing on the stability of individual financial entities, such a regulatory focus exacerbated market-wide systemic risks and undermined overall financial stability.[93] For example, in the sub-prime crisis, common exposures to toxic assets (sub-prime mortgages) led to consequent failures across a number of financial institutions in a number of jurisdictions.[94]

671 Regulators are now looking at ways to limit or mitigate financial system-wide distress. This involves taking into account external systemic risks that could lead to financial instability, including the correlations and common exposures across financial institutions (including those that are currently not prudentially regulated), and exposure to systemic risk over time.

672 The emphasis of regulators immediately following the financial crisis has been on entities and financial activities that may cause systemic risk; however, other sources of systemic risk are now being identified, such as the risks posed by cybercrime.[95] The systemic risk posed by cybercrime arises

[92] See, for example, P Tucker, Deputy Governor Financial Stability, Bank of England, *Macro and microprudential supervision*, speech at the British Bankers' Association Annual International Banking Conference, London, United Kingdom, 29 June 2011, www.bankofengland.co.uk/publications/Documents/speeches/2011/speech506.pdf.
[93] The Warwick Commission, *International financial reform: In praise of unlevel playing fields*, report, The University of Warwick, November 2009, p. 13, www2.warwick.ac.uk/research/warwickcommission/financialreform/report/introduction.pdf.
[94] The Warwick Commission, *International financial reform: In praise of unlevel playing fields*, report, The University of Warwick, November 2009, www2.warwick.ac.uk/research/warwickcommission/financialreform/report/introduction.pdf.
[95] R Tendulkar, *Cyber-crime, securities markets and systemic risk* (SWP1/2013), staff working paper, IOSCO Research Department and World Federation of Exchanges, 16 July 2013, www.world-exchanges.org/files/statistics/pdf/IOSCO_WFE_Cyber-crime%20report_Final_16July.pdf.

primarily from the global and domestic financial systems' heavy reliance on technology for ongoing efficient operation.[96]

673 The financial crisis also affirmed that systemic risk can easily be transferred not only between entities but between countries, an inevitable implication of integrated financial markets and a globalised economy: see Section B.

674 International developments since the financial crisis have emphasised the importance of identifying and addressing issues of systemic risk to protect financial stability.

Integrated oversight of systemic risk overseas

675 A number of jurisdictions, including the United States and the United Kingdom, have adjusted their regulatory frameworks to incorporate an increased focus on systemic risk by introducing a specific obligation to oversee systemic risk.

676 The United States established the Financial Stability Oversight Council in 2010 as an interagency consultative body that operates as a macroprudential authority. The Council is charged with identifying risks to the financial stability of the United States, promoting market discipline, and responding to emerging risks to the stability of the US financial system.

677 In the United Kingdom, the Bank of England is responsible for protecting and enhancing financial stability and regulation of certain financial market infrastructures (e.g. securities settlement systems) to ensure that they are resilient. There is also a Financial Policy Committee, which is a consultative committee within the Bank with representatives from the other financial regulators and is a macroprudential authority that is:

(a) responsible for identifying, monitoring and taking action to remove or reduce systemic risks to the resilience of the UK financial system as a whole; and

(b) able to direct or recommend the PRA and the FCA to take certain actions or refrain from certain activities to address systemic risks for certain sectors.

678 The Financial Policy Committee is also able to make recommendations to HM Treasury regarding the boundary between regulated and non-regulated sectors of the UK financial system (i.e. the regulatory perimeter). Such recommendations may concern what is regulated by the PRA or FCA.

[96] P Sommer, I Brown, *Reducing systemic cybersecurity risk* (IFP/WKP/FGS(2011)3), OECD, 14 January 2011, www.oecd.org/governance/risk/46889922.pdf.

679 Regulation at an individual-entity level, which was formerly conducted by the former Financial Services Authority, is now conducted through a 'twin peaks' model, through the PRA and the FCA.

Systemic risk from outside the current regulated perimeter

680 There has also been a focus following the financial crisis on identifying sources of systemic risk that are not within the scope of the current regulated perimeter. The regulatory perimeter in this context is defined by those entities which are currently subject to oversight by a prudential regulator.

681 By way of example, the FSB published recommendations, *Strengthening oversight and regulation of shadow banking*, in August 2013. The recommendations were intended to address credit intermediation that occurs outside the regulated banking sector and could potentially lead to an increase in systemic risk. The regulatory concern is that, for entities involved in these activities, there may be 'bank-like' failures resulting from a mismatch in maturity or liquidity transformation, or imperfect credit risk transfer or leverage.

682 Specifically, in addition to OTC derivatives market reforms and initiatives relating to trade reporting, the FSB has also proposed increased transparency and regulation of 'shadow banking' sectors, including securities lending markets. Some of the FSB's proposals also relate to increased reporting of data and other information to regulators and/or to relevant investors in relation to these transactions.

683 The RBA[97] and ASIC[98] have not currently identified significant systemic risks posed by the entities that are outside the regulatory perimeter, such as money market funds and securitisation vehicles.

684 However, the financial crisis has emphasised the need to monitor activities outside the regulated perimeter as a potential source of systemic risk. There currently are no specific powers for Australian financial regulators to regulate systemic risk that arises outside APRA's currently regulated populations, apart from the RBA's general obligation to oversee systemic stability: s10, *Reserve Bank Act 1959*.

> Note: Section 760A(d) of Corporations Act includes as an objective 'the reduction of systemic risk and the provision of fair and effective services by clearing and settlement facilities'. To support this objective, the Corporations Act sets various obligations for providers of clearing and settlement facilities, gives the RBA the power to set financial stability standards for such facilities, and gives both the RBA and ASIC various powers relating to licensing, standard-setting and direction over a provider of such facilities.

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[97] RBA, 'A closer look at the shadow banking system in Australia', *Financial Stability Review*, March 2012, pp. 69–72; C Schwartz and T Carr, 'Shadow banking: Australian and international experience around times of financial stress and regulatory reform', *JASSA: The Finsia Journal of Applied Finance*, issue 3, 2013, pp. 30–38.
[98] Report 370 *The Australian hedge fund sector and systemic risk* (REP 370).

Section 823E gives ASIC a directions power over holders of clearing and settlement facility licences, to direct them to take actions to reduce systemic risk. Before giving, varying or revoking such a direction, ASIC must consult the RBA, although failure to do so does not invalidate the direction, variation or revocation.

OTC derivatives regulation

685 OTC derivatives are considered to have significantly contributed to the global financial crisis, when extremely large risks built up between counterparties and were not appropriately managed. Further, there was a general lack of market transparency about the size, direction and interconnectedness of those risk positions which created financial instability when institutions became reluctant to lend to one another and engage each other as counterparties.

686 International consensus has developed around four key reforms to OTC derivative markets, which were shaped by the G20. Many jurisdictions are now in the process of implementing regulatory reforms to give effect to these commitments. The reforms seek to address the risks posed by the lack of transparency in the OTC derivatives markets, and the build-up of systemic risk in these markets, by:

(a) promoting contract standardisation;

(b) requiring the use of centralised market infrastructure, specifically CCPs and organised trade execution venues;

(c) requiring regulatory and public reporting of information about OTC derivatives transactions to trade repositories; and

(d) for non-centrally cleared OTC derivatives transactions, holding higher levels of capital, increased collateralisation and the use of risk mitigation techniques.

687 Implementation of these reforms in Australia is underway: see Table 19.

Table 19: Timeline for Australia's implementation of the G20 reforms

December 2012	Australia established a broad legislative framework for imposing mandatory central clearing, transaction reporting and trade execution requirements in relation to specified OTC derivatives and specified classes of counterparties
May 2013	The Minister made a determination that imposed a broad-based mandatory trade reporting requirement
July 2013	ASIC made rules setting out the details of those requirements, with the rules coming into force on a staged basis from 1 October 2013
March 2014	Treasury commenced consultation on a proposed mandatory central clearing requirement in respect of inter-bank transactions in interest rate derivatives denominated in US dollars, Euros, pounds sterling and yen

688 The globalisation of markets, including the OTC derivatives markets, has required that Australia's implementation of these reforms be consistent with international requirements, particularly to seek recognition of our regime by the US Commodity Futures Trading Commission and the European Securities Markets Authority. Recognition of our requirements means that substituted compliance determinations or equivalence recommendations can be made to allow Australian market participants to comply with Australian requirements instead of some US or EU requirements. This recognition also assists in addressing systemic stability, as it means that the regulation of OTC derivatives in different countries is sufficiently consistent and directed at the same regulatory outcomes.

Note: It should be noted that the European Commission has not yet adopted implementing acts that would give effect to the European Securities Markets Authority's equivalence recommendation.

Systemic risk involving systemically important financial institutions

689 The FSB defines systemically important financial institutions (SIFIs) as institutions whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity.[99]

690 The FSB work on SIFIs includes identifying and putting in place mechanisms to deal with individual global SIFIs and domestic SIFIs. It is also developing methodologies to identify non-bank, non-insurer global SIFIs.

691 Although Australia does not have any global SIFIs, a number of the global SIFIs operate in Australia, including through Australian-incorporated subsidiaries. Australia, therefore, has an interest in the oversight of SIFIs, particularly in their home jurisdictions.

692 Global SIFIs can also be counterparties to transactions with Australian entities in the wholesale financial markets, both within Australia and internationally. This gives rise to the potential for the transfer of risk to the Australian financial system through these markets.

Addressing systemic risk: Refining the prudential boundaries

693 While a number of international jurisdictions have amended their regulatory framework to better address systemic risk in response to the global financial crisis, Australia does not have a flexible arrangement to respond to emerging

[99] FSB, *Reducing the moral hazard posed by systemically important financial institutions*, recommendations and timelines document, 20 October 2010, www.financialstabilityboard.org/publications/r_101111a.pdf.

systemic risk in the financial system. We think that there is merit in considering a mechanism for monitoring the development of areas of unacceptable systemic risk in future and, where necessary, refining the boundary of prudential regulation to respond (i.e. if entities or sectors outside the boundary are identified as raising systemic risks to the market): see paragraphs 118–121 in Section A.

H Investors and financial consumers

Key points

Nearly all adult Australians are investors and financial consumers. This means that more Australians are being asked to make more financial decisions than ever before, in an environment that is becoming increasingly complex.

In making financial decisions, investors and financial consumers face a number of related barriers that can hinder good decision making. These include:

- behavioural biases;
- low levels of financial literacy;
- lack of access to good quality financial advice and factual information;
- information and choice overload; and
- length and complexity of disclosure.

It is inevitable that investors and financial consumers will sometimes make poor financial decisions and suffer loss. There are a number of ways individuals can seek to recover loss. External dispute resolution (EDR) schemes arguably offer the most cost-effective and accessible way for individuals to attempt to recover loss.

Scope of participation in the financial system

694 Nearly all adult Australians are investors and financial consumers. For example, an estimated:

(a) 96.6% have a deposit account;

(b) 70.9% have superannuation or an annuity;

(c) 74.6% have a major credit card (Visa, MasterCard, Bankcard, American Express and Diners Club cards, including credit, debit and charge cards);

(d) 37.6% have a loan (e.g. home loan, mortgage on investment property, bridging loan, home equity loan, personal loan or lease);[100]

(e) 38% own shares and other listed securities, either directly or indirectly;

(f) 34% directly own shares (26% own direct shares only and 8% own both direct and indirect shares); and

[100] Roy Morgan Research, 2013, 12 months to March 2013, people aged 14 and over.

(g) 12% indirectly own shares (4% own indirect shares only and 8% own both direct and indirect shares).[101]

695 This means that more Australians are being asked to make more financial decisions than ever before, in an environment that is becoming increasingly complex:

> … ordinary people are now asked to make complicated decisions that in the past would have been made by bureaucrats, entrepreneurs or bankers. 'Mum and Dad' investors are now forced to come to terms with complex financial concepts and make sophisticated decisions that will ultimately affect their future standard of living.[102]

696 Today's investors and financial consumers are being asked to make financial decisions and calculations in relation to (among other things):

(a) superannuation funds for accumulation and de-accumulation;

(b) transaction accounts;

(c) credit cards;

(d) home loans and the potential use of home equity for products such as reverse mortgages or to invest in leveraged investments;

(e) insurance (health, life, home and contents, car);

(f) telephone, mobile and internet access; and

(g) electricity and gas plans.

Barriers to making good financial decisions

697 In making decisions about products and services, investors and financial consumers face a number of related barriers that can hinder good decision making. These include:

(a) behavioural biases;

(b) low levels of financial literacy;

(c) lack of access to good quality financial advice and factual information;

(d) information and choice overload; and

(e) length and complexity of disclosure.

Behavioural biases

698 Research from psychology indicates that the 'rational' investor that underpins traditional economic theory does not exist. Instead, people are

[101] ASX Limited, *Australian share ownership study*, 2013, www.asx.com.au/documents/resources/asx-sos-2012.pdf.
[102] J Fear, *Choice overload: Australians coping with financial decisions*, Discussion Paper No. 99, The Australia Institute, www.tai.org.au/documents/dp_fulltext/DP99.pdf.

simply ‘normal’, and their decisions are motivated and influenced by a complex mix of cognitive, social and emotional factors.

699 Many decision-making biases have been identified in behavioural studies, and the following is one way the types of behaviours exhibited may be grouped:[103]

(a) *Preferences*—Preferences are often influenced by emotions—for example, immediate gratification is often valued over future gain, and choices can be made simply to avoid negative emotions, such as stress, or to promote positive emotions, such as security.

(b) *Beliefs*—People approach decisions with pre-existing beliefs that are likely to influence those decisions—for example, by over-extrapolating a small number of observations, or being over-confident about the likelihood of certain events occurring.

(c) *Decision-making shortcuts*—Decisions themselves are often made using heuristics or ‘shortcuts’—for example, unconscious rules of thumb, which may lead people to choose options that appear familiar or unambiguous without weighing up all the options.

700 Table 20 lists behavioural biases that have been found to influence decision making in retail financial markets.

Table 20: Ten behavioural biases and effects in retail financial markets

Preferences that are influenced by emotions and psychological experiences	Rules of thumb that can lead to incorrect beliefs	Decision-making shortcuts used when assessing available information
Present bias Example: spending on a credit card for immediate gratification	**Over-confidence** Example: excessive belief in one’s ability to pick winning shares	**Framing, salience and limited attention** Example: overestimating the value of a packaged bank account because it is presented in a particularly attractive way
Reference dependence and loss aversion Example: believing that insurance added on to a base product is cheap because the base price is much higher	**Over-extrapolation** Example: extrapolating from just a few years of investment returns to the future	**Mental accounting and narrow framing** Example: investment decisions may be made asset-by-asset rather than considering the whole investment portfolio

[103] Adapted from K Erta, S Hunt, Z Iscenko and W Brambley, *Applying behavioural economics at the Financial Conduct Authority*, Occasional Paper No. 1, FCA, April 2013.

Preferences that are influenced by emotions and psychological experiences	Rules of thumb that can lead to incorrect beliefs	Decision-making shortcuts used when assessing available information
Regret and other emotions Example: buying insurance for peace of mind	**Projection bias** Example: taking out a payday loan without considering payment difficulties that may arise in the future	**Decision-making rules of thumb** Example: investments may be split equally across all funds in a pension scheme, rather than making a careful allocation decision
		Persuasion and social influence Example: following financial advice because an adviser is likeable

Source: K Erta, S Hunt, Z Iscenko and W Brambley, *Applying behavioural economics at the Financial Conduct Authority*, Occasional Paper No. 1, FCA, April 2013, p. 6.

701 Specific attributes of financial and credit products—such as their complexity, risk, uncertainty and long-term nature—can accentuate people's natural inclination to eschew difficult reasoning and fall back on these behavioural biases.[104] There is potential for effective marketing to target and, in some cases, exploit these biases: see Section B. As a consequence, there is a risk that investors and financial consumers will acquire products and services that are not aligned with their financial situation, risk profile, objectives and needs.

Low levels of financial literacy

702 Financial literacy is the application of knowledge, understandings, skills and values in consumer and financial contexts and the related decisions that have an impact on the individual, others, the community and the environment.[105]

703 For individual investors and financial consumers, knowing how to make sound money decisions is a crucial skill in today's world, regardless of age. It is a 'core life skill for participating in modern society'.[106] It affects quality of life, opportunities people can pursue, their sense of security and the overall economic health of society.[107]

704 Financial literacy allows people to have more informed interactions with industry and with product providers, and be more confident engaging with financial products and services. It is in the interests of industry, regulators and government to have effective financial education programs.

[104] See, for example, Financial Services Authority (FSA), *Product intervention*, DP 11/1, discussion paper, FSA, January 2011.
[105] Ministerial Council for Education, Early Childhood Development and Youth Affairs, *National consumer and financial literacy framework*, revised 2009, Canberra, p. 1.
[106] Organisation for Economic Co-operation and Development (OECD), *Financial education in schools*, www.oecd.org/finance/financial-education/financialeducationinschools.htm.
[107] See Report 229 *National financial literacy strategy* (REP 229).

ASIC's role

705 ASIC shares responsibility for developing and delivering financial literacy programs with the business, community, government and education sectors, with ASIC having overall responsibility for developing the National Financial Literacy Strategy.

706 Under the broad framework set out by the National Financial Literacy Strategy, ASIC's financial literacy work seeks to help people make informed decisions about their money by providing information, tools and resources via a range of different channels designed to appeal to different audiences, ranging from the general public to specific groups within the Australian community.

ASIC's MoneySmart website

One major channel through which ASIC delivers its financial literacy resources is our MoneySmart website, www.moneysmart.gov.au.

Dedicated to issues for investors and financial consumers, MoneySmart features over 400 pages of information, 26 interactive calculators and three mobile applications, and helps around 440,000 Australians a month make better decisions with their money. Our research suggests that the majority of users take specific action in relation to their finances as a result of visiting MoneySmart.

Popular resources include the mortgage calculator, budget planner, retirement planner, *Managing your money* booklet and the TrackMySpend mobile telephone application. MoneySmart also has resources for Indigenous Australians about topics such as managing money, banking and credit, insurance, superannuation and scams, and material for vulnerable and disadvantaged consumers and the intermediaries who work with them, including translated money management resources and information about debt management, financial counselling, hardship and practical help with money problems.

Current levels of financial literacy

707 Financial literacy is difficult to measure. Robust assessment instruments are still developing, financial decision making is complex, behavioural change is slow, and external factors (e.g. market events such as the global financial crisis) can have an impact on measures and results.

708 The leading long-term study of Australians' financial literacy levels is a regular survey of adults conducted by the ANZ Banking Group (ANZ) since 2003.[108] It tells us that:

(a) adult Australians have varying levels of financial knowledge and proficiency—that is, they may perform well on some aspects of financial literacy but poorly on others; and

[108] ANZ, *ANZ survey of adult financial literacy in Australia*, The Social Research Centre, ANZ, 2003, 2005, 2008 and 2011, www.financialliteracy.gov.au/research.

(b) a range of shifting factors correlate with differences in financial literacy levels, including age, financial knowledge and numeracy, financial attitudes, household income, education and occupation.

709 The 2011 ANZ survey[109] identified some positive changes since the previous survey in 2008, such as:

(a) 77% of people try to save regularly (the highest level reported so far);

(b) more people (81%) feel in control of their finances (up 4 points from 2008);

(c) more people (74%) are aware of short-term fluctuations in investments (up 7 points from 2008); and

(d) more people are confident about knowing how to make a complaint against a financial institution (68%, up 5 points from 2008) and more people said they would contact an industry ombudsman if they had trouble resolving an issue (46%, up 10 points from 2008).

710 However, the 2011 ANZ survey also found that many people underestimate their own knowledge gaps, and so their behaviour may not be consistent with how confident they are in their abilities.

711 The 2011 ANZ survey also highlighted some worrying gaps in financial literacy, particularly in keeping track of finances, planning ahead and investment awareness. For example:

(a) for keeping track of finances and planning ahead:

(i) 36% of people said their household just breaks even most weeks;

(ii) 36% found dealing with money stressful, even when things are going well;

(iii) 22% would be unable to manage for a period of time if they had a major loss in income;

(iv) 73% had not identified how much they will need to live on when they retire; and

(b) for investment awareness:

(i) fewer people knew how to assess the performance of a superannuation fund or managed investment (19% were unsure compared with 13% in 2008 and 8% in 2005);

(ii) the proportion of people saying they read their superannuation statements was down to 69% (a drop of 6 points since 2008);

(iii) around a third of people continued to report that they found their superannuation statements difficult to understand; and

[109] A total of 3,502 respondents aged 18 and over answered a series of core questions, with further questions targeted at particular subgroups.

(iv) only 53% of people said they would not invest in 'an investment advertised as having a return well above market rates and no risk'.

Access to good quality financial advice and information

712 Access to good quality financial advice helps investors and financial consumers to make good financial decisions. However, less than 40% of the Australian adult population has used a financial planner.[110]

Benefits of financial advice

713 Accessing personal and general financial advice, as well as factual information, can be beneficial to investors and financial consumers. It can lead to:

(a) individual financial gains;

(b) individual psychological benefits; and

(c) economy-wide fiscal and competitive improvements.

Individual financial gains

714 Industry studies have shown that investors and financial consumers who access financial advice benefit financially as a result of the advice, even after the cost of the advice is taken into account. The financial benefits of advice can include increased savings, reduced expenses through faster debt reduction, or higher investment returns.

Benefits of financial advice

In November 2005, AXA UK conducted a financial social experiment that aimed to demonstrate the value of financial advice. The final report, *AXA avenue*,[111] explained how the experiment tracked the financial wellbeing of 20 households over a 12-month period. Half of the participants received free access to an independent financial adviser, while the other half did not.

The key findings of the experiment included:

- collectively, the 10 households that received financial advice were £50,000 better off, with significant savings increases and debt reduction;
- households that did not have free access to an independent financial adviser actually became poorer through frivolous spending of a quarter of their savings; and
- participants admitted that they relied on the adviser to check up on them—without this extra pressure they would have found it difficult to motivate themselves.

[110] See Report 240 *Access to financial advice in Australia* (REP 240).
[111] AXA UK PLC, *AXA avenue fourth quarter review: Learnings and recommendations*, January 2007.

Individual psychological benefits

715 Accessing financial advice can provide psychological benefits to investors and financial consumers, in addition to financial payoffs. Many people lack confidence when it comes to financial matters and feel uncomfortable making financial decisions. Accessing quality financial advice or knowing where to get reliable information can provide peace of mind.

716 Financial decision making is often required at times of extreme personal stress (e.g. death of a family member, redundancy from employment, marital breakdowns, retirement or starting a new job). Accessing financial advice at these times can be a source of support and comfort. It can help an investor or financial consumer to make a sound decision or put in place a strategy.

Economy-wide fiscal and competitive improvements

717 The sense of confidence, control and engagement with financial matters that can come with accessing advice is of significant value. It can motivate investors and financial consumers to stick to a budget, save for a purpose or look forward to a more comfortable retirement.

718 The potential positive benefits of good financial advice extend beyond the individual, to the broader community. The benefits to the wider community can include a decreased reliance on social security by virtue of increased savings and higher levels of insurance protection, and a more financially literate society capable of sound financial judgement and decision making. More confident and informed investors and financial consumers can lead to greater competition and efficiency in financial markets, and improved financial products and services: see paragraphs 523–528 in Section E.

Why investors and financial consumers do not seek financial advice

719 Socioeconomic factors and age appear to be the most consistent drivers of financial adviser use:

(a) those with higher socioeconomic status and those aged 50 years or older are more likely to use or have used a financial adviser; and

(b) those with lower socioeconomic status and those aged under 25 are less likely to use or have used a financial adviser.[112]

720 There are many reasons why most Australians do not access financial advice. These include:

(a) *financial literacy*—gaps in financial literacy, especially among certain demographics and in relation to certain financial topics, limits some

[112] REP 230, pp. 114–15, citing Roy Morgan Research, 2010 Single Source database, Melbourne (12 months to December 2009).

people's engagement with financial matters and stops them from seeking advice;

(b) *perceptions that advice is out of reach*—evidence suggests some people do not seek financial advice because they feel their financial circumstances do not warrant advice;

(c) *lack of trust in financial advisers*—lack of trust in financial advisers to provide unbiased, professional advice limits the number of people who seek advice and the value they place on financial advice;

(d) *scale of advice provided*—many Australians, particularly those who have never previously accessed financial advice, want piece-by-piece simple advice rather than holistic advice. Many advice providers still provide holistic advice as the default option;

(e) *access to general advice and information*—the provision of general advice or factual information is less extensive than it could and should be. For many investors and financial consumers, general advice and factual information may be sufficient to meet their current advice needs; and

(f) *cost of advice*—a significant gap exists between what investors and financial consumers are prepared to pay for financial advice and how much it costs industry to provide advice.

Information and choice overload

721 For each financial product, an investor or financial consumer is presented with a wide range of options to compare. In addition, products have a number of features that provide competing indicators of their quality (e.g. price to acquire the product, past performance, rewards for acquiring the product such as initial rates, and ongoing costs). Risks associated with products are challenging to compare, particularly when they are complex. It is difficult to be aware of and effectively evaluate all of these aspects simultaneously.

722 In research conducted by Roy Morgan Research for ASIC, investors were asked about their concerns about investing. Information and choice overload was one of the concerns raised. Regardless of their demographic characteristics or level of experience, many investors were overwhelmed both by the volume of information available, and the difficulty in assessing the validity of the available information:

> Sorting out what is a good product—there's so much information and opinion, to sort out the facts from advice that's not necessarily reliable or suitable (*Male, shares interview, age 45–49*).[113]

[113] Unpublished research commissioned by ASIC, 2008.

Comparison websites

723 The need to simplify purchasing decisions promoted the introduction of commercial comparison websites. Comparison websites exist where products have complex features and/or pricing and where there are many different providers to choose from (e.g. insurance, credit cards, home loans, investments and bank accounts).

Use of comparison websites

Almost three-quarters of Australian adult internet users have used commercial comparison websites at least once.

While comparison websites can play a valuable role and assist investors and financial consumers in shopping around, one with misleading or inaccurate information can also cause detriment by steering users towards unsuitable or more expensive products.

ASIC has identified concerns with some comparison websites, including that some of the websites:

- only compare a limited number of brands/products from a limited number of providers. This may not be clearly disclosed, which creates the impression that the extent of comparison is much broader than it actually is;
- use ‘ratings’ and ‘rankings’ for products without a clear explanation of the basis for those ratings and rankings; and
- refer to ‘special offers’ and ‘featured products’ without properly explaining the basis of selection of certain products (Media Release (12-304MR) *ASIC warns comparison websites* (5 December 2012)).

Length and complexity of disclosure

724 The Roy Morgan Research commissioned by ASIC (see paragraph 722) revealed that investors and financial consumers are often overwhelmed by the volume and complexity of investment information available to them, including disclosure material such as Product Disclosure Statements (PDSs), prospectuses and annual reports.

725 Both terminology and length were raised by focus group participants in the investor research:

> Unless you are a qualified accountant or some sort of forensic CPA, it’s quite difficult to read a company’s budget … trying to wade through anywhere between 50 and 250 pages of information, it’s very difficult and I know that they do provide an executive summary one pager … to understand some of the finer detail is very difficult (*Male, shares (active) in-depth interview, age 30–34, income greater than $50,000, Brisbane*).

> I get a feel for it, but I find it very confusing, it is all jargon, not in layman’s terms (*Female, novice investor, managed investments focus group, Melbourne*).

Perceptions about product disclosure

Data from the most recent ASIC stakeholder survey (2013) found that while 27% of those surveyed agreed that investors and financial consumers are adequately protected by existing levels of product disclosure for the financial products they buy, the majority disagreed (26%), didn't know (17%), or didn't have a clear view either way (30%).

Similarly, while 27% of those surveyed agreed that investors and financial consumers get reliable information when they buy financial products, the majority disagreed (23%), didn't know (16%) or didn't have a clear view either way (34%).

726 In recent years, the limitations associated with disclosure have been recognised. To address these limitations, the following reforms were introduced in 2011 and 2012:

(a) shorter PDSs for some superannuation products, simple managed investment schemes and standard margin lending facilities;[114] and

(b) key fact sheets for home loans and credit cards, to give consumers the information they need in a set format to make it easier to shop around and compare loans and credit cards.[115]

ASIC is also considering ways of enhancing and moving beyond disclosure. See paragraphs 128–144 in Section A.

What happens when things go wrong?

727 As described in Sections A and D, financial losses are a feature of our financial system. However, this does not diminish their impact on individual investors and financial consumers. The impact of financial loss can be devastating.

728 In recent years, many Australians have lost money. Much of this loss has been caused by the market downturn and its impact on superannuation savings and other investments. For example, from the period November 2007, at the height of the market, to April 2009, the stock market loss was about $617 billion, or 52% of gross domestic product (GDP).

Impact on individuals when things go wrong

729 In 2010, ASIC's Consumer Advisory Panel (CAP) commissioned Susan Bell Research to conduct research into the social impacts of investors suffering financial losses due to their managed investment scheme or financial

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[114] See Information Sheet 155 *Shorter PDSs: Complying with requirements for superannuation products and simple managed investment schemes* (INFO 155).
[115] See www.bankingreforms.gov.au.

planner. The research findings were published in Report 240 *Compensation for retail investors: The social impact of monetary loss* (REP 240).

730 The key findings of the research were that:

(a) investors who suffered the most had invested all their money, had not diversified or went into debt as part of their investment strategy;

(b) most investors' losses were associated with an underlying product that was either frozen or collapsed;

(c) the impact of the monetary loss was immediate on investors without a financial buffer, while for others the first six months from when they discovered their loss were critical. Most investors received none or only a few cents in the dollar back;

(d) investors had little knowledge of existing avenues of redress, such as their financial services provider's internal dispute resolution (IDR) system or the EDR scheme they belonged to;

(e) investors were reluctant to commence legal action to recover their monetary loss, particularly when they blamed themselves; and

(f) investors who suffered monetary loss lacked confidence in the Australian financial system, financial advisers, the Government and regulators.

731 The research identified four 'degrees of suffering': catastrophic (17%), living frugally (27%), financially settled but angry (27%) and accepting (29%). Table 21 describes these categories in more detail.

Table 21: Description of the four 'degrees of suffering'

Degree of suffering	What that means	Compensation received or capital returned
Catastrophic	The term 'catastrophic' was used to describe the impact where the investor had lost their home or was perilously close to losing it. These investors had no other assets to draw on. Most felt deeply ashamed of their poverty. Many had to rely on charity. All investors interviewed in this category had been diagnosed as suffering from high levels of ongoing stress and/or a range of other illnesses associated with stress, such as high blood pressure, which were not problems before their loss. One lived in a caravan for a while; another in their car.	None of the investors in this category had received any money in compensation. Some had small amounts of capital returned, which went to pay debts, but they remained in serious debt.

Degree of suffering	What that means	Compensation received or capital returned
Living frugally	Some investors did not lose everything, but the impact on their lifestyle was significant. They became frugal and many were suffering from long-term depression. They accepted that they had lost their money, although it took some time for them to adjust their lifestyle to their new income levels. One couple who had been property investors now delivered the local paper to earn some money. Another investor collected cans for recycling 'to get money for a night out or tea out'. Many had ongoing stress, anxiety or depression and related illnesses, especially if there were debts to repay.	Five of the eight investors in this category had received no compensation. The rest had some capital returned. Some had sold assets to pay debts.
Financially settled but angry	For these investors, the financial impact was less severe, because they had only lost part of their investment and/or they had no debt. However, the anger and bitterness remained. These investors were bitter at the scheme owners, or their financial planners. They were also bitter at the system that allowed this to happen.	Several of these investors had some of their capital returned.
Accepting	Some investors accepted what happened financially—usually because the amount of money was a small proportion of their total assets, and was to some extent 'spare'. These investors had no debt, or had secure jobs or businesses from which they expected to recoup some of their losses.	Several of these investors had some of their capital returned.

Accessing dispute resolution and compensation

732 Having efficient and effective dispute resolution and compensation mechanisms is integral to ASIC's strategic priority of promoting the confident and informed participation of investors and financial consumers in the Australian financial services system.

733 ASIC has played a key role in establishing and shaping the dispute resolution system for the financial services industry and credit industry. It is widely regarded as one of the best systems in the world, and has responded effectively to incidents ranging from the global financial crisis to natural disasters. ASIC's approach to dispute resolution reflects an oversight role spanning 15 years. Table 22 details the avenues for obtaining compensation. See paragraphs 734–742 for an overview of Australia's system of dispute resolution.

Table 22: Avenues for obtaining compensation

Avenue	Process
IDR	Investors and financial consumers can approach the financial services provider or credit service provider directly to seek a resolution.
ASIC-approved EDR schemes and the Superannuation Complaints Tribunal (SCT)	Where a complaint is not resolved at IDR: • *ASIC-approved EDR schemes*: There are currently two ASIC-approved EDR schemes—the Financial Ombudsman Services (FOS) and the Credit Ombudsman Service Limited (COSL). Investors and financial consumers can make a complaint free of charge to either scheme, although monetary caps and limits apply. Currently, both FOS and COSL can make maximum monetary awards of up to $280,000 for most banking, insurance and advice-related complaints. Whether an investor or financial consumer can complain to either FOS or COSL depends on which scheme the financial services provider or credit service provider has joined. • *SCT*: Superannuation fund members can complain to the SCT—a statutory body established under the *Superannuation (Resolution of Complaints) Act 1993*. The SCT can review decisions and the conduct of superannuation providers, including trustees of regulated superannuation funds and approved deposit funds, retirement savings account providers and life companies providing annuity policies. Members can make a complaint free of charge to the SCT and there is no limit on the monetary value of any claim.
Self-initiated private action	The investor or financial consumer can sue the financial services provider or credit service provider in court or attempt to obtain an outcome through private negotiation, mediation or arbitration.
Through the external administration of a financial services provider (administrator/ liquidator)	Where a company may no longer be a viable business and may be or may become insolvent, the company may enter a form of insolvency administration, including receivership, voluntary administration and/or liquidation. In doing so, the administrator or liquidator will generally assess the liabilities/debt, assets and income of the company to work out whether the company can recover, should be sold or needs to be wound up. If the company is wound up, the administrator/liquidator will decide which creditors are paid out of the remaining assets or funds. Creditors with secured interests (such as banks) will usually have first priority in being paid out.
ASIC action	ASIC can take action through: • negotiations with an AFS licensee; • legal action or other enforcement action; or • a s50 ASIC Act class action—where ASIC runs a group action to obtain compensation for investors or financial consumers who suffered loss from the same type of misconduct. ASIC has to consider whether it is in the 'public interest' to do so.

Australia's system of dispute resolution

734 When things go wrong, access to justice is important from both an individual and societal perspective. Benefits of accessing justice accrue to:

(a) *individuals*—by enabling them to effectively and fairly resolve their disputes and enforce their legal rights; and

(b) *the broader community*—individual judicial decisions uphold and shape the economic and social relationships between people, organisations and governments, and create valuable precedents so other disputes can be resolved more efficiently, thereby improving certainty and reducing the risks and costs involved in transactions.[116]

735 Access to justice is provided for in the Australian financial system by legislation that requires all AFS licensees, credit licensees and trustee companies to have:

(a) a dispute resolution system,[117] which includes an internal dispute resolution (IDR) procedure and membership of an ASIC-approved external dispute resolution (EDR) scheme; and

(b) compensation arrangements, generally in the form of professional indemnity (PI) insurance.

Internal dispute resolution

736 Investors and financial consumers must first approach their financial services provider or credit service provider directly to seek a resolution. Effective and timely IDR procedures are the first element of an effective dispute resolution system because the AFS licensee or credit licensee is generally best placed to deal with complaints from its own retail clients and consumers.

External dispute resolution

737 EDR schemes provide a relatively cost-effective and more accessible alternative to going to court where a dispute about financial services or credit services cannot be resolved by the parties at IDR.

738 There are two ASIC-approved EDR schemes in Australia that deal with complaints from consumers and retail investors about financial services providers and credit service providers. They are FOS and COSL.

Note: The SCT deals broadly with complaints from superannuation fund members. It is a statutory tribunal and therefore not directly subject to ASIC oversight.

739 ASIC has a direct and ongoing oversight role in relation to the approved schemes. ASIC sets standards, requires regular reporting from schemes about dispute statistics and systemic and serious issues, and must also approve ongoing scheme jurisdiction. ASIC also requires approved schemes

[116] Productivity Commission, *Issues paper: Access to justice arrangements* September 2013, p. 4, www.pc.gov.au/projects/inquiry/access-justice/issues.

[117] The requirement to have a compliant dispute resolution system applies to product issuers and product providers that deal with retail clients, but do not require an AFS licence for various reasons (e.g. a legislative licensing exemption).

to commission an independent review of their operations at least every five years.

Independent review of FOS

In 2013, FOS undertook an independent review of its operations and, on 12 March 2014, released the report of the review and its response to the review's recommendations.[118]

The review assessed FOS against ASIC's benchmarks for EDR schemes: accessibility, independence, fairness, accountability, efficiency and effectiveness. The review found that delay was the main concern identified by stakeholders and that FOS met all but the timeliness aspects of ASIC's requirements.

To address concerns about timeliness, FOS will (among other things):

- introduce a new process to fast-track decisions for simpler and low-value disputes;
- review the current two-step dispute lodgement processes with the aim of introducing a one-step process where the financial services provider has a final opportunity to resolve the dispute before FOS starts its review;
- add specialist expertise earlier in the dispute process and reduce the number of times a dispute changes hands; and
- consult with stakeholders on its current approach to hardship disputes.

740 Without these schemes, the tens of thousands of consumers (see Table 23) who have a dispute relating to financial services or credit services or superannuation would be more likely to:

(a) seek direct assistance from ASIC or other government or community agencies;

(b) seek to pursue legal action if this was economically viable, requiring more resources to be directed to those agencies and the courts; or

(c) abandon their claim altogether.

Table 23: Total complaints received by COSL and FOS, 2009–13

Year	Number	% change
COSL		
2009–10	1,154	N/A
2010–11	1,983	72% increase
2011–12	2,741	38% increase
2012–13	3,763	37% increase

[118] Available at www.fos.org.au/about-us/independent-reviews/.

Year	Number	% change
FOS		
2009–10	23,790	6% increase
2010–11	30,283	27% increase
2011–12	36,099	19% increase
2012–13	32,307	11% decrease

Source: COSL Annual Report on Operations 2012 and 2013; FOS Annual Reviews 2009–10, 2010–11, 2011–12 and 2012–13.

741 Importantly, EDR schemes also provide an opportunity to improve industry standards of conduct. The schemes gather data and intelligence about disputes. By maintaining close connections with industry, they can assist in improving market conduct, product features and standards of disclosure to reduce the risk of future disputes arising.

742 The effective functions that the EDR schemes perform in resolving individual matters mean that, consistent with our statutory role, ASIC can focus on broader and systemic issues and serious misconduct. By reporting systemic issues, serious misconduct and data on complaints and disputes to ASIC, the EDR schemes also play a significant role in assisting ASIC to target this work effectively.

Compensation arrangements and uncompensated loss

743 AFS licensees and credit licensees must have arrangements for compensating retail clients and consumers for loss or damage due to breaches of the financial services or credit laws. The law requires that unless the licensee is exempt (i.e. because they are prudentially regulated) they must generally hold adequate professional indemnity (PI) insurance cover.

744 A licensee’s PI insurance cover must be adequate having regard to the licensee’s business. ASIC’s guidance also requires that a licensee’s PI insurance must cover EDR scheme awards.

745 PI insurance is designed to protect licensees against business risk, and not to provide compensation directly to investors and financial consumers. It is a means of reducing the risk that a licensee cannot pay claims because of insufficient financial resources, but has some significant limitations, including where there are insolvency issues, or multiple claims against a single licensee.

746 The shortcomings of PI insurance as a compensation mechanism have been raised in a number of government inquiries and reviews. FOS has recently contributed to the publicly available information about uncompensated loss.

747 In *Unpaid determinations by financial services providers*, FOS reports that between 1 January 2010 and 1 January 2014, 18 financial services providers have been unable to comply with 99 determinations exceeding $8.3 million.

748 These have arisen almost exclusively in the financial advice sector, and in most of these cases the licensee has become insolvent and/or ceased business. PI insurance did not respond to compensate consumers because of policy exclusions or where multiple clients suffered monetary loss at the same time, exhausting the limit or maximum aggregate limit of the licensee's PI insurance policy and any capital reserves it may have had.

749 COSL has reported to ASIC that three determinations, totalling about $277,000, remain unpaid. These all relate to credit licensees.

750 These reports of uncompensated loss from FOS and COSL should be treated as a minimum. The schemes are unable to quantify losses suffered by investors and consumers who did not lodge disputes because there was no reasonable prospect of success or where the losses were not 'proven' by the scheme.

751 Growing levels of uncompensated loss arising out of unpaid EDR determinations threaten to erode trust and confidence in the financial services sector and the effectiveness of the dispute resolution system. The concentration of these unpaid determinations in the small-to-medium advisory services sector potentially also places these licensees at a competitive disadvantage to larger AFS licensees who are more likely to be able to ensure compensation (through self-insurance) for their clients.

752 One option that has been suggested to address this issue is the introduction of a last resort compensation scheme, with a narrow focus (i.e. to provide compensation where all other options have truly been exhausted). It has been suggested that this would create a more level playing field between different financial advice business models when it comes to compensating investors and financial consumers for financial loss caused by poor advice.

ASIC's regulatory toolkit and recent outcomes

753 As Australia's corporate, markets, financial services and consumer credit regulator, we strive to ensure that Australia's financial markets are fair and transparent and supported by confident and informed investors and consumers. We do this by using a range of regulatory tools to enforce and promote compliance with the laws that ASIC administers, as well as to improve investor and financial consumer understanding and decision making.

754 When breaches of the law occur, this can have a significant and detrimental impact on investors and financial consumers. In the context of a corporate collapse, large numbers of investors are often affected. The nature of the conduct involved can range from serious conduct that is intentional, dishonest or highly reckless to systemic compliance failures within an organisation.

755 In response to a potential breach of the law, ASIC may undertake an investigation that may lead to enforcement action. ASIC can pursue a variety of types of enforcement action, falling into the broad categories of criminal, civil and administrative action.

756 Table 24 summarises ASIC's regulatory responses to some of the major corporate collapses that have occurred in Australia in the last eight years.

757 In cases where investors or consumers have suffered loss, ASIC will carefully consider whether any action we can take may result in compensation being paid. Ordinarily, recovery of compensation is left to private litigation and class actions. However, ASIC sometimes obtains compensation (see Table 25) for investors by:

(a) *Conducting a group proceeding under s50 of the ASIC Act* to obtain compensation for investors who suffered loss from the same type of misconduct—before taking such action ASIC must, as a result of an investigation or from an examination, form the view that it is in the public interest to conduct the proceeding; and

(b) *Pursuing negotiated outcomes* where we can achieve quick and efficient outcomes—this may arise from surveillances, investigations or after ASIC has commenced a proceeding. Often (but not always) this will result in an enforceable undertaking. An enforceable undertaking is a written undertaking given to ASIC that an entity or person will operate in a certain way. It is a flexible and effective remedy in improving compliance with the law and may be enforced through the courts.

Table 24: Major collapses: Recent ASIC outcomes

Matter	Description	ASIC's regulatory response
ABC Learning	ABC Learning was an ASX top 100-listed company, with a capitalisation of over $4 billion before entering administration in November 2008. ABC Learning's estimated shortfall was in excess of $2.5 billion.	• Enforceable undertaking against the former auditor of ABC Learning, Simon Green (formerly of Pitcher Partners). Mr Green agreed to a 5-year suspension of his licence to act as an auditor, as well as a number of conditions related to any subsequent return to practice after suspension. • Criminal action against the former Chief Financial Officer of ABC Learning, James Black. Mr Black was charged with three counts of authorising false or misleading information. A committal hearing has been set for May 2014. • Criminal investigation of two former executive directors of ABC Learning, Edmund Groves and Martin Kemp. Messrs Groves and Kemp were charged with breaching their directors' duties under the Corporations Act. Mr Kemp was found not guilty of the charges brought against him. Following this verdict, the prosecution against Mr Groves was discontinued by the Commonwealth Director of Public Prosecutions.
Australian Property Custodian Holdings Ltd (APCHL) and Prime Retirement and Aged Care Property Trust	APCHL was the responsible entity of the Prime Retirement and Aged Care Property Trust (Prime Trust), a managed investment scheme that owned retirement villages in Queensland, New South Wales and Victoria; 9700 investors (predominantly retail) invested over $500 million in Prime Trust. APCHL was placed into liquidation on 23 November 2011. It is estimated that unsecured creditors of Prime Trust were owed $23 million and secured creditors were owed $207 million.	• Civil proceedings against APCHL and five of its former directors in relation to conduct involving a fee of approximately $33 million being paid to APCHL from Prime Trust's assets in 2008. ASIC successfully made out its case. Note: The matter is due back before the Federal Court for submissions on penalty and exoneration in July 2014.
Kleenmaid	The Kleenmaid Group was founded in Maroochydore in 1985 and sold appliance products direct to the public. In May 2009 the Kleenmaid Group was placed into liquidation with net liabilities of $82 million.	• Criminal action against three former directors of Kleenmaid, who have each been charged with 18 counts of insolvent trading of debts totalling more than $4 million and a $13 million fraud committed on Westpac Bank. • Two of the directors face further charges of fraud relating to withdrawal of $330,000 from the company's bank account 2 days before it went into administration. • The three former directors were ordered to stand trial, following a committal hearing.

Matter	Description	ASIC's regulatory response
MFS (Octaviar)	MFS Limited (now known as Octaviar Limited) and a number of its subsidiaries were placed into administration in 2008.	• Civil proceedings against MFS Investment Management Ltd (MFSIM), a subsidiary of MFS Limited and four former officers and one manager of MFSIM. The proceedings relate to the use of $147.5 million in funds of the Premium Income Fund (PIF), for which MFSIM was the responsible entity at the relevant time. The trial is now part-heard in the Supreme Court of Queensland.
Opes Prime Stockbroking Ltd (Opes Prime)	Opes Prime was a securities lending and equity financing business that collapsed in March 2008 leaving creditors $630 million out of pocket. ANZ and Merrill Lynch were major financiers of Opes Prime.	• Settlement negotiations between ASIC, ANZ, Merrill Lynch and the liquidators of Opes Prime, which resulted in ANZ and Merrill Lynch paying $226 million to Opes Prime (with other assets and recoveries of approximately $253 million being available for creditors, resulting in an approximate dividend of 37c in the dollar). • Enforceable undertaking against ANZ, which required ANZ to complete a program to remedy deficiencies in procedures across the ANZ Custodian Services business, including its securities lending operations. • Criminal action against three former directors of Opes Prime, Julian Smith, Laurie Emini and Anthony Blumberg. Messrs Smith, Emini and Blumberg were charged with dishonestly breaching their duties as directors of Opes Prime. Mr Emini and Mr Blumberg each entered into early guilty pleas and were sentenced to 12 months and 6 months imprisonment respectively. The case against Mr Smith proceeded to trial in the Victorian Supreme Court; Mr Smith was found not guilty.
Sonray Capital Markets	Sonray was established in 2003 and held an AFS licence. It was one of the first brokers in Australia to provide advice on contracts for difference (CFDs). On 22 June 2010, voluntary administrators were appointed. On 27 October 2010, Sonray was placed into liquidation. According to the liquidators, Sonray had (as at 22 June 2010): • gross client positions of $76.85 million; • gross client holdings in either cash or equities held by counterparties of $30.15 million; • a shortfall of $46.70 million; and • approximately 3,500 clients.	• Criminal action against the former Chief Executive Officer of Sonray, Scott Murray, and the sole director of Sonray, Russell Johnson, in relation to conduct that resulted in a deficiency in segregated account funds. • Mr Murray was sentenced to 5 years imprisonment on 10 charges brought by ASIC, including six charges of false accounting, two charges of theft, and one charge each of obtaining a financial advantage by deception and misleading an auditor concerning a capital injection. Mr Johnson pleaded guilty to seven charges brought by ASIC, including three charges of false accounting, one charge of submitting a false document to ASIC, two charges of theft and one charge of obtaining a financial advantage by deception. Sentence is awaited. • Administrative action against Mr Murray, which resulted in the permanent banning of Mr Murray.

Matter	Description	ASIC's regulatory response
Storm Financial	Storm Financial was based in Townsville, Queensland, and provided financial services to clients across Australia. Until about the time it was placed in liquidation on 26 March 2009, Storm Financial operated a number of investment schemes for its customers throughout Australia. There are 2,780 investors or investor groups who ASIC assesses as having suffered loss. The estimated amount of loss is approximately $830 million.	• Civil directors' duties proceedings against the former directors of Storm Financial, Emmanuel and Julie Cassimatis. These proceedings are ongoing. • Two civil compensation proceedings against, variously, the Commonwealth Bank of Australia (CBA), the Bank of Queensland (BOQ), Macquarie Bank and Senrac. Settlements to date have resulted in: – two former Storm Financial investors, Barry and Deanna Doyle, being paid $1.1 million, to fully compensate their financial loss; – CBA making $136 million available as compensation for losses suffered on investments made through Storm Financial (in addition to the $132 million and other benefits previously paid by CBA to Storm Financial investors); and – proceedings against BOQ and Macquarie Bank in one civil compensation action continue; the trial has concluded and we are awaiting judgment. • Intervention in the application for court approval of an agreed settlement of $82.5 million in the Richards class action negotiated between Levitt Robinson Lawyers and Macquarie Bank Ltd. ASIC had concerns regarding the fairness of the settlement arrangements and, accordingly, appealed the court's original decision to approve the settlement. The appeal was successful and the parties subsequently entered into a further settlement agreement, which addresses ASIC's concerns regarding fairness. It has recently been approved by the court.
Trio Capital (Trio)	Trio was a superannuation fund trustee and licensed responsible entity for 17 active managed investment schemes, including the Astarra (ASF) and ARP Growth (ARP) funds, which included investments in a number of overseas vehicles. Trio also operated a superannuation administration service, which provided back-office administration to superannuation trustees. Trio funds were promoted by a number of advisers to their clients. Trio went into voluntary administration on 19 December 2009 and was placed into liquidation on 22 June 2010.	• Criminal action against Shawn Richard, former investment manager of the ASF fund. Mr Richard was sentenced to 3 years and 9 months imprisonment with a minimum of 2 years and 6 months. • Criminal action against Tony Maher (formerly known as Paul Gresham), which resulted in Mr Maher pleading guilty to 20 criminal charges, including making false or misleading statements to obtain a financial advantage relating to the ARP fund. Mr Maher will be sentenced in June 2014. • Administrative action as follows: – permanent banning of Eugene Liu, ASF's chief investment strategist, from providing financial services; – enforceable undertakings with five former Trio directors in which they agreed not to be involved in the financial services industry or manage a company for between 2 and 15 years. The former directors are Natasha Beck, Keith Finkelde, David O'Bryen, David Andrews and Rex Phillpott; – enforceable undertaking with planning firm Killara Financial Solutions to address compliance issues; – enforceable undertaking with Tony Maher to never provide financial services or manage a company; – suspending the licence of financial planners Seagrims, with this licence then being cancelled at the company's request on 19 September 2011;

<table>
<tr><th>Matter</th><th>Description</th><th>ASIC’s regulatory response</th></tr>
<tr><td></td><td>The following losses are associated with Trio funds:
$125 million: alleged misappropriation of ASF and Trio superannuation and other retail client money, with 6,048 investors; and
$69.5 million: assets of ARP Growth Fund, which had 79 investors (mostly SMSF investors).</td><td>– banning Seagrims’ directors Peter Seagrim and Anne-Marie Seagrim for 3 years, with the Administrative Appeals Tribunal subsequently cutting the ban to 6 months; and
– enforceable undertaking with former ASF auditor Timothy Frazer, providing he would not act as a registered company auditor for 3 years.
Note: See Section I for further discussion of the collapse of Trio.</td></tr>
<tr><td>Westpoint</td><td>The investors in Westpoint-related financial products had total capital invested of $388 million outstanding as at January 2006 when the group collapsed.</td><td>19 civil compensation proceedings to recover funds for the benefit of investors in the majority of the Westpoint companies. To date ASIC has recovered in excess of $93 million from these compensation claims.
Criminal actions as follows:
– former Westpoint Chief Financial Officer, Graeme Rundle, was found guilty of two offences of making a false statement with intent to obtain a financial advantage. Mr Rundle was sentenced to 18 months imprisonment on each count with the sentence to be suspended upon him entering into a good behaviour bond;
– former promoter of Westpoint products, Neil Burnard, was convicted on nine criminal charges in relation to the raising of investor funds. Mr Burnard was fined $50,000 and sentenced to 12 months imprisonment, fully suspended on condition that he be of good behaviour;
– a Queensland unlicensed adviser was convicted and sentenced to 6 months imprisonment, with an order that he be released after entering a $1,000 good behaviour bond for 3 years after pleading guilty to an ASIC charge; and
– an Adelaide financial planner was jailed for 6 months after being found guilty of an ASIC charge. On release, the person charged will enter a $1,000 good behaviour bond for 3 years.
Administrative action as follows:
– banning of 23 licensed advisers, four unlicensed advisers and one corporate entity in relation to advice concerning Westpoint-related products for periods between 3 years and permanently; and
– enforceable undertakings from three KPMG partners preventing them from practising as auditors for periods between 9 months and 2 years.</td></tr>
</table>

Table 25: Compensation obtained for investors and financial consumers

Matter name	Description	Compensation ($ million)	Method for obtaining compensation
Opes Prime	Opes Prime was a securities lending and equity financing business, which collapsed in March 2008 leaving creditors $630 million out of pocket. ANZ and Merrill Lynch were major financiers of Opes Prime. Settlement negotiations between ASIC, ANZ, Merrill Lynch and the liquidators of Opes Prime resulted in ANZ and Merrill Lynch paying $226 million to Opes Prime.	226	Negotiated outcome
Storm Financial	ASIC commenced civil compensation proceedings against CBA and others, arising from the collapse of Storm Financial. Proceedings were settled against CBA on the basis that it make $136 million available as compensation for losses suffered on investments made through Storm Financial.	136	Negotiated outcome
Westpoint	ASIC commenced 19 civil compensation proceedings to recover funds for the benefit of investors in the majority of the Westpoint companies.	93	Negotiated outcome/court-ordered compensation/compensation under s50 of the ASIC Act
Don Nguyen, Anthony Awkar, Alison White and Commonwealth Financial Planning Limited (CFPL)	In August 2010, CFPL, a wholly owned subsidiary of Commonwealth Bank of Australia, agreed to implement a major client compensation program following ASIC's investigation.	51	Negotiated outcome
Suncorp Group	In 2013, ASIC sought an independent review of Suncorp Group's compliance systems after it reported a significant number of breaches of the law to ASIC. Following the independent review of its compliance systems, Suncorp Group agreed to enhance its compliance systems across its life and general insurance businesses. Suncorp Group will continue to report to ASIC until the compliance system changes are complete. Over 849,000 customers were affected and approximately $23 million was refunded to customers.	23	Negotiated outcome

Matter name	Description	Compensation ($ million)	Method for obtaining compensation
Bank of Queensland (BOQ)	BOQ agreed to refund customers after a system error resulted in a failure to link mortgage offset accounts to some eligible home loan accounts over a number of years. It is estimated that the error affected approximately 6,000 customers and total refunds will be approximately $12 million.	12	Negotiated outcome
Primelife Corporation Limited (Primelife)—Brighton Bay Syndicate Scheme	ASIC filed 39 proceedings in the Federal Court against Primelife and others, alleging that the Brighton Bay Syndicate Scheme was an unregistered managed investment scheme. ASIC's actions involved over 20 schemes and over 800 investors and resulted in an average return of 94 cents in the dollar to investors across all schemes.	9.9	Negotiated outcome
Elders Insurance	In September 2010, Elders advised ASIC that it had inadvertently underpaid customers when paying total loss claims for market value insured motor vehicles. Up until September 2010, Elders' motor vehicle insurance policy covered the cost of stamp duty on the purchase of a replacement vehicle of the same value where the insured vehicle was a total loss. Stamp duty varies from state to state but on average is about 3% of the purchase price. Despite this, Elders had failed to include the stamp duty amounts when paying total loss market value claims. Approximately 9,657 customers were affected and approximately $5.3 million was refunded to customers.	5.3	Negotiated outcome
RHG Mortgage Corporation (RHG)	Following an industry review of early termination fees and receiving a number of complaints about RHG, ASIC became concerned that some of RHG's discharge and early termination fees were unconscionable or unjust under the National Credit Code. ASIC reached a negotiated outcome with RHG, under which RHG: • provided refunds to consumers; • agreed to reduce its discharge fees on existing loans; • agreed to the staggered removal of early termination fees for thousands of customers; and • 6,400 customers were affected and $3.3 million was refunded to customers.	3.3	Negotiated outcome

Matter name	Description	Compensation ($ million)	Method for obtaining compensation
Tyre and rim insurance	In mid-2012, BMW notified ASIC that it had breached the National Credit Code because it had financed insurance tyre and rim premiums for more than one year. Financing of car insurance premiums for more than one year can lead to customers paying undue interest on premiums and being unfairly locked into longer contracts with one insurer. 2,466 customers were affected and $1.4 million was refunded to customers.	1.4	Negotiated outcome
	Industry surveillance Following BMW's breach report, ASIC conducted an industry-wide review that found that there had been improper financing of tyre and rim insurance premiums by some of Australia's largest car financiers. This work resulted in a number of major car financiers agreeing to pay back money to car owners. Approximately 30,000 car owners were affected and over $15 million was refunded to customers.	15	

Specific issues facing disadvantaged Australians

758 Disadvantaged Australian investors and financial consumers face particular problems when accessing and using financial services, and they may be less likely to raise these problems with ASIC or to pursue individual matters successfully through EDR or the courts. Such investors and financial consumers include Indigenous Australians, rural and remote residents, newly arrived migrants, people from lower socioeconomic backgrounds and people living in the outer suburbs of large metropolitan areas. ASIC pays particular attention to identifying and addressing their needs.

759 ASIC works closely with other agencies such as legal aid providers, financial counsellors and community legal centres that provide services to disadvantaged Australians. ASIC has partnered with these organisations in a number of initiatives, and many are represented on our Consumer Advisory Panel. This facilitates the early identification of problems and issues.

760 ASIC also has two outreach teams—a general one and a specific Indigenous outreach team. These teams reach out to disadvantaged investors and financial consumers and communities to:

(a) provide targeted education and resources specifically designed for them;

(b) work with industry and other stakeholders to identify better ways to address their needs in relation to financial services;

(c) identify problems that are being experienced, including misconduct by financial services providers and credit service providers; and

(d) communicate these issues back to ASIC and work with other teams to identify and employ the appropriate regulatory tools for addressing them.

761 Campaigns and resources developed by the outreach team include:

(a) a campaign in 2011 on mortgage health, encouraging people to take action if experiencing mortgage stress; and

(b) a Money Management Kit, launched in March 2012, with a suite of translated online and printed resources originally developed for settlement workers supporting newly arrived Australians, and now used more widely by intermediaries in the community sector.

762 ASIC's specific Indigenous outreach program supports Indigenous people in understanding and making decisions about financial services. This team liaises with Australia's Indigenous community, looks into their complaints about financial services issues and promotes resources for Indigenous Australians about topics such as managing money, banking and credit, insurance, superannuation and scams. The team's work in remote

communities has identified problems and conduct that have resulted in a number of ASIC enforcement outcomes.

Specific issues relating to retirement and ageing

763 For most people there is no mandatory or official retirement age.[119] However, superannuation, taxation and social security policy settings implicitly designate 'normal' retirement ages. The age pension eligibility age, currently 65 years of age for most Australians, is the most commonly used of these benchmarks.[120]

764 However, many people retire when they are younger than 65 years, in some instances at considerably younger ages. Early retirement has a double effect on retirement finances, all else being equal. Retiring early reduces the amount of time people have to accumulate retirement savings (because they are in the workforce for a shorter period of time) while simultaneously increasing the average number of years of retirement living that those savings have to support (assuming there are no life expectancy effects of early retirement, which may or may not hold true).

765 While encouraging people to consider working longer is one way to address the individual financial impacts of early retirement, for other people health or other factors mean this is not an option.

766 The extent to which people plan in advance for the financial side of retirement varies considerably across the population. Differences in circumstances, financial resources, the degree of financial literacy and personality traits can all have an impact on whether or not a retiree plans in advance for retirement and, if they do plan, what form that planning takes.

Pressures and decisions facing investors and financial consumers

767 It is important to understand the pressures and decisions facing investors and financial consumers around retirement and retirement decision making, including:

(a) the effect of retirement finances on an individual's wellbeing; and

(b) the pressure on baby boomers, who are financially diverse, to make good financial decisions as they approach retirement.

[119] Some occupations or sectors do have mandatory retirement ages (e.g. most members of the Australian Defence Force are required to retire at 60 years of age).
[120] The age pension eligibility age for women was 60 years of age; however, in 1994 legislation was changed to bring the eligibility age for women into line with that for men, through a staged increase, which took full effect in 2013.

Effects of retirement finances on an individual's wellbeing

768 Decisions about retirement finances have a profound impact on the long-term wellbeing of investors and financial consumers. To make the most of their retirement savings, people need to balance their current consumption needs with saving for the future, and make decisions about the types and degree of risk they are comfortable being exposed to.

769 Poor decisions can be very costly, both for individual households and the economy overall. For example, spending a large proportion of retirement savings in early retirement can significantly affect how much money is available to provide an income in retirement and/or how long that money will last.

770 People may find themselves with less money than they need or with unintended exposure to risks. At an aggregate level, a lack of informed and confident investor and financial consumer behaviour leads to inefficient capital allocation, uncompetitive financial product and service markets, and potentially a higher level of reliance on the age pension.

771 Unfortunately, working out how to make good decisions about retirement finances is difficult. A large number of factors need to be considered, including several unknown variables such as longevity and future investment returns. Poor decisions are often not apparent until it is too late to change course, and so people generally do not have the opportunity to learn from experience. Further, because saving for retirement through superannuation is relatively recent, the ability of people to learn from the experience and decisions of earlier generations is also restricted.

Pressure on baby boomers as they retire

772 The baby boomer generation is approaching retirement having had the benefit of superannuation for only part of their working lives. While the baby boomers are wealthy in aggregate, this group is financially diverse. Most baby boomers have some retirement savings but few have enough to be totally self-sufficient. Research on average superannuation balances in 2005–06 found that the average superannuation balance for men aged 60–64 years at that time was approximately $136,000 and for women of the same age was only $63,000.[121] More recent research found that the average superannuation balance for people aged 55–64 years was approximately $165,000, with the median balance for the same age group being only $72,000.[122]

[121] R Clare, *Retirement savings update*, report for the Association of Superannuation Funds of Australia, February 2008.
[122] ABS, *Retirement and retirement intentions, Australia, July 2008 to June 2009*, Cat. No. 6238.0, 17 December 2009, www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/6238.0Main+Features1Jul%202008%20to%20Jun%202009?OpenDocument.

773 For some people, the superannuation they accumulate by the time they retire will be the largest sum of money they have ever had to manage. While the dollar value of their retirement savings might appear significant, when their savings balance is translated into an income stream, the level of income can be disappointingly low. Other people approaching retirement may realise quite quickly that their savings are unlikely to be adequate, and so they may be tempted to pursue risky investment strategies to try and boost their capital. Both these scenarios can result in people making less than optimal decisions about their retirement savings.

Challenges relating to financial decisions at retirement

774 Our analysis of consumer research relating to retirement decision making and retirement planning has identified several issues and challenges that need to be addressed in order to best help all investors and financial consumers deal with their financial decisions at retirement. Table 26 summarises the main challenges and their potential implications for ASIC, the government and industry.

Table 26: Challenges and implications relating to financial decision making at retirement

Challenge	Implications for ASIC, the government and industry
There is no average ‘retiree’ or pathway to retirement.	Resources and financial products and services need to be available to meet the needs of all different types of retirees. Flexibility and the ability to tailor products and information to people’s individual circumstances are important.
Many people retire earlier than 65 years of age. Some people retire early by choice; others, however, are forced to retire earlier than they would have liked.	Ensuring information, advice and products are available to help people make good decisions when they retire early is vital. Intending retirees should be encouraged to consider the impact that retiring earlier or later than anticipated may have on their retirement plans.
Being forced to retire early often has a significant negative impact on the financial and emotional wellbeing of retirees.	Providing targeted, independent advice to help people in the event of unexpected early retirement is important. Intending retirees more generally should be encouraged to build contingencies into their retirement planning to enable them to cope in the event they are forced to retire earlier than planned.
Many people recognise that planning in advance for retirement is important or could be beneficial, but most do not take much action until retirement is reasonably imminent.	Encouraging people to not only appreciate the value of planning but to take action is a significant challenge.
People often focus heavily on planning for and considering their retirement lifestyle, but give far less consideration to planning their retirement finances.	Lifestyle is key to getting people to think about retirement. Discussions and messages about lifestyle need to be incorporated with messages about planning retirement finances if ASIC is to successfully engage and assist people approaching retirement.

Challenge	Implications for ASIC, the government and industry
Cultural, social and psychological factors can significantly affect retirement decision making and retirement planning.	Information and educational materials need to recognise and take into account these factors, rather than ignoring them. The language and messages used need to resonate with popular beliefs and attitudes in order to grab pre-retirees' and retirees' attention.
There appears to be a low level of investor and financial consumer awareness and understanding of the benefits of retirement-phase superannuation products.	Many retirees are unaware of the tax and other advantages of continuing with a superannuation product in retirement. Initiatives to increase awareness of retirement-phase products and decisions are needed.
The predominant focus on accumulation-phase superannuation remains.	The overarching aim of the superannuation system is to provide members with an adequate income in retirement, yet most of the public discussion and awareness of superannuation revolves around the pre-retirement (accumulation) phase.
Account-based products dominate the retirement-phase market, but these products generally do not address longevity risk issues for retirees.	This may raise questions around the appropriateness of retirement advice, and the suitability of retirement products being recommended.
Product and system complexity are likely to lead to investor and financial consumer confusion and poor decision making.	Strategies to address this problem may include consumer education materials, resources and other awareness campaigns from government and industry that enable wider and better understanding of the products and system.
Many people do not know what they do not know, and only continue to look at information until they feel they have enough to make a satisfactory decision, rather than trying to make the best decision.	Messages need to be crafted so as to take into account common attitudes and behavioural biases, and encourage people to take concrete actions to improve their retirement outcomes.
Many people recognise that receiving personal financial advice could be helpful, but there is a high level of distrust of financial advisers. People are unsure of how to assess the quality of any advice they receive.	ASIC needs to provide further assistance to investors and financial consumers to help them understand the financial advice process, what to expect, what questions to ask and how to assess whether they are receiving good advice. Industry needs to undertake further initiatives to demonstrate the value of good advice and to help dispel distrust of advisers.

ASIC's work: Reverse mortgages

775 ASIC has undertaken a number of initiatives to assist those approaching retirement and/or those aged over 55, including, in particular, in relation to reverse mortgages. Reverse mortgages are one type of product that was developed by industry to meet the needs of older consumers who are cash poor but asset rich. These products allow consumers to borrow money against the equity in their homes and the principal and interest are not repaid until the home is sold (usually when the consumer dies or voluntarily repays the loan).

776 ASIC identified reverse mortgages as posing particular risks for potentially vulnerable consumers, including:

(a) long-term financial risks that consumers would be left with insufficient or no funds well before the end of their life (i.e. all the equity in their property is used up). In the worst case scenario consumers could be left with negative equity (owing more than the value of their property);

(b) risks to the consumer if their lender collapsed (including the cessation of ongoing payments, the imposition of onerous fees and charges, and possible eviction for technical breaches of the contract); and

(c) significant limitations on the affordability, independence and quality of available advice.

777 Of these, potentially the most common and significant economic risk identified was that consumers would have no funds available at a time in their lives when they were most likely to face significant costs associated with ageing, such as medical, aged care and accommodation needs.

778 From about 2005, as the market for reverse mortgages increased significantly, ASIC used the limited jurisdiction we had to attempt to address these risks by:

(a) documenting and analysing the issues involved;

(b) publishing two public reports (Report 59 *Equity release products report* (REP 59) in November 2005 and Report 109 *'All we have is this house': Consumer experiences with reverse mortgages* (REP 109) in November 2007);

(c) providing resources for consumers, including a reverse mortgage calculator and an information guide; and

(d) working with industry to encourage the development of a code of practice and promote membership of EDR schemes.

779 The National Credit Act now:

(a) provides that reverse mortgages must include a 'no negative equity' guarantee;

(b) includes a presumption that reverse mortgages that offer a too high loan-to-valuation ratio for borrowers of a certain age will be unsuitable;

(c) stipulates that providers must provide a prescribed information statement; and

(d) stipulates that providers must use ASIC's reverse mortgage calculator to show potential borrowers projections of likely long-term costs.

I Financial advice

Key points

Over the past 15 years, ASIC has identified broad and sustained problems in the quality of retail financial advice arising from embedded conflicts of interest and low levels of competence, compounded by weaknesses in the regulatory system.

ASIC has sought to take a strategic approach to addressing these problems, using existing regulatory tools as well as discussing issues publicly and calling for reform.

The Future of Financial Advice (FOFA) reforms are designed to address some of these problems, and to improve the quality of financial advice.

The financial advice industry

780 At the time of the Wallis Inquiry, financial advisers were regulated in a fragmented way. Investment advisers were regulated separately from others who would typically provide advice on financial products in the course of selling products (e.g. insurance brokers), and there was no clear legal concept of 'financial product advice'. The Wallis Inquiry's recommendation that all persons responsible for financial advice should be subject to a single licensing regime, along with those selling and dealing in products, has been part of the ongoing evolution of the financial advice profession in Australia.

781 Based on our work with the financial advice industry, we estimate the number of advisers currently operating in Australia at:

(a) nearly 40,000 authorised representatives; and

(b) around 14,000 employee representatives.

This brings the total number of advisers to around 54,000 advisers for the over 3,000 AFS licensees that are authorised to provide personal financial product advice.

Note: Without a register of employee adviser representatives, we do not have exact data on adviser numbers. We have recommended law reform to introduce an employee adviser register: see Section A.

Quality of financial advice

782 ASIC has long been concerned about the quality of financial advice provided to consumers and about conflicts of interest in the financial advice industry. Our concerns arose as a result of our monitoring and surveillance work,

reports of misconduct, and market intelligence, and were strongly reinforced by the results of our shadow shopping surveillances in 1998, 2003, 2006 and 2011.

783 ASIC's concerns were not limited to a few 'bad apples' in the industry, or even a few bad firms. Instead, they reflected broad systemic problems within the financial advice industry, driven by ownership and remuneration conflicts of interest and low levels of competence, compounded by weaknesses in the regulatory system.

784 ASIC has sought to identify and understand the nature and size of the problems through both our shadow shopping surveillances and our more traditional surveillance work.

785 In 2003, ASIC and the then Australian Consumers Association conducted a survey of the quality of advice provided by financial product advisers: see Report 18 *Survey on the quality of financial planning advice* (REP 18). As part of this work, industry experts were asked to judge real financial product advice provided to retail clients who sought comprehensive financial plans from advisers.

786 Overall, the quality of advice provided to consumers was disappointing, with 27% of financial plans judged to be poor or very poor, and a further 14% judged to be borderline. Only half of the advisers provided a financial plan that was judged to be clearly acceptable when measured against industry's good practice standards and the client's request for a comprehensive plan.

787 A common observation by several judges was that clients' interests did not appear to be the sole factor in the financial plan strategy or product selection. They characterised this practice as 'commission-driven product selling, not impartial advice'.

788 In 2006, we released the results of a third shadow shopping study, conducted during the first seven months of superannuation choice: see Report 69 *Shadow shopping survey on superannuation advice* (REP 69). The key findings from this survey were that:

(a) 16% of advice was clearly not reasonable, given the client's needs (as required to be addressed by law), and a further 3% was probably not reasonable;

(b) where consumers were advised to switch funds, a third of this advice lacked credible reasons and risked leaving the consumer worse off;

(c) unreasonable advice was three to six times more common where the adviser had an actual conflict of interest over remuneration (e.g. commissions for recommending products); and

(d) investors were rarely able to detect bad advice.

789 In response to the survey, ASIC conducted specific follow-up action with 14 AFS licensees where the most significant problems were detected—however, compliance problems were noted across a wide range of firms.

790 In 2011, we conducted further shadow shopping research, looking at financial advice about retirement. We published the results of this research in March 2012: see Report 279 *Shadow shopping study of retirement advice* (REP 279). The examples of advice seen in this research were generally not of a sufficiently high standard:

(a) over a third of the advice examples were poor in quality (39%);

(b) there were only two examples of good quality advice (3%); and

(c) the majority of advice examples reviewed (58%) were adequate.

791 Where advice was poor, common problems included:

(a) inadequately assessing or addressing the client's personal circumstances, needs or objectives;

(b) conflicted remuneration structures (e.g. product commissions and percentage asset-based fees) affecting the type of advice and recommendations, and the quality of advice given; and

(c) failing to provide adequate justification for recommendations, particularly when advising a client to switch products, where the new product was sometimes less advantageous to the client.

792 ASIC's other regular surveillance work has reinforced our concerns about poor quality and inappropriate advice, and about the role of conflicts of interest in driving those problems. It has also confirmed our belief in the need to raise professional and training standards in the industry.

Conflicted remuneration structures

793 As the financial advice industry developed, most financial advisers were remunerated by product issuers paying them a commission for selling financial products to clients.

794 Commission payments create real conflicts of interest. Conflicts of interest can generate real or potential harm by:

(a) encouraging advisers to sell products rather than give strategic advice (e.g. advice to the client that they should pay off their mortgage), even if this strategic advice would be low risk and in the best interests of the client; and

(b) influencing the choice of products recommended by advisers to their clients.

795 The payment of commissions tends to generate a strong sales culture rather than a culture of providing prudent and strategic advice. Until the introduction of the FOFA reforms, the regulatory system contained no prohibition on advisers receiving commissions: see paragraphs 810–813.

Standard of care for advisers

796 Additionally, the Corporations Act did not contain provisions requiring a financial adviser to act in the best interests of their client or to give priority to the interests of the client when providing advice. As long as the advice met the lower standard of being ‘appropriate’, and the necessary disclosures had been made, the adviser was not prohibited by the Corporations Act from giving advice that benefited the adviser rather than, and in preference to, the client.

Competency and training

797 In ASIC’s view, the competence and training of financial advisers requires significant improvement. This was also a conclusion of the 2009 PJC Inquiry into Financial Products and Services in Australia (Ripoll Inquiry). Only well-trained, competent advisers can provide good quality advice. Some of the deficiencies in current training standards, as well as measures we have proposed to improve adviser competency, are outlined in Section A.

ASIC’s strategic approach to problems in the industry

798 Given the widespread nature of the concerns we had, ASIC sought to take a strategic approach to trying to achieve change in the industry. This involved:

(a) liaison with and provision of guidance to industry;

(b) risk-based surveillance with targeted work on individual firms;

(c) negotiated settlements, including major long-term enforceable undertakings, administrative bannings and enforcement action; and

(d) the provision of information for the users of financial advice.

799 One element of that strategic approach was to have a significant focus on the larger players in the industry that had the greatest number of authorised representatives. In our view, if their practices and culture could be improved, it would benefit the large number of investors obtaining advice through them.

800 This was one of the drivers for ASIC undertaking major financial advice surveillance projects in relation to three of the largest industry participants: Commonwealth Financial Planning Limited (CFPL), AMP and Professional Investment Services.

801 Each of these surveillance projects found significant problems. They also found sufficient evidence of the problems to convince the licensees' management of the need for change. As a result, ASIC obtained detailed enforceable undertakings from all three licensees. The enforceable undertakings were designed to address past problems, change the firms' practices and lift the quality of advice: see Media Release (06-251MR) *ASIC accepts a legally enforceable undertaking from AMP financial planning* (27 July 2006), Advisory (10-275AD) *ASIC accepts enforceable undertaking from Professional Investment Services Pty Ltd* (20 December 2010) and Media Release (11-229MR) *ASIC accepts enforceable undertaking from Commonwealth Financial Planning* (26 October 2011).

802 More recent regulatory actions undertaken in the financial advice sector include:

(a) entering into enforceable undertakings with:

(i) Macquarie Equities Limited (see Media Release (13-010MR) *ASIC accepts enforceable undertaking from Macquarie Equities Ltd* (29 January 2013));

(ii) UBS Wealth Management Australia Ltd (see Media Release (11-52MR) *ASIC accepts legally enforceable undertaking from UBS Wealth Management Australia* (17 March 2011)); and

(iii) Wealthsure (see Media Release (13-240MR) *ASIC accepts enforceable undertaking from Wealthsure Pty Ltd, Wealthsure Financial Services Pty Ltd and their former CEO* (2 September 2013));

(b) cancelling the AFS licences of AAA Financial Intelligence and AAA Shares (in liquidation) (see Media Release (13-019MR) *ASIC cancels licences of national financial planning business* (6 February 2013)), Morrison Carr Financial Services (see Media Release (12-183MR) *ASIC cancels licences of Morrison Carr and permanently bans sole director* (2 August 2012)) and Addwealth Financial Services Pty Ltd (see Media Release (13-050MR) *ASIC cancels the licence of Addwealth Financial Services* (15 March 2013));

(c) imposing additional AFS licence conditions on Moneywise Securities (see Media Release (13-259MR) *ASIC imposes licence condition on Moneywise Securities* (17 September 2013)); and

(d) negotiating improved practices with Anne Street Partners (see Media Release (13-248MR) *ASIC concerns prompt Anne Street Partners to change their financial advice practices* (5 September 2013)) and AMP Horizons Group (see Media Release (12-326MR) *AMP Horizons improves compliance measures following ASIC concerns* (20 December 2012)).

803 We have also undertaken a risk-based surveillance of the 50 largest AFS licensees that provide advice to retail clients. We have released two public reports, Report 251 *Review of financial advice industry practice* (REP 251) and Report 362 *Review of financial advice industry practice: Phase 2* (REP 362). To address issues we had found through our surveillance, our reports recommended that licensees:

(a) ensure that they effectively manage conflicts of interest in their business models;

(b) continue to give training a high priority because this lessens the risk of poor advice being provided to consumers;

(c) ensure their advisers comply with their stated procedures;

(d) check references of new advisers to exclude 'bad apples' (advisers who provide inappropriate advice to clients);

(e) report breaches and demonstrate that remediation plans are in place;

(f) retain access to client records at all times;

(g) educate clients about risk and return so that their expectations are more realistic;

(h) handle complaints well; and

(i) ensure that their compensation arrangements (including professional indemnity (PI) insurance) adequately cover all the products and services they advise on.

804 In addition to our surveillance work, we have also undertaken a significant amount of work to better understand the financial advice industry and the drivers of poor advice, and to work with industry to try to improve the quality of advice provided to consumers. Some examples of this work include:

(a) In 2002, we reviewed primary production managed investment schemes: see Report 17 *Compliance with advice and disclosure obligations: Report on primary production schemes* (REP 17) (released in February 2003). REP 17 examined the findings of a nationwide surveillance campaign where we reviewed 92 offer documents of 131 managed investment schemes operated by 103 licensed responsible entities. We also reviewed 301 client adviser files and conducted interviews with more than 100 investors. One of the findings of our work was that there was a correlation between primary production scheme promoters paying high commissions to advisers and those advisers providing inappropriate financial advice when they recommended those products to clients.

(b) In late 2004 and early 2005, we reviewed the advice given by financial advisers to more than 260 people thinking of switching superannuation funds: see Report 50 *Superannuation switching surveillance* (REP 50) (released in August 2005). One of our findings was that there was a strong tendency among advisers to recommend switching to a fund related to the licensee. We cautioned that, in these cases, there was an inherent conflict of interest that must be carefully managed to avoid the perception that the advice is inappropriate or not given on a reasonable basis, or that the interests of the licensee are placed above those of the client.

(c) In 2007, we worked closely with industry and Standards Australia on a voluntary reference-checking handbook, which was designed to encourage industry to seek and provide reference-checking information. Media Release (07-267 MR) *ASIC teams with industry on reference-checking initiative for financial advisers* (11 October 2007) publicised the reference-checking handbook as well as alerting industry to problems associated with dishonest, incompetent or unethical financial advisers.

(d) In 2010, we undertook a comprehensive study of access to financial advice in Australia, including examining the barriers to accessing financial advice: see Report 224 *Access to financial advice* (REP 224) (released in December 2010). One of our findings was that some consumers did not trust financial planners to provide them with unbiased, professional advice and were reticent to seek advice.

805 In ASIC's submission to the Ripoll Inquiry, we publicly expressed serious concerns about commission payments and we said that these risked distorting the quality of advice provided to clients.

806 The Ripoll Inquiry considered a variety of issues associated with a number of corporate collapses, including Storm Financial and Opes Prime. In its report, the Inquiry stated a number of concerns about the financial advice industry and how it was regulated at the time, including about conflicts of interest and the standard of care required of financial advisers. Subsequently, a number of reforms were introduced to address these concerns. These are generally referred to as the Future of Financial Advice, or FOFA, reforms.

Overview of the FOFA reforms

807 The FOFA legislation was passed by Parliament on 25 June 2012 and commenced on 1 July 2012. For the first 12 months, compliance with the reforms was optional. Compliance has been mandatory from 1 July 2013. Two key FOFA reforms are:

(a) amendments to the conduct obligations for financial advisers; and

(b) a prospective ban on conflicted remuneration structures, including commission and volume-based payments.

Best interests and related obligations

808 Advisers who provide personal advice to retail clients are now subject to three new conduct obligations:

(a) an obligation to act in the best interests of their client in relation to the advice, subject to a 'safe harbour', specifying that the adviser will have met their legal obligations if they meet certain requirements;

(b) an obligation to give appropriate advice; and

(c) an obligation to give priority to the interests of clients when there is a conflict between the interests of the client and those of the adviser and various related parties, see: Div 2 of Pt 7.7A.

Note: Div 2 of Pt 7.7A also contains the obligation to give the incomplete advice warning: s961H

809 ASIC has provided guidance on meeting the best interests duty in Regulatory Guide 175 *Licensing: Financial product advisers—Conduct and disclosure* (RG 175).

Ban on conflicted remuneration

810 The FOFA reforms also implement a prospective ban on conflicted remuneration structures relating to the distribution of, and advice about, a range of retail investment products.

811 'Conflicted remuneration' is any benefit given to an AFS licensee, or its representative, that provides financial product advice to retail clients that, because of the nature of the benefit or the circumstances in which it is given, could reasonably be expected to influence:

(a) the choice of financial product recommended to clients by the AFS licensee or representative; or

(b) the financial product advice given to clients by the AFS licensee or representative (s963A).

812 There is a presumption that volume-based benefits—benefits that are wholly or partly dependent on the total number or value of financial products recommended by an AFS licensee or representative to clients, or acquired by clients to whom an AFS licensee or representative provides financial product advice—are conflicted remuneration: s963L.

813 The ban does not apply to some products and advice services. Appendix 1 of Regulatory Guide 246 *Conflicted remuneration* (RG 246) provides a detailed summary of benefits that are exempt from the ban on conflicted remuneration.

814 Additionally, the FOFA reforms allow a number of benefits to be 'grandfathered', so that the conflicted remuneration provisions do not apply

to them. Whether a benefit is grandfathered depends on who is giving the benefit. The effect of the grandfathering provisions is that the conflicted remuneration provisions do not apply in many situations—either to pre-existing arrangements with advisers or to benefits given through new arrangements before 1 July 2014.

Amendments to the FOFA reforms

815 The Government has announced various amendments to the FOFA legislation. To give effect to these amendments, the Government introduced the Corporations Amendment (Streamlining of Future of Financial Advice) Bill into Parliament on 19 March 2014. Regulations are also expected to be introduced shortly following further consultation.

J Consumer credit

Key points

Before ASIC took over the regulation of consumer credit on 1 July 2010, consumer credit was primarily regulated by the states and territories. These regulatory regimes were inconsistent and did not address developments in the credit industry.

ASIC had limited jurisdiction in relation to credit before 2010, but where possible took action on credit matters and monitored and reported on practices in the credit industry.

The current national regulatory regime for credit includes significantly enhanced protections for consumers. Many of the tools are examples of how a departure from disclosure-based regulation can be an effective means of addressing market problems.

History of consumer credit regulation in Australia

816 ASIC took over the regulation of consumer credit on 1 July 2010 under the National Credit Act. Before 1 July 2010, consumer credit was primarily regulated by the states and territories.

817 The Campbell Inquiry of 1981 noted the need for consistency in the regulation of credit. That inquiry's final report recommended a cooperative scheme be established to achieve uniformity in the regulation of consumer credit providers, with credit legislation applying to all institutional providers of consumer finance. This eventually occurred on a state level under the Uniform Consumer Credit Code (UCCC), which commenced operation on 1 November 1996.

818 The UCCC was developed before non-bank mortgage lending, securitisation and the use of mortgage brokers became common features of the home finance market. As a result, it did not address many of the issues arising from these developments and, most particularly, it did not regulate the intermediary and advice role played by mortgage brokers.

819 Some states implemented additional legislative requirements, but there was a great deal of inconsistency. For example, Western Australian legislation contained licensing requirements for finance brokers and credit providers, and New South Wales legislation covered finance broker contracts.

820 The UCCC commenced operation shortly after the Wallis Inquiry had been established. The Wallis Inquiry noted industry concern at the slow and inefficient review and amendment processes associated with the UCCC continuing areas of non-uniformity in regulation. However, the Wallis

Inquiry ultimately recommended that the regulatory arrangements should not be changed, in order to allow for a longer period on which to judge the effectiveness of the UCCC.

ASIC's role before national credit regulation

821 From March 2002, ASIC had a restricted regulatory role over credit under the ASIC Act. This role was limited in scope, with jurisdiction limited to administering broad standards of conduct, including prohibitions on:

(a) unconscionable conduct;

(b) misleading or deceptive conduct; and

(c) undue harassment and coercion.

822 This jurisdiction allowed us very little capacity to regulate and improve industry standards of conduct, either at a systemic level or in relation to specific cases. On the latter, for example, the courts have set a high bar for establishing that conduct is unconscionable, particularly for commercial transactions, meaning we had great difficulty bringing successful court action in credit matters at this time.

823 Nevertheless, while acknowledging the primary role of the states and territories in the regulation of consumer credit, we made strategic use of our limited jurisdiction. ASIC:

(a) sought to take court action where we could potentially achieve an impact beyond the individual case and provide a wider benefit for consumers or obtain improvements in industry conduct;

(b) provided guidance to industry in areas where practice was poor;

(c) developed resources, tools and information for consumers of credit (including financial literacy material on managing credit and loans and debt);

(d) undertook surveillances where we saw problems in the credit market in order to understand their causes and impacts; and

(e) published reports bringing the issues to public and government attention.

824 ASIC also worked with industry, consumer groups and the external dispute resolution schemes to improve practices and access to dispute resolution. This included work fostering:

(a) the development of a code of practice applicable to brokers and non-bank lenders;

(b) enhancements to the codes of practice of both the banking industry and the mutual sector;

(c) the ongoing development of the Financial Ombudsman Service (FOS); and

(d) the establishment and development of the Credit Ombudsman Service Limited (COSL), a dispute resolution scheme covering many brokers and non-bank lenders.

825 As a result of this work, we were able to identify significant problems in the credit industry and publicly express concerns about the practices involved and the effectiveness of the regulatory system in place at the time to address them.

826 Some of these problems particularly centred on the mortgage broking industry. In 2003, ASIC released Report 19 *A report to ASIC on the finance and mortgage broker industry* (REP 19). This report provided a comprehensive analysis of the role of brokers, presented evidence that standards needed to improve in the mortgage broking sector and identified options for reform. REP 19 found that consumers who used mortgage brokers could face problems that included poor advice (including no obligation to consider the borrower's capacity to repay any loan), conflicts of interest and inadequate disclosure of fees and commissions, and, in some cases, fraudulent practices in completing loan documentation.

827 The report concluded that 'the development of the broker industry has seen responsibility at the point of sale shift from the lender to brokers, who in practice are unaccountable'. As the law considered the broker to be the consumer's agent, the consumer generally had no recourse to the lender for the misconduct or poor advice of the broker.

828 Other problems ASIC identified during this period included:

(a) poor practices in the debt collection industry (Report 155 *Debt collection practices in Australia* (REP 155)—a joint report with the ACCC);

(b) risks in loans arranged by finance brokers on the fringe of the market (Report 119 *Protecting wealth in the family home: An examination of refinancing in response to mortgage stress* (REP 119));

(c) a need for improvement in relation to assisting borrowers in financial hardship (Report 152 *Helping home borrowers in financial hardship* (REP 152)); and

(d) a number of problems relating to the operation and sale of reverse mortgages (Report 59 Equity release products report (REP 59) and Report 109 *'All we have is this house': Consumer experiences with reverse mortgages* (REP 109)) and mortgage exit fees (Report 125 *Review of mortgage entry and exit fees* (REP 125)).

Subsequent reform of the credit industry

829 In 2008, the final report of the Productivity Commission's Review of Australia's Consumer Policy Framework was released. This report recommended that the Commonwealth take over responsibility for the regulation of credit. This was shortly followed by a Government green paper, *Financial services and credit reform: Improving, simplifying and standardising financial services and credit regulation*, and subsequently by legislation implementing the new national consumer credit framework, administered by ASIC as the single national regulator.

830 Central elements of the credit reforms include the introduction of a licensing regime that imposes minimum standards of conduct for credit industry participants and responsible lending obligations, which mandate that credit licensees must make inquiries into a consumer's objectives and financial situation and verify their financial situation.

831 Lenders must also comply with the National Credit Code, which largely mirrors the now-superseded UCCC, together with some key enhancements, including extended coverage (now encompassing lending to invest in residential property) and greater access to assistance for borrowers in financial difficulty.

832 Additionally, the credit reforms also included margin loans as a financial product subject to regulation under the Corporations Act.

833 The combination of the licensing framework and responsible lending obligations set out in the National Credit Act, and the obligations set out in the National Credit Code, provide a far more explicit regulatory framework on what credit providers and intermediaries (including finance brokers) must do before providing credit, as compared to the general prohibition on unconscionable conduct in the ASIC Act. These credit reforms have significantly increased the level of regulatory protection for borrowers and led to substantial improvements in industry practice.

834 Some types of credit are not regulated under the National Credit Act. For instance:

(a) the National Credit Act protections apply to consumers borrowing to invest in residential property, but not to consumers borrowing to invest in financial products or non-residential property. Consumers are not necessarily more likely to be able to repay a loan where its purpose is to secure financial products or non-residential property rather than residential property; and

(b) small businesses, which are protected as retail clients under the financial services regime, are not protected as consumers under the National Credit Act.

835 In early 2013, Treasury consulted on proposals for the regulation of investment lending, peer-to-peer lending, small business lending, short-term and indefinite-term leasing, and a number of anti-avoidance mechanisms. A final policy decision has not been made on these proposals.

Impact of the credit reforms

836 The credit reforms have gone a long way to addressing many of the issues that were prevalent throughout the credit industry before 2010.

837 The credit reforms have imposed minimum competency and honesty standards on credit providers, mortgage brokers and other industry participants. These standards apply consistently across all Australian jurisdictions and include a number of areas not adequately covered by previous state-based and territory-based regulation, such as mortgage brokers and loans to invest in real property.

838 Many of the obligations imposed by the National Credit Act are a departure from traditional disclosure-based regulation. Examples of different regulatory approaches that have been applied in the regulation of credit include:

(a) *The responsible lending obligations*, which go beyond disclosure requirements to limit the circumstances in which credit products can be recommended or provided—these obligations recognise that the trade-off between accessing credit today, and having fewer available funds in the future when repayment is due, may be difficult for consumers to readily appreciate, and that decision-making biases lead people to over-value immediate gratification relative to future needs. The experience under the state-based and territory-based regulatory regime was that many consumers took out unaffordable loans.

(b) *Prohibitions on unsolicited offers to increase credit limits*—it may be consumers' natural inclination to accept such offers, without necessarily being able to predict their future capacity to repay this additional credit. This means that such increases cannot be distributed directly to consumers without their prior consent.

(c) *Limits on fees that may be charged, particularly in relation to small-amount credit contracts*—the National Credit Act has a series of prescriptive rules about fees and interest charges that may be levied in relation to credit contracts of less than $2,000 with terms of less than two years. These specific obligations were imposed because of the particular risks that arise to consumers from the use of small amount credit contracts. In particular, there are risks that the repeated or continued use of credit provided through this form of credit results in consumers entering into multiple contracts where the overall level of indebtedness increases over time so that an increasing proportion of their income will need to be used to meet the repayments, and the capacity of the borrower to use the credit for purposes that can improve their standard of living is diminished.

839 We consider that the obligations imposed by the National Credit Act have been generally successful at addressing the regulatory gaps and market problems prevalent before 2010. These reforms provide an example of how regulatory tools that are not based purely on disclosure can address significant market problems.

K Managed investments and superannuation

Key points

This section provides an overview of developments in the managed funds sector—that is, managed investment schemes (including investment platforms) and superannuation (including self-managed superannuation funds (SMSFs)).

While these two areas operate in distinct regulatory regimes, there are clear levels of functional equivalence between them—namely, that both a managed investment scheme and a superannuation fund are a structure through which a client can access investment management.

Managed funds sector in Australia

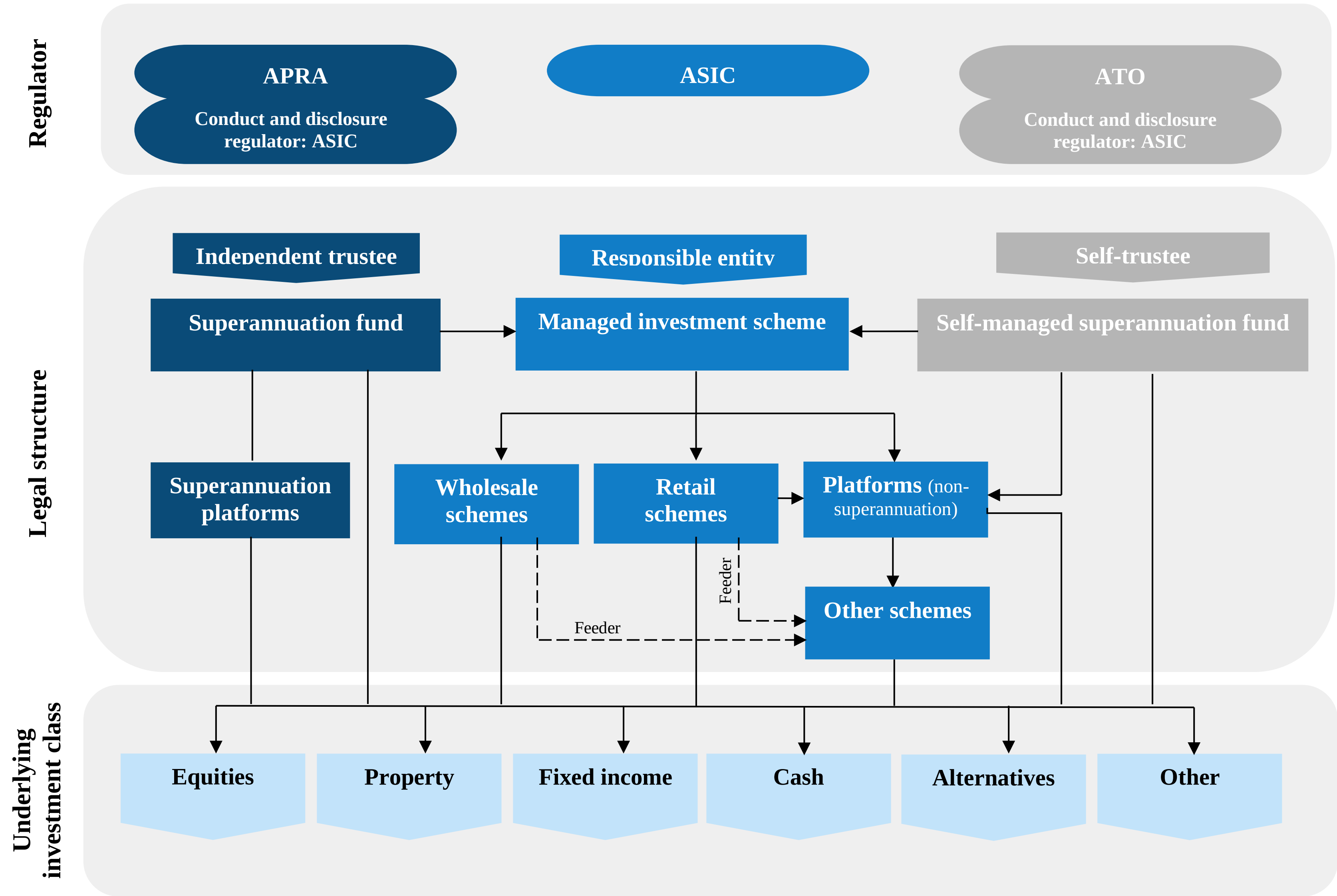
840 The managed funds sector has become an increasingly important part of Australia's financial system and broader economy. Interim statistics from APRA for the December 2013 quarter indicate that total unconsolidated assets held by managed funds institutions amounted to $2.3 trillion, including $1.8 trillion from superannuation funds.[123] Underpinned by a compulsory, government-mandated superannuation scheme, Australia's managed funds sector is rapidly becoming one of the largest and fastest growing in the world. Superannuation funds, life insurance offices and retail investors (investing via unit trusts and cash management accounts) account for the main sources of funds flowing to investment management.

841 This section reviews developments in the managed funds sector—that is, in managed investment schemes (including investment platforms) and superannuation (including self-managed superannuation funds (SMSFs)).[124] Despite these different types of funds operating in multiple regulatory frameworks, it is important to highlight that the managed funds sector has developed over time into a highly integrated system. Figure 9 provides an illustration of the interdependence of the managed funds sector.

Note: The managed funds sector has developed a range of investment vehicles that provide investors with the opportunity to build an investment portfolio. They are typically known as 'platforms' or 'wraps' and are more formally referred to as 'investor-directed portfolio services' (IDPSs) and 'IDPS-like schemes'.

[123] Australian Bureau of Statistics, *Managed funds*, Cat. No. 5655.0, 27 February 2014, www.abs.gov.au/ausstats/abs@.nsf/mf/5655.0.
[124] For the purpose of this section, the following are excluded from consideration: timeshare schemes, investment-linked insurance and investment companies.

Figure 9: Investment flows between superannuation, managed investment schemes and self-managed superannuation funds



842 While there is a degree of functional equivalence between various forms of funds management, superannuation—and compulsory superannuation, in particular—remains a central driver. During the global financial crisis, when discretionary contractual savings largely dried up, compulsory superannuation contributions continued to flow into the funds management sector, allowing funds to rebalance portfolios without discharging assets. Compulsory superannuation effectively acted as a portfolio stabiliser.

843 Because of its compulsory nature, superannuation requires a unique regulatory environment, unlike other parts of the managed funds sector. With a guaranteed superannuation system, governments have acknowledged that a high degree of regulatory intervention is warranted to promote Australians actively saving for and funding their own retirement.

844 While there is a higher regulatory standard within the superannuation regulatory framework (as outlined in more detail in Appendix 3), superannuation funds invest heavily in the comparatively less intensively regulated managed investment scheme regime as underlying funds. ABS data indicates that, at the time of the Wallis Inquiry, $65.6 billion (24% of total superannuation assets) was held in shares, while $31.2 billion (11% of total assets) was held in unit trusts. By December 2013, the amount of assets held in shares had increased to $486.6 billion (or 29% of total superannuation assets), while the assets held in unit trusts had increased to $205.3 billion (or 12% of total assets).[125] Superannuation funds often invest in wholesale funds, which have reduced obligations under the Corporations Act compared to operators of funds offered to retail investors.

> Note: See paragraphs 849–851 for an overview of the current legislative framework for managed investments.

845 At the same time, an increasing amount of superannuation is invested via platforms. Such platforms accommodate both superannuation and non-superannuation funds, notwithstanding that the former are regulated by APRA under the *Superannuation Industry (Supervision) Act 1993* (SIS Act) and involve both compulsory and discretionary savings, whereas the latter are regulated by ASIC under the Corporations Act[126] and involve discretionary savings. SMSFs also invest in managed investment schemes and are approximately a third of investments into the platforms sector.[127]

> Note 1: Many industry funds have developed direct share investment options, which has meant that a number of the large industry funds appear functionally very similar to the platform sector.

[125] Australian Bureau of Statistics, *Managed funds*, Cat. No. 5655.0, 27 February 2014, www.abs.gov.au/ausstats/abs@.nsf/mf/5655.0.

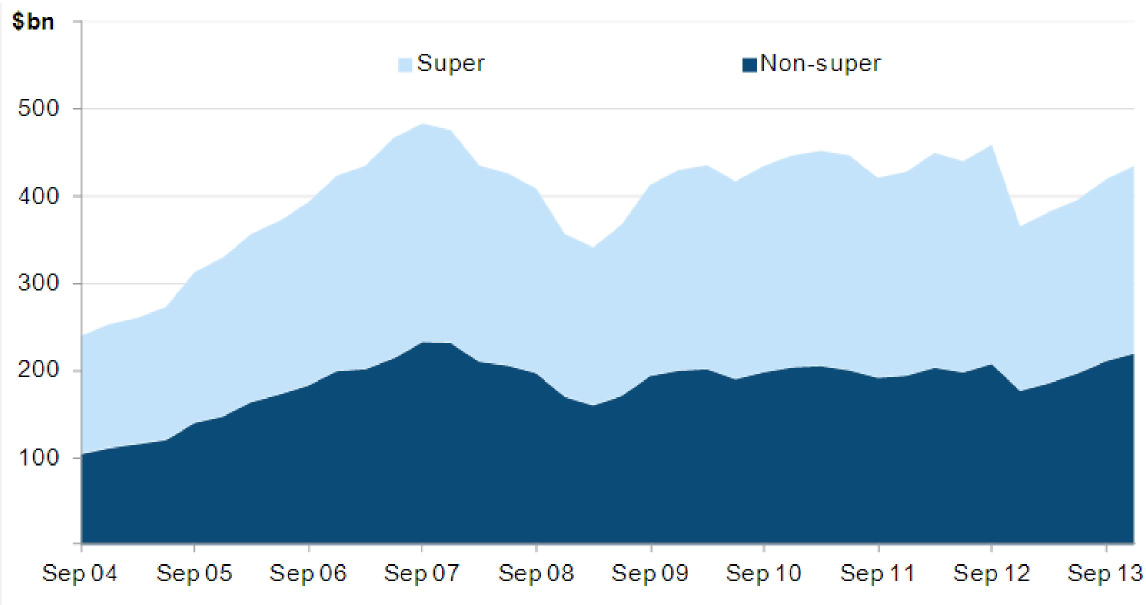
[126] As modified and amended by the class orders outlined in Regulatory Guide 148 *Platforms that are managed investment schemes* (RG 148).

[127] ASIC recently reviewed the SMSF activities of 14 platforms and approximately one-third of inflows into these platforms came from this sector.

Note 2: Table 31 in Appendix 3 sets out a comparison between the regulatory regimes for managed investment schemes and superannuation.

846 In relation to the platform and wrap sector, since September 2004, total funds under administration almost doubled from $239 billion to $434 billion in September 2013—and is more or less split evenly between superannuation and non-superannuation funds. The fall in funds under administration in 2008 can be mostly attributed to the global financial crisis: see Figure 10–Figure 11.

Figure 10: Total growth in funds under administration of the platforms sector (to 30 September 2013)*



Note: Superannuation includes superannuation wraps and superannuation master trusts, while non-superannuation includes allocated pension master trusts, investment master trusts, investment wraps, pension master trusts, pension wraps and term allocated pension master trusts.

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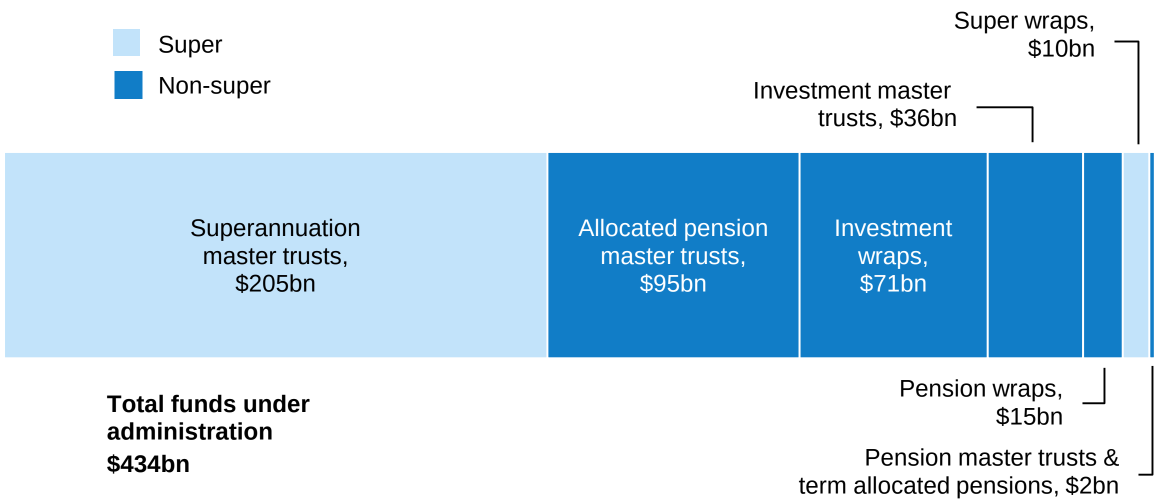
Figure 11: Breakdown of superannuation and non-superannuation funds by product type (as at 30 September 2013)*



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Managed investment schemes

847 ‘Investment funds’, ‘managed funds’ or ‘collective investments’ are generally referred to in Australia as ‘managed investment schemes’. This is a broadly defined term under the Corporations Act encompassing most arrangements (regardless of their legal form) involving passive investors contributing money or money’s worth to be pooled, or used in a common enterprise, to produce a financial or property-related benefit to the contributor.

Note: Most superannuation funds have been excluded from this definition and are instead regulated by APRA and the Australian Taxation Office (ATO) under the SIS Act. Other entities excluded from the managed investment scheme definition include a body corporate and statutory funds maintained under the *Life Insurance Act 1995*. Managed investment schemes are typically structured as unit trusts due to this type of vehicle’s tax-efficient nature. They allow an investor to gain broad exposure to a variety of investments (e.g. equities, property and fixed income) and can potentially be a more convenient and cost-effective way to own a diversified investment portfolio—compared, for example, with buying a diversified portfolio of shares directly.

848 Popular managed investment schemes include:

(a) cash management trusts;

(b) property trusts;

(c) Australian equity (share) trusts;

(d) many agricultural schemes (e.g. horticulture, aquaculture, commercial and horse breeding);

(e) international equity trusts;

(f) film schemes;

(g) timeshare schemes; and

(h) mortgage schemes.

Legislative framework: Managed investment schemes

Current legislative framework

849 The primary regulation governing managed investment schemes is contained within Chs 5C and 7 of the Corporations Act, supplemented by policies and guidance released by ASIC: see Appendix 3. While the legislation does not distinguish between types of managed investment schemes (e.g. equity funds, property trusts and mortgage schemes), ASIC has issued specific regulatory guides and class orders to provide added guidance and flexibility to ensure effective regulation of the broad classes of products available.

850 ASIC registers managed investment schemes with more than 20 members and issues AFS licences to responsible entities. Registered managed investment schemes have increased obligations under the Corporations Act, including that they be operated by a single public company called a responsible entity: see Appendix 3.

851 ASIC is also responsible for, among other things:

(a) overseeing the disclosure regime for managed investment schemes. Interests in a registered scheme must generally be offered to retail investors through a complying PDS. ASIC may examine PDSs in the market on a risk-assessed basis and may require corrective disclosure or issue a stop order for defective disclosure; and

(b) conducting surveillance activities and taking enforcement action, where appropriate.

Legislative framework: Reviews and inquiries

852 The legislative framework for managed investments has undergone numerous reviews and inquiries, including:

(a) a review of the *Managed Investments Act 1998*, commissioned by the Government in 2001;

(b) the 2009 Ripoll Inquiry, which covered managed investment schemes among other matters;

(c) the 2009 Parliamentary Joint Committee inquiry into agribusiness managed investment schemes;

(d) the 2011–12 Parliamentary Joint Committee inquiry into the collapse of Trio Capital; and

(e) the Corporations and Markets Advisory Committee (CAMAC) 2012 report, *Managed investment schemes*.

Note: CAMAC released a second discussion paper, *The establishment and operation of managed investment schemes*, in March 2014. The key principle underlying CAMAC's views within the discussion paper is that the regulatory regime for managed investment schemes should be aligned with that for companies, unless there are compelling reasons for treating schemes differently.

853 Notwithstanding these reviews and a significant amount of work in developing potential refinements, the legislative framework has remained largely the same.

Global financial crisis: Impact on managed investments

854 The global financial crisis and tightening of available credit exposed the weaknesses of those funds with highly leveraged investment or funding structures and weak business models, ultimately resulting in a number of high-profile failures. These funds were predominantly mortgage funds, unlisted property schemes, agribusiness schemes, and other complex schemes that were highly leveraged in structure (e.g. in property, financial asset or infrastructure projects).

Frozen funds

855 The term 'frozen fund' refers to a registered managed investment scheme that was originally marketed on the basis that investors had an ongoing or periodic right to redeem their investments on request, but where that right has subsequently been suspended by the responsible entity.

856 Throughout the global financial crisis, most open-ended Australian managed investment schemes (e.g. cash, money market, equities and balanced funds) were not frozen and continued to offer redemption facilities. However, various types of funds suspended redemptions during this period, including a significant number of open-ended pooled mortgage schemes, and a smaller number of open-ended real property schemes, enhanced cash schemes and retail hedge funds. This followed, among other things, a substantial increase in the number of redemption requests, received in circumstances where the responsible entity could not realise sufficient assets to satisfy the requests within the time set out in the scheme's constitution for redemption payments.

857 By November 2009, there were 87 frozen funds with estimated total funds under management of $25.4 billion.

858 Responsible entities are required by law to freeze payments if the scheme ceases to be 'liquid'. Under the Corporations Act, a scheme is liquid if at least 80% of its assets comprise cash, bills, marketable securities or other property that the responsible entity reasonably considers able to be realised for its market value within the period provided for in the scheme's constitution for satisfying withdrawal requests. Once a fund is frozen, a responsible entity cannot make any exceptions to the blanket freeze on redemptions. It may, however, make a withdrawal offer in accordance with the Corporations Act if it is in the best interests of members to do so.

859 Such a freeze on payments can prevent assets from being sold off too cheaply in order to meet requests for repayments, and therefore helps to ensure that all scheme members are treated fairly and that their capital is protected. This does not necessarily mean that members will not receive their money back, or that distributions will cease. The length of time that it will take to have all capital returned to members seeking it will vary significantly from scheme to scheme.

860 Following the freezes in 2008, ASIC made an urgent modification of the Corporations Act to allow responsible entities to return some capital to certain members in exceptional circumstances. This is known as 'hardship relief', with responsible entities needing to apply to ASIC to rely on this relief.

861 The terms of the hardship relief modification allow responsible entities to accept partial redemption applications from members who, for example, were unable to meet reasonable and immediate family living expenses or who were experiencing circumstances warranting compassion, including medical costs for serious illness, funeral expenses or to prevent foreclosure.

Note: See Media Release (MR 08-214) *ASIC facilitates withdrawals from frozen funds* (31 October 2008) and Media Release (MR 09-148) *ASIC expands relief for hardship withdrawals from frozen mortgage funds* (17 August 2009).

Agribusiness schemes

862 'Agribusiness scheme' is a term used to describe primary production agricultural managed investment schemes where investors' money (or money's worth, such as land) is either pooled, or contributed towards a common enterprise. Typically, such agribusiness schemes are formed under the latter 'common enterprise' structure, where members' contributions are used towards a common enterprise, without those contributions being pooled together under the scheme (except on harvest, where the harvest is typically pooled for marketing).

863 The risks of investing in various types of agribusiness schemes were highlighted during 2009 and 2010 with the collapse of several operators of large agribusiness schemes, causing significant losses to investors. These

failed schemes included Environinvest Limited, Timbercorp Securities Limited, Great Southern Managers Australia Limited, FEA Plantations Limited, Rewards Project Limited and Willmott Forests Limited.

864 Since these collapses, ASIC has been working to ensure that the interests of retail investors in failed managed investment schemes are preserved, notwithstanding difficult commercial situations. Alongside this work, and following consultation with industry, ASIC released further regulatory guidance with new disclosure benchmarks and principles for agribusiness managed investment schemes to improve investor awareness of the risks associated with these products.

Note: See Regulatory Guide 232 *Agribusiness managed investment schemes: Improving disclosure for retail investors* (RG 232).

865 These benchmarks are designed to assist retail investors and their advisers to make informed investment decisions. The benchmark disclosure regime highlights key risks of agribusiness scheme investments and requires prominent and clear disclosure about how a responsible entity proposes to manage those risks. It is intended that the benchmarks will illuminate the positive and negative aspects of commercial structures chosen by agribusiness scheme operators when they offer investments to retail investors.

Key development: Outsourcing

866 It is common practice for fund operators such as responsible entities and RSEs to outsource certain functions (e.g. custody, investment management, investment administration, and fund administration services) to specialist firms.

867 Custodians, investment administrators and fund administrators have a systemically important role: together, they are responsible for the operational administration of wholesale and retail superannuation and non-superannuation investment money. Given the size of the managed funds sector, there are a relatively small number of administrators and custodians acting for both superannuation and non-superannuation funds and providing the vast bulk of these services (although vertically integrated wealth management investment platforms are more likely to use an in-house administrator).

868 The PJC inquiry into the collapse of Trio Capital highlighted that there may be a gap between what custodians, in particular, do and what community expectations are of their role. In particular, the inquiry argued for the need for more direct oversight of funds administrators and fund custodians. In response, ASIC reissued Regulatory Guide *133 Managed investments and custodial or depository services: Holding assets* (RG 133), which:

(a) sets out the minimum standards that apply to asset holders, including responsible entities of registered schemes, licensed custodians, platform operators and managed discretionary account operators;

(b) explains requirements relating to the content of agreements with asset holders; and

(c) details the requirement for primary production scheme responsible entities to safeguard the land on which the scheme operates.

Superannuation

869 Superannuation has existed in various forms for over a century in Australia, with institutionalised superannuation having its origins in the mid-1980s when the Conciliation and Arbitration Commission agreed to approve industrial agreements that would provide for contributions of up to 3% to approved superannuation funds. Superannuation coverage increased from around 40% to nearly 80% of employees in the four years following this decision.[128]

870 In 1992–93, the Government introduced superannuation guarantee changes that required employers to make contributions of 3% for their employees. Over time, the superannuation guarantee amount has increased to its current rate of 9.25%.

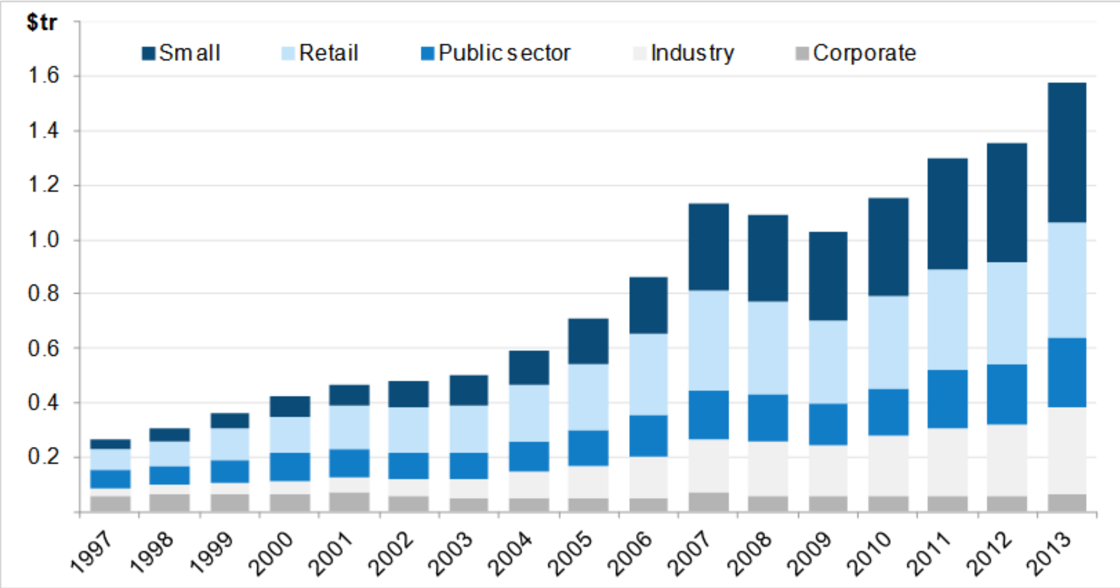
871 Largely due to its compulsory nature, superannuation has grown significantly over this period. According to APRA statistics, superannuation assets in June 1997 totalled $321 billion (at 58% GDP) and in June 2013 they were $1.62 trillion (at 106% GDP), with SMSFs experiencing the highest growth at around 1300% since 1997. More recent interim statistics from APRA for the December 2013 quarter indicate that superannuation assets totalled $1.8 trillion. This represents a 19.8% increase in total superannuation assets. Over the December quarter alone, the growth in superannuation assets increased by 3.3%.[129]

872 Figure 12 illustrates the growth in assets held by each superannuation sector, including SMSFs.

[128] APRA ‘A recent history of superannuation in Australia’, *Insight*, Issue 2, 2007, www.apra.gov.au/Insight/Pages/APRA-Insight-Issue-2-2007.aspx

[129] APRA, *Annual Superannuation Bulletin June 2012*, statistics, revised 5 February 2014, www.apra.gov.au/Super/Publications/Documents/Revised%202012%20Annual%20Superannuation%20Bulletin%2005-02-14.pdf; APRA, *Annual Superannuation Bulletin June 2013*, statistics, 5 February 2014, www.apra.gov.au/Super/Publications/Pages/annual-superannuation-publication.aspx.

Figure 12: Total superannuation assets held by superannuation funds



Source: APRA, *Annual Super Bulletin*, 5 February 2014, Table 9.

Note: The APRA classification 'Small' is made up nearly entirely of SMSFs, with the exception of a few small APRA-regulated funds.

Reforms

Portability of benefits

873 Portability of benefits was introduced from 1 July 2004 and allows members with accumulation benefits to request their benefits to be transferred to another superannuation fund.

Choice of funds reforms

874 Choice of fund reforms were introduced in July 2005, and allow most employed persons to nominate the fund into which their superannuation guarantee contributions are paid by their employer. Coupled with the choice of fund reforms, portability opened the door to increased competition in the industry. Prior to these reforms, competition for membership and funds under management focused on employers, as they were the main decision makers in relation to which fund their employees used. Portability and choice have shifted the focus to individual members. This type of competition has led to innovation and better services to members as trustees have attempted to differentiate their product offering in a crowded market.

875 These changes also made it possible for members with multiple accounts to more easily consolidate these accounts and reduce the amount of fees they pay for maintaining multiple accounts. However, in practice, this consolidation did not lead to a decrease in the number of accounts in the industry. The number of accounts continued to grow to more than 30

million, even though the number of employed persons in Australia is roughly 40% of this number.[130] This means that for every employed person there are approximately 2.5 accounts. A large number of these accounts are small, unclaimed or lost and some are for retirees receiving superannuation in the form of a pension.

Stronger Super reforms

876 Stronger Super reforms were introduced in response to the 2010 review into the governance, efficiency, structure and operation of Australia's superannuation system (Super System Review). Since 2011, numerous legislative acts and associated regulations have been progressively introduced to implement the Stronger Super reforms to:

(a) create a new, simple, low-cost default superannuation product (called 'MySuper') to improve the simplicity, transparency and comparability of default superannuation products. MySuper has a number of features designed solely with the interests of members in mind, including increased trustee obligations;

(b) make the processing of everyday transactions easier, cheaper and faster through the 'SuperStream' package of measures; and

(c) strengthen the governance, integrity and regulatory settings of the superannuation system, including particular focus on SMSFs. This includes establishing a register of SMSF auditors. It also includes enhancements to the disclosure and reporting requirements for superannuation.

Drivers of change

SIS Act

877 The SIS Act (enacted in 1993), established the current framework for superannuation. The genesis of the SIS Act regime for superannuation was very similar to that of the managed investment scheme regime.

Greater member engagement

878 Average balances have increased significantly since the commencement of compulsory superannuation in the mid-1990s. It is also the case now that superannuation is considered to be a normal benefit received as part of being employed, with most people exposed to the superannuation sector within their working lives. These trends have led to increasing member engagement, although member engagement has traditionally been lower where contributions are compulsory.

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[130] APRA, *Annual Superannuation Bulletin June 2013*, statistics, 5 February 2014, www.apra.gov.au/Super/Publications/Pages/annual-superannuation-publication.aspx.

SMSFs

879 Many members have felt a greater need for control of their superannuation as their balance grew and their satisfaction with their APRA-regulated fund's performance and/or services decreased. This made SMSFs a more attractive alternative and, coupled with the empowerment that choice of fund and portability have brought, many members have opted to set up their own SMSF, perhaps with the assistance of an adviser, to manage their own superannuation.

Closure of defined benefit and corporate funds

880 In addition to the regulatory drivers behind consolidation, many employers no longer considered it appropriate to operate their own corporate fund for their staff's superannuation. Operating a corporate fund—in particular, a corporate defined benefit fund,—became less desirable because it increased unnecessarily the risk to employers' balance sheets because the liability of the employer to the superannuation fund is in part determined on the level of investment return achieved by the fund.

Ageing of the population

881 The proportion of Australians aged over 60 has increased since 1997 from 15.9% of the total population to 19.8% of the total population in 2013.[131] This change is also reflected in superannuation membership. In June 2005, 6.5% of superannuation fund members were aged over 60; this had risen to 11% of superannuation members in June 2013. By 2040, the ABS forecasts that the proportion of Australians over 60 will reach 25%.[132] In June 2005, superannuation members aged over 60 held 23.2% of vested benefits.[133] This had increased to 33.4% of vested benefits at June 2013.[134]

Consolidation of funds

882 The number of funds in the superannuation system (other than SMSFs) has been reducing steadily since the Wallis Inquiry (particularly corporate funds), with a strong focus on industry consolidation: see Table 27. The reasons for this consolidation in industry are varied and include the costs and efforts associated with regulatory reform as well as the offering by government of tax incentives to undertake successor fund transfers. Further, new requirements in Stronger Super for default superannuation products (MySuper) to consider scale will have an impact in the future. Over time, as performance and fee data

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131 ABS, *3101.0 Australian Demographic Statistics, June 2013*, 17 December 2013, www.abs.gov.au/ausstats/abs@.nsf/mf/3101.0.
132 ABS, *3222.0 Population Projections, Australia 2012*, 26 November 2013, www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/3222.02012%20(base)%20to%202101?OpenDocument.
133 APRA, *Insight*, Issue 1, 2013, www.apra.gov.au/Insight/Pages/APRA-Insight-Issue-1-2013.aspx
134 APRA, *Annual Superannuation Bulletin June 2013*, statistics, 5 February 2014, www.apra.gov.au/Super/Publications/Pages/annual-superannuation-publication.aspx.

is published by APRA, non-performing and/or high-cost funds should start to exit the market.

Table 27: Number of funds by type to 30 June 2013

	June 1997	June 2013	Percentage change (%)
Small*	149,971	512,375	241.6
Retail	353	127	–64.0
Corporate	4,106	108	–97.4
Pooled superannuation trusts	192	61	–68.2
Industry	176	52	–70.5
Public sector	77	38	–50.6
Total	**154,875**	**512,761**	**—**

Source: APRA, *Annual superannuation bulletin*, 5 February 2014, Table 1, www.apra.gov.au/Super/Publications/Pages/annual-superannuation-publication.aspx.

* APRA classification 'small' is made up nearly entirely of SMSFs, with the exception of a few small APRA-regulated funds.

Asset allocation

883 In terms of investments made by the superannuation industry, the asset allocation of APRA-regulated superannuation (which excludes SMSFs) tends to be focused on Australian and international shares, particularly for the default option of superannuation funds: see Table 28.

Table 28: Asset allocation of APRA-regulated funds

Asset	June 2004 (%)	June 2013 (%)
Australian shares	31.0	26.5
International shares	22.8	24.9
Other assets	12.7	16.5
Australian fixed interest	12.1	8.5
Cash	7.9	8.2
Unlisted property	4.6	7.2
International fixed interest	5.7	5.9
Listed property	3.3	2.3
Total	**100.0**	**100.0**

Source: APRA, 'Asset allocation of default investment strategy', *Insight: Celebrating 10 years of superannuation data collection 1996–2006*, Issue 2, 2007, Table 14 (2004 data), www.apra.gov.au/Insight/Documents/Insight_2_2007_web.pdf, APRA, 'Asset allocation of default investment strategy', Annual superannuation bulletin, 5 February 2014, Table 18 (2013 data), www.apra.gov.au/Super/Publications/Pages/annual-superannuation-publication.aspx.

Note: Asset allocation figures only include those in the default strategy of the funds.

884 Superannuation funds are often invested in shares and managed investment schemes, which are regulated by ASIC. ABS data indicates that in September 1997, $65.6 billion (24% of total superannuation assets) was held in shares, while $31.2 billion (11% of total assets) was held in unit trusts. By December 2013, the amount of assets held in shares had increased to $486.6 billion (or 29% of total superannuation assets), while the assets held in unit trusts had increased to $205.3 billion (or 12% of total assets).

885 Further, approximately 30 superannuation providers also offer managed investment schemes (these are dual regulated entities), whereas others are part of a conglomerate group that offer both superannuation and managed investment (and other) products.

886 In addition, IDPSs, IDPS-like schemes, and superannuation platforms that allow members to select their own investments are all very similar investment vehicles and often offer the same underlying investment options (such as direct equities, managed investments). The primary difference from an investor perspective is the additional restrictions that exist in relation to superannuation and the use that can be made of superannuation money, along with the concessional tax environment. However, investors are generally exposed to the same market risk by investing under either structure.

Regulatory framework

887 APRA's registrable superannuation entity (RSE) licensing commenced from 1 July 2006, a transition that required all trustees of APRA-regulated funds to obtain an RSE licence and register their fund with APRA. This licensing regime improved the governance and risk management practices of the industry.

888 In ASIC's regulatory experience, the introduction of the licensing regime not only improved the governance and risk management practices of the industry, it also resulted in greater sophistication in the industry and an increased use of outsourced service providers with speciality skills and the ability to harness scales of efficiency. It also appears to have led to a large number of funds winding up or merging as their trustees opted not to obtain an RSE licence.

889 APRA's prudential regulation of the superannuation industry is not the same as its regulation of the banking and insurance sector. For example, superannuation is not subject to the Basel II (or III) requirements.

> Note: Developed by the Basel Committee on Banking Supervision, the Basel Accords (I, II, III) outline frameworks designed to improve the regulation, supervision and risk management within the banking sector. These range from introducing minimum capital requirements, supervisory review processes and market discipline (Basel II) to improving the banking sector's ability to absorb financial and economic stress, improve risk management and strengthen transparency (Basel III).

890 Public offer superannuation fund trustees (i.e. trustees of funds that are generally open to members, rather than only being available for certain groups, such as employees of a single employer) are required to hold an AFS licence. Similarly, trustees who provide other financial services (most commonly, this would be advice related) are also required to hold an AFS licence with ASIC. Recent ASIC figures suggest that, of the current APRA-regulated trustees:

(a) 120 trustees hold an AFS licence;

(b) three trustees have ceased their AFS licence; and

(c) 55 trustees never held an AFS licence with ASIC.

891 Where a trustee holds an AFS licence, ASIC monitors compliance with the AFS licensee obligations: s912A of the Corporations Act. These include competency requirements, and the requirement to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly. The AFS licensee conditions in relation to adequacy of resources and risk management do not apply where the trustee is also APRA regulated.

> Note: From 1 July 2015, dual-regulated entities (i.e. entities that are both superannuation trustees and responsible entities of managed investment schemes) will need to meet AFS licensee obligations in relation to risk management and financial resources, in addition to similar obligations administered by APRA.

892 However, regardless of whether or not a trustee is an AFS licensee, ASIC regulates the disclosure trustees provide to fund members. This includes point-of-sale disclosure (i.e. PDSs) as well as advertising, and ongoing disclosure obligations (such as significant event notices and periodic statements).

893 Disclosure requirements have been significantly expanded as a result of the Stronger Super reforms. This includes improvements in consumer-focused disclosure (such as the new product dashboard requirements for MySuper products from 31 December 2013) but also includes the systemic transparency requirements in s29QB of the SIS Act, which requires disclosure of executive officer remuneration and other key information on a fund website. Further, s29QC requires that if a trustee provides information calculated in a particular way to APRA under a reporting standard and the trustee provides the same or equivalent information to another person, including on a website, then the trustee must ensure that this information is calculated in the same way as the information given to APRA.

Note: The product dashboard is intended to provide members with key information about the product in relation to five separate measures detailed in s1017BA of the Corporations Act—the return target, the returns for previous financial years, a comparison between the return target and the returns for previous financial years, the level of investment risk, and a statement of fees and other costs.

894 Similarly, Stronger Super has significantly increased APRA's regulatory powers, particularly its ability to make standards for the industry, including data standards that will later be used for disclosure purposes under ASIC's oversight. APRA is also responsible for authorising MySuper trustees and monitoring their compliance with the additional trustee obligations that apply to MySuper.

895 There are other key gatekeepers that are common across both the superannuation and managed investments industries. These include custodians, actuaries, asset consultants and administrators. In some cases, APRA regulates these third parties through its supervision of trustee outsourcing arrangements (such as administrators). ASIC may also regulate these third parties through the AFS licensing regime, depending on what type of financial services these third parties offer.

Self-managed superannuation funds

896 Since the 1997 Wallis Inquiry, there has been an unprecedented growth in the number of SMSFs, at the same time as there has been consolidation in the number of non-SMSF funds.

Note: In September 2000 there were 187,000 SMSFs registered with the ATO, representing a relatively small part of the overall superannuation sector. In the intervening years, SMSFs have surged in popularity and, as at 30 June 2013, there are now 509,000 SMSFs holding $506 billion in assets. This represents an increase in assets of nearly 550% since June 2001, at which time total SMSF assets were $78 billion.

897 The regulatory structure for SMSFs is slightly less onerous than that of other managed funds discussed in this chapter, because it is predicated on the fund member(s) being the fund's trustees—giving them significant flexibility and control over the management and running of the fund.

898 SMSFs are primarily regulated by the ATO, rather than either APRA or ASIC. ASIC's involvement in SMSFs has tended to focus more on the gatekeepers, particularly advisers recommending the establishment and/or appropriate investments for SMSFs. ASIC recently conducted a review of advice provided by financial advisers and accountants on setting up SMSFs: see Report 337 *SMSFs: Improving the quality of advice given to investors* (REP 337).

899 ASIC also has responsibility for registering 'approved SMSF auditors', setting competency standards and imposing any necessary administrative outcomes. These reforms have been implemented to improve the quality of auditing standards, and serve to increase trustee confidence in the SMSF industry.

Note: While ASIC is now responsible for SMSF auditor registration, the ATO will continue to monitor auditor conduct, but may refer a matter to ASIC to consider taking enforcement action if necessary.

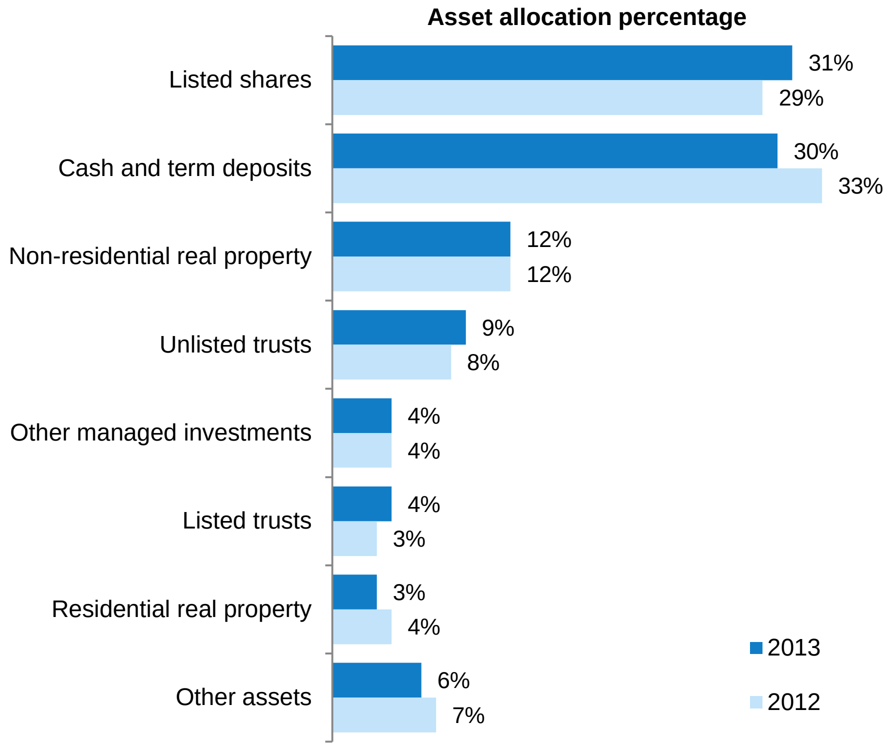
900 Given the increasing commoditisation of SMSFs, an important question concerns the appropriateness of SMSFs for some super fund members with less investment experience, fewer investable funds, and less time to manage their superannuation. Inexperienced investors may not fully understand their trustee duties and obligations, including reporting obligations to the ATO. There are administrative and civil penalties for failing to lodge documentation, and funds that breach ATO requirements risk losing their status as a complying fund and the taxation concession granted to superannuation funds.

901 The collapse of the Trio Capital group further highlighted that SMSFs do not have the same access to compensation as APRA-regulated funds in the event of loss or fraud. In this case involving the collapse of a group of related funds, investors investing through APRA-regulated funds were able to obtain some compensation available under the SIS Act, but those investing through SMSFs were not because the SIS Act compensation regime does not extend to SMSFs. SMSFs are a higher risk area for mis-selling of investments—particularly direct property and property schemes: see the box below paragraph 917 for further discussion.

902 As with other types of superannuation funds in Australia, SMSFs have exposure to direct equities and a more limited exposure to managed funds,

although we estimate that roughly a third of all funds in platforms originates from an SMSF. The asset breakdown of SMSFs is outlined in Figure 13.

Figure 13: Growth in SMSFs (by total assets and number)



Source: ATO, *Self-managed super funds statistical report*, June 2013, www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Super-statistics/SMSF/Self-managed-super-fund-statistical-report---June-2013/?page=2#Population_and_asset_allocation_tables.

Key themes: Managed investment schemes and superannuation

903 The financial services industry, including superannuation and managed investments (and associated gatekeepers), has evolved significantly since the Wallis Inquiry. As a result of this evolution, there are key issues and themes that warrant further consideration in any decisions made in the future of the financial services industry. Some of these themes are outlined in further detail below.

Functional convergence

Common technological infrastructure

904 Developments in technology and improved network-based facilities have enabled greater cross-distribution of financial products between various distribution channels. In the managed funds sector, this will often mean that both superannuation and non-superannuation products are offered from the same underlying investment and administration infrastructure. These

systems provide support in generating member reports, as well as providing access to similar underlying investments to the investor.

905 Superannuation contributions are often invested in parallel with discretionary investments, but are nonetheless subject to quite different regulatory regimes with different levels of oversight. From a consumer perspective, the difference is primarily in the gateway and interface that gives access to the products. For example, superannuation funds will still have restrictions on access to benefits, and retain concessional taxation treatment.

Common gatekeepers and advisers

906 As superannuation funds continue to invest increasing amounts into managed investment schemes, superannuation trustees and responsible entities have tended to use similar gatekeepers to assist in the operations of their schemes and funds. These include custodians, actuaries, asset consultants, auditors and administrators.

907 Superannuation funds and managed investment schemes may further be distributed by the same advisers and dealer groups, and distributed on the same investment platforms.

908 The roles of these gatekeeper entities is currently impacted by the regulation of both APRA and ASIC. In some cases, APRA regulates these third parties through its supervision of trustee outsourcing arrangements (such as administrators). ASIC may also regulate these third parties through the AFS licensing regime, depending on what type of financial services these third parties offer.

Convergence between superannuation fund types

909 A noticeable trend has been the increasing similarities in services offered by retail, industry and public sector super funds. Industry and public sector funds are increasingly offering more investment options, financial planning, and individual insurance arrangements, while retail funds have started to develop simple cost-effective superannuation products to compete against industry funds. We have also seen retail funds and industry funds expand the direct share options and managed investment scheme options that the member can select themselves, which is similar to the investment choice available within an SMSF.

Increasing similarities between managed investment schemes and superannuation

910 As the superannuation and the broader managed investment industries have evolved, the differences in the manner in which they operate have reduced.

911 Both managed investment schemes and superannuation funds are required to have a third party trustee (except for SMSFs). Generally, this means that, even with the limited member direction available in some products, a third party is managing a member's money on their behalf.

912 As the two regulatory regimes have evolved, both superannuation funds and managed investment schemes now work within a strict statutory framework that prescribes how the trustee or responsible should behave, including requiring licensing and/or registration of both the trustee and the investment vehicle (whether superannuation fund or managed investment scheme, including through the application of the AFS licensing regime). This enables basic checks to be undertaken about the fitness or otherwise of the trustee and its personnel to manage money on behalf of others.

913 Additionally, both managed investments and superannuation have (different) financial resource requirements imposed on them and are required to lodge notifications with respective regulators where significant breaches occur, and are both subject to broadly the same disclosure regime.

Note: See Appendix 3 for further information about the regulation of both superannuation and managed investments in Australia.

Key differences

914 Some features remain distinctive despite the trend to functional convergence.

Superannuation is compulsory

915 Superannuation has some particular features that clearly distinguish it from the rest of the managed investments sector. The compulsory nature of the superannuation guarantee provides a rationale for a range of specific consumer protection measures beyond those provided under the managed funds or SMSF regimes. This includes:

(a) superannuation contributions (including voluntary contributions) receiving concessional taxation treatment;

(b) restrictions on a member's ability to withdraw money from their fund before retirement;

(c) specific rules imposing additional trustee responsibilities to act in the best interests of members (such as the 'sole purpose' test); and

(d) additional disclosure obligations to encourage member engagement with super (such as product dashboards).

916 These measures reflect a need to protect a member's money in the circumstances where investments of at least 9.25% of an employee's salary are not optional. For this reason, APRA-regulated superannuation funds are

more closely regulated, and include a statutory compensation mechanism, compared to managed investment schemes and SMSFs.

Interdependence in funds management, but different access to compensation

917 The funds management sector is highly interdependent. While superannuation funds invest in managed investment schemes (including through platforms), and ultimately hold the same underlying assets, they are subject to different regulatory regimes. SMSFs invest in both managed investment schemes and investment platforms, among other assets. Increasingly, managed investment schemes and superannuation funds also use the same administrators and custodians. However, when something goes wrong, for example in the case of Trio Capital, differences emerge in terms of access to potential compensation.

Example of interdependence within the funds management sector: Trio Capital

Trio Capital (Trio) was the trustee of four superannuation funds and one pooled superannuation trust. Trio further operated a superannuation administration service, which provided back office administration to superannuation trustees.

Trio was also a licensed responsible entity for 17 active managed investment schemes, including the Astarra (ASF) and ARP Growth (ARP) funds, which made investments in a number of overseas vehicles. These managed investment schemes were promoted by a number of advisers to their clients, and were listed on both superannuation and non-superannuation platforms.

Trio went into voluntary administration on 19 December 2009 and was placed into liquidation on 22 June 2010. On 19 March 2010, the NSW Supreme Court made winding up orders in relation to five Trio registered schemes, including the ASF and ARP funds. To date, the liquidator has been unable to recover any of the overseas investments made by either the ASF or ARP.

The following losses are associated with Trio funds:

- Approximately $125 million: alleged misappropriation of ASF and Trio superannuation and other retail client money, with 6048 investors.
- Approximately $69.5 million: assets of ARP Growth Fund. It had 79 investors (mostly SMSF investors).
- On 13 April 2011 the Assistant Treasurer approved the payment of approximately $55 million under Part 23 of the SIS Act to benefit the members of the four APRA-regulated superannuation funds that were formally under the trusteeship of Trio where those funds had invested in the ASF, as investments made into the ASF were found to have been lost through criminal conduct. The assistance is for members of the Astarra Superannuation Plan, the Astarra Personal Pension Plan, the My Retirement Plan and the Employers Federation of NSW Superannuation Plan.

Unitholders in the ASF and ARP fund who invested through SMSFs or non-superannuation funds are not entitled to payments under the announced compensation scheme.

Since ASIC's investigation started on 2 October 2009, more than 11 people have

Example of interdependence within the funds management sector: Trio Capital
either been jailed, banned from providing financial services, disqualified from managing companies or have agreed to remove themselves from the financial services industry for a total of more than 50 years.

918 Superannuation, investment platforms and SMSFs all invested in Trio Capital; however, compensation was only made available under Pt 23 of the SIS Act to four APRA-regulated superannuation funds. SMSFs and retail clients investing through non-superannuation investment platforms do not have the same access to compensation as APRA-regulated funds in the event of loss or fraud. The rationale for different treatment is presumably to do with the fact that these four superannuation funds largely manage compulsory superannuation rather than discretionary savings.

SMSFs are unique

919 While there are increasingly similar regulatory structures between managed investment schemes, superannuation, and platforms (IDPSs and IDPS-like schemes), the governance structure for SMSFs is different from all of the other parts of the managed funds sector discussed in this chapter. SMSF investors are effectively the fund members, trustee and investment manager. As outlined in paragraphs 897–898, the regulatory structure reflects the assumption that SMSF investors are able to look after themselves and therefore provides a less onerous regulatory environment.

920 This raises questions about the appropriateness of SMSFs for some super fund members with less investment experience or investable funds, and less time to manage their superannuation. As discussed in paragraph 900, inexperienced investors may not fully understand their trustee duties and obligations, including reporting obligations to the ATO.

Appendix 1: Additional options for change to address regulatory barriers and gaps

921 ASIC has recently responded to the Senate Economic References Committee Inquiry into the performance of ASIC (Senate inquiry).

922 We made four submissions to the Senate inquiry:

(a) an *Initial submission by ASIC on Commonwealth Financial Planning Limited and related matters*, providing an overview of ASIC's actions on Commonwealth Financial Planning Limited (CFPL), as well as context about our work in the financial advice industry;

(b) a *Submission by ASIC on reforms to the credit industry and 'low doc' loans*, dealing with ASIC's role in regulating consumer credit both before and after the primary responsibility for credit regulation shifted from the states to the Commonwealth in 2010;

(c) our *Main submission*, detailing our performance track record, addressing all of the terms of reference and making a number of policy suggestions; and

(d) a supplementary submission in relation to *Commonwealth Financial Planning Limited*, detailing the wholesale changes in the manner and culture in which financial services are now provided by CFPL.

923 In our main submission, we outlined proposals that, if implemented, would improve ASIC's ability to deliver on our legislative responsibilities and increase our effectiveness, to allow us to achieve better outcomes for investors and financial consumers.

924 These proposals relate to:

(a) regulating the quality of financial advice (also discussed in Section A of this submission);

(b) protecting whistleblowers;

(c) ensuring we can take all relevant factors into account when making a licensing decision;

(d) investigating potential breaches of the law; and

(e) achieving effective enforcement outcomes through penalties that act as a genuine deterrent to future misconduct (also discussed in Section A of this submission).

Appendix 2: ASIC's regulatory work

Our work to meet our strategic priorities

925 Operationally, we apply our statutory objects[135] as three strategic priorities, being to ensure:

(a) confident and informed investors and financial consumers;

(b) fair and efficient financial markets; and

(c) efficient registration and licensing.

926 In meeting our strategic priorities, we carry out work in a number of areas, including:

(a) promoting compliance with and enforcing the law;

(b) assisting and providing guidance to our stakeholders;

(c) facilitating business;

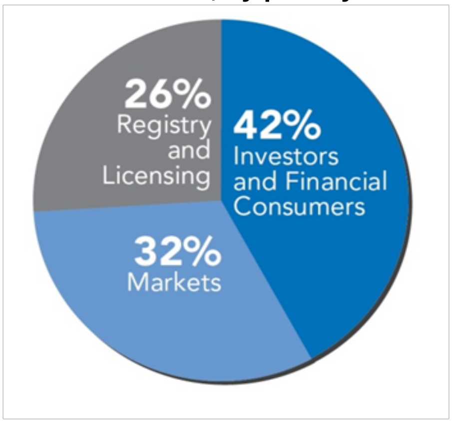
(d) promoting financial literacy; and

(e) detecting and responding to market issues and risks.

927 Figure 14 shows the proportion of ASIC's 2012–13 budget allocated to achieving each of our three priorities, and Figure 15 shows the proportion of this budget allocated to each of the tools we use to achieve these priorities—engagement, surveillance, policy advice, guidance, education and enforcement, as well as our registry responsibilities.

Note: Percentages are based on ASIC's budgeted staff and supplier costs (totalling $341.2 million), which reflects ASIC's 2012–13 budget, excluding statutory bodies, ASIC's costs to support statutory bodies and implementation costs for new projects.

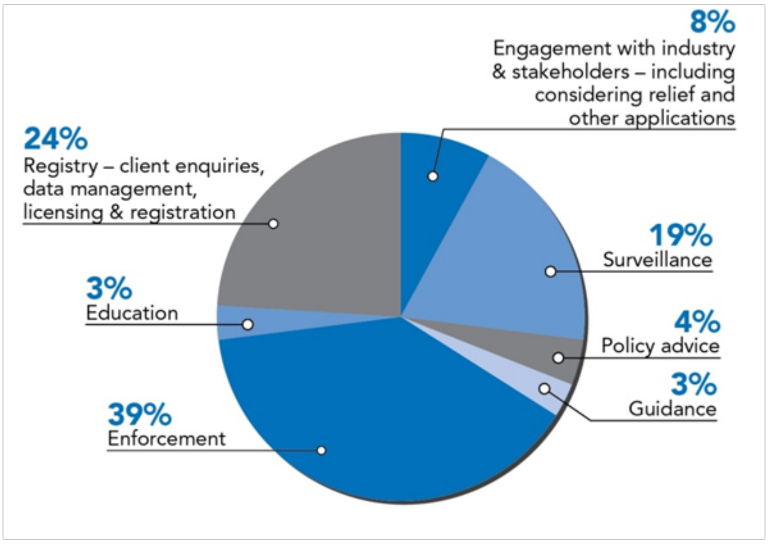
Figure 14: Resource allocation, by priority—2012–13



Source: ASIC Annual Report (2013).

[135] Section 1 of the ASIC Act.

Figure 15: Resource allocation, by tool—2012–13



Source: ASIC Annual Report (2013).

Compliance and enforcement

928 Each year, we take a wide range of compliance and enforcement action to enforce the law and deal with misconduct. Actions we take include surveillances, negotiated outcomes, seeking compensation, and administrative, civil and criminal action. We take these actions in order to achieve long-term change in behaviour.

Surveillances

929 ASIC undertakes extensive surveillance to monitor the activities of individuals and entities within our large regulated population. Within our resources, ASIC takes a risk-based approach to surveillance, identifying significant and strategically important industry participants and gatekeepers, and directing surveillance resources towards the entities, products or transactions:

(a) where the risk of non-compliance or misconduct is greatest; and

(b) where the non-compliance or misconduct will result in the greatest harm in the context of delivering against ASIC's strategic priorities.

930 Since 2010, we have completed approximately 4,000 surveillances. As part of our commitment to improving transparency and increasing awareness of the work we do, we released the first snapshot of our surveillance work in September 2012.

931 We undertake surveillances to:

(a) assess compliance with the laws that we administer;

(b) identify and better understand problems that exist in the market;

(c) produce constructive change in the regulated populations; and

(d) enhance public confidence.

932 Through surveillances we engage with our regulated populations (often on a face-to-face basis) and actively monitor activity. This presence in the market increases the regulated populations' awareness of the law and of the need to comply.

933 In many cases, we publish the findings of, and recommendations arising from, our surveillance work either in a media release or as a report. Publishing this information improves compliance levels, encourages awareness of statutory obligations, and may deter future contraventions.

ASIC report on self-managed superannuation funds following thematic surveillance

In late 2012, ASIC conducted a surveillance of over 100 investor files relating to the establishment of SMSFs that were provided by financial planners and accountants. The files targeted were considered to be in higher risk categories through, for example, having lower balances or less diversified investments. Following our surveillance, we released Report 337 *Improving the quality of advice given to investors* (REP 337). The report discussed the findings of our surveillance as well as providing specific recommendations to advisers on steps to improve the quality of their SMSF advice.

934 Where particular concerns are discovered, depending on their nature, ASIC may address these concerns by working with the industry sector or with specific entities. Working with individual entities may involve a negotiated outcome or enforcement action. A specific problem may indicate a systemic issue—in which case, ASIC may initiate a further, broader surveillance to ensure compliance across a particular sector.

Negotiated outcomes

935 ASIC frequently deals with market misconduct by negotiating an outcome with an entity or individual. Negotiated outcomes, such as enforceable undertakings, can offer a faster, more flexible and effective regulatory outcome than could otherwise be achieved through administrative or civil action.

936 Since 2010, ASIC has entered into 86 enforceable undertakings with entities. Many of these enforceable undertakings have required entities to pay compensation to consumers, improve internal compliance arrangements, appoint an independent expert to oversee elements of the entity's business and report back to ASIC on performance.

Case study: Stakeholder and enforcement teams working together to obtain an enforceable undertaking from Macquarie Equities Limited

Through a surveillance of Macquarie Equities Limited's (MEL) compliance systems and client files, ASIC found MEL had failed to address recurring compliance deficiencies, including:

- instances of client files not containing Statements of Advice;
- advisers failing to demonstrate a reasonable basis for advice provided to the client;
- poor client records and lack of detail contained in advice documents; and
- lack of supporting documentation on file to determine whether there was a reasonable basis for advice provided to the client.

Working together, ASIC's stakeholder and enforcement teams negotiated an enforceable undertaking, under which:

- MEL reviewed its Macquarie Private Wealth business, including its licence risk and operating model and systems, and its legal and regulatory obligations; and
- MEL was required to develop and implement, with the oversight of an independent expert, a plan to rectify licence risk management and compliance deficiencies.

See Media Release (13-010MR) *ASIC accepts enforceable undertaking from Macquarie Equities Ltd* (29 January 2013).

937 Through negotiating outcomes in appropriate cases, we can:

(a) provide compensation for affected investors and financial consumers that may not otherwise be obtained in a timely and cost-effective manner;

(b) specifically deter the entity involved from future instances of the conduct that gave rise to the undertaking;

(c) deter the rest of the industry from engaging in similar conduct by raising awareness of the conduct and the regulatory consequences;

(d) compel the entity to implement improved compliance arrangements, and change its culture monitored by an independent expert who reports to ASIC over an extended period of time to ensure that changes are in fact made;

(e) restrict the activities that the entity may undertake; and

(f) achieve specific regulatory outcomes far more quickly and cost-effectively than through court action.

Changing behaviour

938 Beyond direct compensation, the outcomes ASIC achieves that result in changes of behaviour can have very tangible benefits for investors and

financial consumers. For example, in the case study below on RHG Mortgage Corporation, the direct payment of compensation to affected borrowers exceeded $3.3 million, but the impact of the agreement to reduce and remove future fees will generate even greater savings over the longer term.

Case study: Negotiated outcome—RHG Mortgage Corporation

Following an industry review of early termination fees and receiving a number of complaints specifically in relation to RHG Mortgage Corporation (RHG), ASIC became concerned that some of RHG's discharge and early termination fees were unconscionable or unjust under the National Credit Code.

ASIC reached a negotiated outcome with RHG, under which:

- RHG provided refunds to 6,400 consumers totalling more than $3.3 million. Affected customers received refunds ranging from $50 to over $10,000, with the most common refund being $400.
- RHG agreed to reduce its discharge fees on existing loans and to the staggered removal of early termination fees for thousands of customers.

See Media Release (12-169MR) *RHG customers refunded over $3.3 million* (19 July 2012).

939 Similarly, in February 2012, ASIC achieved changes in the manner in which American Express Australia Limited charged default interest to its cardholders who were late in making payments. Those changes, which reduced the default rate of interest by up to 6% and reduced the period during which the 'default' rate is imposed, have resulted in significant savings to cardholders who may be experiencing financial difficulty. These savings are ongoing: see Media Release (12-31MR) *American Express agrees to change credit card interest rate policy for defaulting cardholders* (24 February 2012).

Case study: HIH insurance

The collapse of HIH is now clearly identified as one of the largest and most significant financial failures in Australia's history, with liquidators estimating the total losses up to $5.3 billion.

Formal action was taken by ASIC as part our own investigation and following referrals made after a Royal Commission into HIH's collapse.

Background

On 27 February 2001, ASIC commenced a formal investigation into HIH Insurance Limited's market disclosure and sought the suspension of trading in its shares on the basis that the market was inadequately informed about the company's financial position.

HIH went into provisional liquidation on 15 March 2001 without seeking to re-list.

At the commencement of our investigation, ASIC assembled a specialist team of investigators, drawing on both internal resources and external experts with specialist actuarial, auditing, claims management and insolvency skills to determine whether any person or persons should be brought to account for offences under the Corporations Law. ASIC's investigation strategy clearly differentiated between prospective criminal and civil avenues of inquiry.

ASIC's regulatory response

A combination of regulatory tools was used at different stages of the investigation to achieve a number of objectives, including:

Education and guidance

Following the provisional liquidation of the HIH Insurance Group, ASIC together with APRA took steps to protect and inform policyholders.

Preservative action

In May 2001, ASIC sought protective orders as an interim step in our broad investigation into the collapse of HIH and obtained court undertakings from the following former directors of HIH Insurance Limited—former Chief Executive Officer Ray Williams, former HIH Director Rodney Adler, and former Chief Financial Officer Dominic Fodera, restraining their assets and requiring them to notify ASIC of their overseas travel movements.

Civil penalty proceedings

In May 2001, ASIC commenced civil proceedings against Messrs Adler, Williams and Fodera alleging breaches of their duties as directors, specifically the duties of care and diligence and good faith, and their duties not to improperly use their position or information. ASIC's civil penalty proceedings were in relation to a $10 million payment to Pacific Eagle Equities.

In March 2002 the court found that the three former directors had breached their duties as directors. Although one finding at trial against Mr Adler was subsequently overturned by the Court of Appeal, in May 2004 the High Court rejected Mr Adler's application for special leave to appeal these trial findings further.

In May 2002, the following penalties were handed down:

- Mr Adler was banned from acting as a director of any company for a period of 20 years;
- Mr Adler and Adler Corporation were each ordered to pay pecuniary penalties of $450,000 (totalling $900,000);
- Mr Williams was banned from acting as a director of any company for a period of 10 years and was ordered to pay pecuniary penalties of $250,000; and
- Mr Fodera was ordered to pay pecuniary penalties of $5,000.

In addition, Messrs Adler and Williams and Adler Corporation were ordered to pay aggregate compensation of $8 million to HIH Casualty and General Insurance Limited (subject to verification of the calculation of interest).

Criminal action

ASIC's HIH investigation led to criminal prosecutions of nine former senior executives, including directors, of FAI, HIH and associated entities.

The persons convicted were:

- William Howard, former Finance General Manager of HIH, sentenced on 23 December 2003 to imprisonment of three years, fully suspended on the basis of a number of factors including his ongoing assistance to the HIH investigation;
- Rodney Adler, a former director of HIH, sentenced on 14 April 2005 to imprisonment of four and a half years with a non-parole period of two and a half years;
- Ray Williams, former Chief Executive Officer of HIH, sentenced on 15 April 2005 to imprisonment of four and a half years with a non-parole period of two years and nine months;
- Terry Cassidy, the former Managing Director of HIH, sentenced on 29 April 2005 to imprisonment of 15 months;
- Antony Boulden, the former Financial Controller of FAI's Corporate and Professional Insurance Division, sentenced on 1 December 2006 to imprisonment of 12 months to be served by way of periodic detention;
- Bradley Cooper, the former Chairman of the FAI Home Security Group, which had dealings with the HIH Group, sentenced on 23 June 2006 to imprisonment of eight years with a non-parole period of five years;
- Robert Kelly, former Assistant Company Secretary of HIH, sentenced on 3 November 2006 to 500 hours community service;
- Frederick Lo, former Company Secretary of HIH, sentenced on 23 February 2007 to imprisonment of nine months; and
- Dominic Fodera, former HIH Chief Financial Officer, sentenced to three years imprisonment, following his conviction on criminal charges of authorising a prospectus that contained a material omission and three years and four months imprisonment, after pleading guilty to charges with respect to the Hanover Re insurance arrangements. The court specified a single non-parole period of three years in respect of both charges.

Enforceable undertakings

ASIC also accepted the following enforceable undertakings:

- In May 2004, ASIC accepted an enforceable undertaking from General Re Australia Limited, which provided for the payment of $27.2 million by General Re to the liquidator of the HIH Group, the implementation of an agreed compliance program in conjunction with ASIC and the St James Ethics Centre for all of its resident senior executive officers and departmental managers, and an undertaking from current officers and a former officer of General Re not to apply for an AFS licence, accept authorisation by a holder of an AFS licence, or be involved in the management of a corporation requiring such a licence or any listed Australian corporation for at least 12 months.

- As a result of investigations and the findings of the HIH Royal Commission, ASIC formed the view that the audits for FAI and HIH Insurance Ltd for the financial year ending 20 June 2000 were inadequate and that the respective auditors had failed to carry out or perform adequately and properly the duties of an auditor in respect of each audit.
- In 2007, ASIC accepted an enforceable undertaking from Jonathan Pye, formerly a partner of Arthur Andersen, the auditor of HIH Insurance Ltd (HIH) who signed an unqualified audit report for the financial statements of FAI Insurance Limited (FAI) for the financial year ending 30 June 2000. Mr Pye undertook not to sign any audit reports until after 30 June 2007 and not to sign the first five audits he undertook after 30 June 2007, until those audits have been subjected to review by a registered auditor approved in advance by ASIC, and the reviewing auditor has provided a written statement that the audits have been conducted to the required standard.
- In July 2008 ASIC accepted an enforceable undertaking from John Buttle, former partner of Arthur Anderson and auditor of HIH after raising concerns regarding the 2000 audit of HIH. The enforceable undertaking provided for Mr Buttle's registration as an auditor to be cancelled and for him not to apply for re-registration until after 1 March 2010.

Administrative action (including bannings)

940 Each year, ASIC undertakes a range of administrative actions to uphold the law and support our strategic priorities.

941 Since 2010, we have taken action to ban 138 individuals from providing financial services or credit services. In taking banning action, we remove the source of misconduct and consumer detriment from the marketplace, thereby addressing the risk of ongoing misconduct and future harm.

942 The top five matters since 2007 resulting in bannings or undertakings not to engage in financial services are listed in Table 29.

Table 29: Top five matters resulting in bannings or undertakings not to engage in financial services, 2007–13

Matter	Number of persons involved*
Westpoint	31
Hobbs	8
CFPL	8
Trio Capital	7
Storm Financial	5

* Includes bannings by administrative or civil action and enforceable undertakings.

943 ASIC may disqualify a director from managing a corporation for up to five years, where they have been a director of two or more failed companies in the past seven years. Since 2010, 209 directors have been banned by ASIC for an average period of 2.7 years. ASIC can also make an application to the court to disqualify a person from managing a corporation in some circumstances. Since 2010, nine directors have been disqualified by the court for periods ranging from 15 months to permanently (with an average period of 10.5 years). ASIC has also accepted enforceable undertakings from 10 directors not to act as a director for periods ranging from two years to permanently. Table 30 summarises these results.

Table 30: Total number of directors disqualified from managing a corporation, 2010–13

Type of matter	2010–11	2011–12	2012–13
Civil	0	2	7
Administrative	72	76	61
Enforceable undertaking	0	6	4

944 In 2012–13, we also:

(a) took stop order action in relation to 33 prospectuses;

(b) issued nine infringement notices; and

(c) cancelled, suspended or varied 13 AFS licences and 19 credit licences.

Case study: AAA licence cancellation

In February 2013, ASIC cancelled the AFS licences of AAA Financial Intelligence and AAA Shares (in liquidation) after we found that the entities had comprehensively and repeatedly failed to comply with their legislative obligations and licence conditions.

See Media Release (13-019MR) *ASIC cancels licences of national financial planning business* (6 February 2013).

Civil action

945 Where we see more serious contraventions of the law, we will often take civil action. Since 2010, ASIC has completed 95 civil proceedings, with outcomes ranging from declarations that individuals and companies have breached the law, orders disqualifying individuals from managing corporations and providing financial services, orders for the payment of a pecuniary penalty and/or compensation, and orders for the winding up of companies and schemes.

Case study: Recent successful civil outcomes

Recent successful outcomes of civil actions include:

- declarations of contravention against seven directors of Centro Properties Group and Centro Retail Group for breaches of directors' duties (see Media Release (11-125MR) *Decision in Centro civil penalty case* (27 June 2011));
- declarations that Camelot Derivatives Pty Limited and its sole director, Neil King, engaged in misleading and deceptive conduct in relation to the ability of its clients to generate significant returns from investments in an options trading market (see Media Release (12-78MR) *ASIC obtains Federal Court order banning derivatives trading director from providing financial services for six years* (23 April 2012));
- orders for the payment of pecuniary penalties and disqualification orders against former non-executive directors and the company secretary of James Hardie Industries Limited (see Media Release (12-275MR) *Decision in James Hardie penalty proceedings* (13 November 2012));
- orders permanently banning David Hobbs from providing financial services and from managing a corporation following his role in illegal offshore schemes (currently under appeal). In the same matter, three advisers were jailed following criminal proceedings and a further three people were disqualified from managing corporations and from providing financial services (see Media Release (13-031MR) *Ponzi scheme 'mastermind' handed record penalty* (21 February 2013));
- orders banning Melinda Scott from providing any financial services and from managing corporations for 25 years after she defrauded clients of more than $3.6 million over eight years (see Media Release (12-302MR) *ASIC obtains court orders permanently banning Sydney financial adviser* (4 December 2012));
- orders against the operators of a Gold Coast-based unlicensed financial services business, preventing it from carrying on its activities after an investment scam resulted in 37 investors losing approximately $680,000. ASIC alleged that West Trade Group Pty Ltd, West Trade Cars Pty Ltd, West Two Pty Ltd and its directors Tiffany Lea O'Donnell, Russell John Lewis and John Steven Pitcher used cold calling and a website to induce investors to deposit funds into a number of bank accounts with the promise that funds would be used to buy shares on behalf of investors and generate profits well above market returns (see Media Release (12-157MR) *ASIC obtains court orders against Gold Coast-based investment scam* (5 July 2012)); and
- orders prohibiting Melbourne liquidator Andrew Leonard Dunner from being registered as a liquidator for five years. The court found that Mr Dunner had failed to adequately investigate the circumstances and affairs of companies to which he was appointed, had inaccurately reported to ASIC and creditors, and that he had drawn remuneration in excess of $600,000 without appropriate approval or adequate supporting documentation (see Media Release (13-239MR) *Federal Court indicates Melbourne liquidator should be banned for 5 years* (30 August 2013)).

Criminal action

946 Where we see serious conduct that is intentional, dishonest or highly reckless, we may take criminal action. Since 2010, 105 criminal proceedings have been completed. Outcomes range from the imposition of fines, good behaviour bonds and community service to jail terms.

Case study: Recent successful criminal outcomes

Recent successful outcomes of criminal actions include:

- sentencing of former Chartwell Enterprises director Graeme Hoy to 13 years and nine months imprisonment after pleading guilty to 44 deception charges. Former company secretary Ian Rau was sentenced to two years and seven months imprisonment on eight charges (see Advisory (11-55AD) *Chartwell director Graeme Hoy sentenced to jail for 13 years and nine months for one of Australia's largest Ponzi schemes* (23 March 2011));
- sentencing of Fincorp Chairman and Chief Executive Officer Eric Krecichwost to three years and six months imprisonment for dishonest use of his position as a company director with the intention of gaining an advantage for himself and others (see Media Release (11-78AD) *Fincorp director imprisoned for dishonesty offences* (8 April 2011));
- sentencing of Peter Couper, the former Chief Financial Officer of the parent company of Bill Express, to 22 months imprisonment following an ASIC appeal against a suspended jail sentence. The sentence was imposed on Mr Couper over his role in the collapse of the payments processor. Mr Couper was sentenced to 22 months in jail, to be released after 60 days, and fined $10,000 (see Media Release (13-077MR) *ASIC appeal sees former CFO jailed* (10 April 2013));
- sentencing of Nicholas Glynatsis, a former tax consultant, on nine charges of insider trading following a guilty plea. Mr Glynatsis was initially sentenced to two years imprisonment to be served by way of intensive correction order. In June 2013, the NSW Court of Criminal Appeal upheld a prosecution appeal that the original sentence was manifestly inadequate and re-sentenced Mr Glynatsis to imprisonment for a total period of 21 months with a minimum term (involving full-time custody) of 12 months. Mr Glynatsis also consented to a pecuniary penalty order of $50,826 to the Commonwealth representing total profits from his trading (see Media Release (13-133MR) *Prosecution appeal sees insider trader sent to jail* (7 June 2013));
- sentencing of the former director of investment manager Astarra Asset Management Pty Ltd, Shawn Richard, to three years and nine months imprisonment with a minimum of two years and six months, following a guilty plea. Mr Richard was an investment manager of the Astarra Strategic Fund and Astarra Superannuation Plan, which were part of the Trio group of companies. Mr Richard also entered into an enforceable undertaking which permanently prevents him from working in financial services or from managing a corporation (see Advisory (10-261AD) *Former Astarra investment manager pleads guilty to dishonest conduct*

(7 December 2010); Media Release (12-116MR) *ASIC provides update on Trio* (5 June 2012));

- sentencing of the former CEO of Sonray Capital Markets Pty Ltd, Scott Murray, to a minimum of two years and six months imprisonment after pleading guilty to charges of false accounting involving fictitious deposits, false withdrawals, theft, obtaining a financial advantage by deception and misleading an auditor (see Media Release (11-222MR) *Former Sonray CEO jailed* (14 October 2011)); and
- sentencing of former company director and financial adviser Simon Finnigan to nine years imprisonment after pleading guilty to nine charges of dishonest conduct relating to a financial product or financial service (see Advisory (11-304AD) *Sydney company director sentenced to jail* (16 December 2011)).

Assisting and providing guidance to our stakeholders

947 We work very closely with our diverse range of stakeholders to achieve our strategic priorities and to understand developments in the markets we regulate. In 2012–13, we participated in over 600 stakeholder meetings.

948 Our recent interactions with stakeholders have included a series of national roadshows on financial education for young people, workshops and training programs for Indigenous consumers, national roadshows on the implementation of the Future of Financial Advice (FOFA) and Stronger Super reforms, and consultation with the banking sector about the implications of the Basel III reforms for the marketing of term deposits.

Taking the lead on FOFA reforms

ASIC undertook a significant program of work to prepare industry for the commencement of the FOFA reforms.

We held a series of public FOFA workshops in Brisbane, Sydney, Melbourne, Hobart, Adelaide and Perth in early 2013. The workshops focused on practical advice about the implementation of FOFA. At the workshops, senior staff from ASIC's Financial Advisers team provided an overview of the legislation, and detailed ASIC's approach to FOFA, including enforcement and our facilitative approach.

The audience was able to ask questions and be involved in an interactive panel on the practical application of ASIC's policy. The interactive panel featured leading industry participants. Over 1,200 industry participants attended the sessions.

949 We have a structured program of periodic liaison meetings with key industry bodies. We also regularly meet with stakeholders on an individual basis. For example, during the past financial year, we visited 24 new AFS licensees to build relationships with them and to help them understand and meet their obligations. During our visits, we asked questions about the licensees' general business model, their advice processes and their approach to risk and

compliance. As a result of the positive feedback we received, we will be conducting similar visits this financial year.

950 We also regularly provide guidance to assist our industry stakeholders. The legislation we administer sets broad principles for how our industry stakeholders should conduct themselves. In many cases, specific guidance from ASIC on how to apply these principles in particular circumstances is helpful and much welcomed.

951 Our guidance is only settled after an extensive process of consultation with all of our stakeholders, including industry, investors and financial consumers, and other government departments and agencies. We also comply with the Government's Best Practice Regulatory Requirements, including undertaking regulatory impact assessments.

952 We provide guidance to our stakeholders in a number of circumstances, including:

(a) to help industry comply with new legislation;

(b) where industry asks us for guidance on how the existing law applies to a particular situation;

(c) where we become aware of a novel situation and there is uncertainty about how the existing law applies; and

(d) where we detect a lack of compliance with the law that is systemic and relates to industry not understanding what the law requires of them.

Facilitating business

953 ASIC plays a very active role in facilitating Australian business. We are committed to continually improving our systems and processes to create more efficient registration and licensing for business. We also proactively look for ways to save business time and money. Without ASIC undertaking this role, there would be a major impact on Australian businesses, financial markets, and the broader economy.

Using our relief powers to facilitate business

954 ASIC has powers under the legislation we administer to vary or set aside certain requirements of the law. ASIC's policy on the use of these powers is outlined in Regulatory Guide 51 *Applications for relief* (RG 51).

955 ASIC seeks to facilitate business transactions by granting relief (waivers) from the legislation we administer where there is a net regulatory benefit, or any regulatory detriment is minimal and is outweighed by the commercial benefit.

956 We regularly publish reports summarising examples of situations where we have exercised, or refused to exercise, our exemption and modification powers for participants in the capital markets and financial services industry who are prospective applicants for relief. In 2012–13 ASIC received 3,094 applications for relief. Of these, 2,047 have been approved, 358 have been refused, 318 have been withdrawn and 371 are under consideration.

957 In many cases, financial innovation would not be possible without ASIC relief, denying business opportunities to expand, and investors and financial consumers the possibility of new and more useful products.

ASIC's relief to facilitate the operation of platforms

Many investors want the opportunity to build an investment portfolio through an investment vehicle that gives them the convenience of transactional and reporting services where the client makes all of the investment decisions and can access a wide range of financial products that would not otherwise be available to them. Industry has developed a range of such vehicles that are typically known as 'platforms ' or 'wraps', which are more formally referred to as investor-directed portfolio services (IDPS) and IDPS-like schemes.

The legislation does not specifically recognise such structures, and most technically fall within the definition of a 'managed investment scheme'.

However, meeting the legal requirements for registering and operating a managed investment scheme would be onerous in practice for many platform operators, for example, because investors investing through a platform are able to exercise more discretion in their portfolio than a typical scheme member, or because applying the general product disclosure requirements to platform operators would result in duplication and unnecessary cost.

Because of this, ASIC provides the following relief to platform operators:

- For IDPS-like schemes: relief from fundraising, cooling-off requirements and financial product disclosure provisions (to the extent that these provisions require disclosures about the investments available through the scheme in the PDS); and
- For IDPS: relief from registration as a managed investment scheme, fundraising, hawking and most of the financial product disclosure provisions of the Corporations Act.

ASIC has provided this relief to create a tailored regulatory regime for platform operators, which balances the objectives of:

- applying the minimum required regulatory requirements to platform operators, consistent with the objectives of the broader financial regulatory regime; and
- ensuring that there is a high degree of protection for investors through appropriate disclosures and reporting to investors.

Our relief is contained in Class Order [CO 13/763] *Investor directed portfolio services* and Class Order [CO13/762] *Investor directed portfolio services provided through a registered managed investment scheme*. Our relief for platform operators is explained further in Regulatory Guide 148 *Platforms that are managed investment schemes* (RG 148).

Applying for, or varying, a licence

958 Each year, many businesses either apply for, or ask to vary, an AFS licence or credit licence. Since 2010, we have handled nearly 12,000 applications for a new AFS licence or credit licence, or a licence variation.

959 We have recently conducted an internal review of our online AFS licence application form.

960 As a result of our review, we have reworded or completely removed a number of questions from the form. The form now requires applicants to answer 105 questions, down from 150 questions. The majority of questions now require a yes/no response or allow applicants to select from a menu of responses. This mirrors the simplified approach we developed for our credit licence application form, introduced when we assumed responsibility for the regulation of credit. The *Submission by ASIC on reforms to the credit industry and 'low doc' loans* to the Senate Economic References Committee provides more details about ASIC's role in regulating the credit industry.

Engagement with small business

961 We are working to better understand, meet the needs of, and communicate with, small business. In 2012–13, ASIC's small business team conducted over 45 meetings with industry representatives and small businesses to discuss regulatory initiatives, ASIC's role, and the assistance available to help small business understand and comply with the law.

962 We also conducted an online survey seeking feedback from small businesses on our engagement with the sector and how we can keep small businesses better informed. More than 1,500 small businesses took part in our survey. Based on the survey findings, we have developed a strategy that focuses on engagement, assistance and regulatory initiatives to raise awareness, enhance compliance and target illegal phoenix activity.

Note: 'Phoenix activity' is typically associated with directors who transfer the assets of an indebted company to a new company of which they are also directors. The directors then place the initial company into administration or liquidation with no assets to pay creditors, meanwhile continuing the business using the new company structure.

Doing more business online

963 One of our priorities is to increase the proportion of business done online. This reflects ASIC's view that online transactions are easier and cheaper for business. In 2012–13, 83.8% of the 2.4 million forms lodged with ASIC were submitted online, up from 75.5% in 2011–12.

964 In March 2012, we launched a new online user interface, ASIC Connect. ASIC Connect allows customers to conduct ASIC registry searches online through ASIC's website and pay search fees by credit card.

965 Over 28.3 million free searches and 250,700 paid searches were conducted through ASIC Connect in 2012–13. The availability of the ASIC Connect online search has seen a 56% decrease in paper searches conducted directly with ASIC (on paper and over the counter). These fell from 27,492 in 2011–12 to 12,028 in 2012–13.

Business Names Register

966 ASIC launched the new national Business Names Register in May 2012. The Business Names Register replaces the eight previous state and territory services, so that businesses only need to register their name once to be registered throughout Australia. The Business Names Register is also cheaper, especially for customers with multiple business names.

967 At its one year anniversary, the Business Names Register had saved business $34 million in reduced fees to register or renew a name.

968 ASIC has continued to improve key services introduced at the launch of the Business Names Register. This includes data migration, process changes, systems enhancements, website content updates, and new communication products to improve services and the register, based on known defects and customer feedback.

SMSF auditor register

969 ASIC's new register of SMSF auditors went live on 31 January 2013, allowing auditors doing SMSF audits to apply for registration online using ASIC Connect.

970 The new register is part of the Government's Stronger Super reforms. ASIC has worked closely with the Government and industry on measures, including the register, to improve integrity and community confidence in the sector.

971 At 30 June 2013, ASIC had registered 5,935 SMSF auditors, with 100% of applications received online. Ninety-eight per cent of applications were registered within 28 days of receipt of a full application.

Promoting financial literacy

972 ASIC shares responsibility for developing and delivering financial literacy programs with business, community, government and education sectors, with

ASIC having overall responsibility for developing the National Financial Literacy Strategy.

973 Under the broad framework set out by the National Strategy, ASIC's financial literacy work seeks to help people make informed decisions about their money by providing information, tools and resources via a range of different channels designed to appeal to different audiences, ranging from the general public to specific groups within the Australian community.

974 One major channel through which we deliver our financial literacy resources is ASIC's MoneySmart website, www.moneysmart.gov.au. Dedicated to issues for consumers and investors, ASIC's MoneySmart website features over 400 pages of information, 26 interactive calculators and three mobile applications, and helps around 400,000 Australians a month make better decisions with their money. The website resources are easy to use on mobile devices such as tablets and smart phones. Our research suggests that the majority of users take specific action in relation to their finances as a result of visiting MoneySmart.

975 Popular resources include the mortgage calculator, budget planner, retirement planner, *Managing your Money* booklet and *TrackMySpend* mobile phone application. MoneySmart also has resources for Indigenous Australians about topics such as managing money, banking and credit, insurance, superannuation and scams; and material for vulnerable and disadvantaged consumers and the intermediaries who work with them, including translated money management resources and information about debt management, financial counselling, hardship and practical help with money problems.

976 Young Australians today are interacting with money and making consumer choices from an earlier age than ever before and growing up in a fast paced consumer and financial society. In order to help the next generation become confident and informed consumers and investors, ASIC also has a specific focus on promoting and supporting financial literacy in schools.

977 ASIC's MoneySmart Teaching program (www.teaching.moneysmart.gov.au) includes the development and promotion of teacher resources for primary and secondary schools that are linked to the relevant curriculum. We also deliver professional learning packages for teachers, as well as online resources for primary and secondary schools. So far over 8000 teachers have been trained and the modules have been trialled in 93 MoneySmart schools nationally. Five states have signed the 2013–17 MoneySmart Teaching National Partnership Project Agreement (Western Australia, New South Wales, Victoria, Queensland and South Australia) and begun implementing the agreement, which will deliver professional development to 24,000 teachers and develop further teaching and learning resources over four years.

978 ASIC also supports MoneySmart Week, an annual independent, not-for-profit national initiative set up by the Australian Government Financial Literacy Board and involving over 50 organisations from the business, government and community sectors working together to promote financial literacy.

979 Finally, Australia is regarded as something of a leader in the financial literacy field internationally. ASIC plays an active role in contributing to international financial literacy forums, including the OECD International Network for Financial Education (INFE) and most recently IOSCO Committee 8 on Investor Education. ASIC also supports the Programme for International Student Assessment (PISA) and represents Australia on the OECD PISA working group to develop the Financial Literacy Assessment option, which will establish international benchmarks of the levels of financial literacy and financial behaviours of students around the world.

Detecting and responding to market issues and risks

980 Where there are significant issues and risks in a market, we take action using a range of tools to address them. Surveillance is important for identifying the problems and their causes and for gathering initial evidence. Subsequently, we commonly use negotiated outcomes, and administrative and court action, as well as enhanced guidance for the rest of industry to achieve change. We may report on the issues to encourage public understanding, discussion and debate, and potential consideration of reform. We also develop information and tools for consumers to help them better navigate the issues or problems in the market.

981 An example of this longer term, multifaceted effort to address market problems, the *Submission by ASIC on reforms to the credit industry and 'low doc' loans* to the Senate Economic References Committee outlines our efforts to identify and address problems in the credit industry.

External assessment of our performance

982 Our performance has recently been measured in the 2013 ASIC stakeholder survey.[136] The survey provided stakeholders' frank assessment of how well we are meeting our three strategic priorities.

983 Pleasingly, the survey found that the majority of stakeholders are positive about ASIC's performance and consider that ASIC is performing better than,

[136] The regular independent survey of ASIC's stakeholders commissioned by ASIC. To date, ASIC has commissioned surveys to be undertaken in 2008, 2010 and 2013.

or the same as, two years ago. Among those surveyed, particular strengths were ASIC's work in:

(a) market supervision;

(b) keeping markets free from insider trading, and ensuring companies provide reliable and timely information to the market;

(c) holding to account the organisations that are involved in providing financial products and services;

(d) holding auditors to account; and

(e) holding market operators to account.

984 The majority of respondents also found that ASIC:

(a) acts professionally, promotes confidence in Australia's financial system, and understands the industries and markets we regulate;

(b) is easy to deal with;

(c) demonstrates transparency in enforcement actions;

(d) effectively monitors compliance by industry;

(e) provides guidance to industry to help organisations to comply with the law; and

(f) provides registration and licensing systems that are easy, efficient, timely and cost-effective, accompanied by information that is easy to understand.

985 In addition to our stakeholders, the International Monetary Fund (IMF) has also recently commented on ASIC's performance, concluding that Australia's legal and regulatory framework for securities markets is highly compliant with IOSCO's *Objectives and principles of securities regulation*,[137] although a few concerns need to be resolved.

986 IMF conducts a regular Financial Sector Assessment Program (FSAP). The FSAP review is a comprehensive and in-depth analysis of a country's financial sector. It assesses the financial sector and rates the quality of its financial market supervision against international standards.

987 Australia's first FSAP review was conducted in 2005–06 and the second review was undertaken in 2012, consistent with a recent commitment of the international Financial Stability Board members to undergo an FSAP review approximately every five years.

[137] IOSCO released its *Objectives and principles of securities regulation* in May 2003. These comprise 30 principles of securities regulation, which are based upon three objectives of securities regulation, being the protection of investors; ensuring that markets are fair, efficient and transparent; and the reduction of systemic risk.

988 In 2012, ASIC prepared material about Australia's regulation and our supervision of financial markets for the FSAP review of Australia's financial sector.

989 A report containing the IMF's detailed assessment and policy recommendations was published in November 2012. While the report was very positive about Australia's legal and regulatory framework for securities markets, it also raised concerns with ASIC's operational independence, sufficiency of resources and our ability to discharge our supervisory functions adequately and effectively across the entire regulated population.

990 While some of these recommendations are matters for the Government's consideration, ASIC is working with Treasury to address recommendations for changes that fall within our operational jurisdiction.

Appendix 3: Regulation of managed investment schemes and superannuation funds

991 The main regulatory requirements for managed investments and superannuation are set out in the Corporations Act and SIS Act, respectively. Table 31 compares the key requirements.

Table 31: Comparison of the regulatory requirements applying to managed investment schemes and superannuation funds

Type of obligation	Managed investment schemes (obligations that apply under the Corporations Act, unless otherwise specified)	Superannuation funds (obligations that apply under the SIS Act, unless otherwise specified)
Registration	The managed investment scheme (scheme) must be registered if it has more than 20 members or is promoted by a scheme promoter: s601ED. ASIC must register the scheme if (s601EB): • the application is complete and provides details of a responsible entity; • the responsible entity is a public company and holds an AFS licence; • the scheme has a compliant constitution; • the scheme has a compliant and signed compliance plan; and • the scheme has a compliant auditor in place.	To qualify for tax concessions, the trustee must notify APRA in the approved form that it elects that the fund be regulated under the SIS Act: s19. In applying for a registrable superannuation entity (RSE) licence, the trustee must provide everything required under the relevant APRA-approved form (s29C), including: • the trustee's contact details; • details of the company and its AFS licence; • details of the appointed auditor and actuary; and • documents demonstrating compliance with prudential standards, including, for example, risk management, business plan, internal audit arrangements and insurance. To be able to register an RSE, APRA must be satisfied that nothing in the governing rules of the entity conflicts with the requirements of Pt 6. In this regard, the trustee must submit all governing rules that together demonstrate to APRA that they contain and are consistent with these requirements. Trustees also need to obtain 'complying fund' status from the Australian Taxation Office (ATO) to receive the benefit of concessional tax arrangements.

Type of obligation	**Managed investment schemes (obligations that apply under the Corporations Act, unless otherwise specified)**	**Superannuation funds (obligations that apply under the SIS Act, unless otherwise specified)**
Company status and licensing	The responsible entity must be a public company that holds an AFS licence authorising it to operate a scheme: s601FA.	The trustee must generally be a constitutional corporation: s19. The trustee must obtain an RSE licence and must also obtain an AFS licence where it is providing financial services.
Duties	The duties of the responsible entity are to (s601FC): • act honestly; • exercise due skill and diligence; • act in the best interests of members and give priority to members' interests where a conflict arises; • treat members of the same class equally and members of different classes fairly; • not make improper use of information acquired; • ensure the scheme has a compliant constitution; • ensure the scheme has a compliant compliance plan; • ensure that the scheme property is clearly identified and segregated from property of the responsible entity or other schemes; • ensure scheme property is valued at appropriate intervals; • ensure distributions comply with the constitution; and • report breaches to ASIC. Note: Officers and employees of the responsible entity are also subject to a number of these duties: s601FD and 601FE.	The governing rules include covenants for the trustee to (s52): • act honestly; • exercise due skill and diligence; • act in the best interests of members; • give priority to the interests of beneficiaries where a conflict arises; • act fairly in dealing with classes of beneficiaries; • act fairly in dealing with beneficiaries within a class; • keep the money and assets of the entity separate from money and assets held by the trustee or an employer–sponsor; • not enter a contract that would have an impact on the trustee properly performing its functions and powers; • if there are any reserves of the entity—regularly review a strategy for the prudential management of the reserves; and • allow a beneficiary of the entity access to certain information and documents. Note: Officers of the trustee are also subject to a number of these duties: s52A.
Member control	Members do not have day-to-day control over the operation of the scheme: see the definition in s9 of 'managed investment scheme'.	Other than in specified circumstances, the governing rules must not permit the trustee to be subject, in the exercise of the trustee's powers, to direction by any other person: s58.

Type of obligation	Managed investment schemes (obligations that apply under the Corporations Act, unless otherwise specified)	Superannuation funds (obligations that apply under the SIS Act, unless otherwise specified)
Changing the responsible entity/trustee	The responsible entity may resign (s601FL). The responsible entity may be removed by members (s601FM) by extraordinary resolution, by ASIC or a scheme member applying to the court (s601FN), or by the appointment of a temporary responsible entity (s601FP) by the court.	APRA may remove the trustee (s133) and appoint a temporary trustee: s134. The trustee may resign: s137.
Disclosure and member reporting	Both a scheme and a superannuation fund require Product Disclosure Statements (PDSs) at the point of sale (with some variations to timing for the giving of PDSs for employer-sponsored superannuation—s1012F of the Corporations Act provides an issuer with up to 3 months to give the PDS). Content requirements, particularly under the shorter PDS regime, differ to reflect variations in the product features. Obligations to give additional information on request apply to both products: s1017A of the Corporations Act. Ongoing disclosure requirements (significant event notices) are required for both products: s1017B of the Corporations Act. Periodic statements are required for both products: s1017D of the Corporations Act. Note: Some disclosure obligations are specific to superannuation trustees (e.g. s1017C—additional information requests and s1017DA—annual reports).	
Governance	The scheme must have a constitution that provides for (s601GA): • consideration to acquire an interest in the scheme; • the powers of the responsible entity in making investments or dealing with scheme property; • the method for dealing with complaints; • the right of the responsible entity to receive fees and be indemnified out of scheme property in relation to the performance of its duties; • powers to borrow or raise money; and • a right and procedure for members to withdraw from the scheme. The scheme must have a compliance plan that sets out measures that the responsible entity must apply in operating the scheme to (s601HA): • ensure compliance with the Corporations Act and the scheme's constitution; • ensure that the scheme property is segregated from other property; • if the scheme has a compliance committee, ensure the committee functions properly;	The trust deed (governing rules) will set out the way in which the trustee must deal with trust property for the benefit of beneficiaries. The trust deed will set out all obligations imposed on the trustee and the relationship between the trustee, the beneficiary and trust property: see s10 on 'governing rules'. Part 6 imposes additional covenants in the governing rules, including (s52) to: • keep the money and assets of the entity separate from money and assets held by the trustee or an employer–sponsor; • implement an investment strategy (and review it periodically); • implement an insurance strategy (and review it periodically); and • implement a risk management strategy (and review it periodically). Additional obligations include to: • comply with prescribed standards on who can make contributions, investments and payment of benefits; • not lend money, or give financial assistance, to a fund member or relative;

<table>
<tr><th>Type of obligation</th><th>Managed investment schemes (obligations that apply under the Corporations Act, unless otherwise specified)</th><th>Superannuation funds (obligations that apply under the SIS Act, unless otherwise specified)</th></tr>
<tr><td></td><td>• ensure that scheme property is valued at regular intervals;
• ensure that compliance with the plan is audited; and
• ensure that adequate records of the scheme’s operations are kept.</td><td>• not acquire assets, other than money, from members or their relatives;
• not borrow on the fund’s behalf, apart from in limited circumstances;
• prepare annual accounts and have them audited;
• set up systems for dealing with members’ inquiries and complaints within 90 days; and
• comply with directions and determinations of the Superannuation Complaints Tribunal.

Under s34C, APRA may impose prudential standards. APRA Prudential Standard SPS 510 sets out governance requirements, including:
• the board of the trustee corporation must have a policy on board renewal and procedures for assessing the performance of the board;
• a Board Remuneration Committee must be established;
• a Board Audit Committee must be established; and
• an RSE licensee must have a dedicated internal audit function.

Trustees must also meet obligations specific to superannuation—for example, the equal representation rules in Pt 9, which are currently subject to government consultation. This reflects the strong connection between employment and superannuation (beyond superannuation guarantee contributions). Many superannuation funds are named in industry awards.

Trustees must also comply with the sole purpose test, which reflects the aims of the superannuation system to provide benefits for members’ retirement (and in some cases, death): s62.</td></tr>
</table>

Type of obligation	Managed investment schemes (obligations that apply under the Corporations Act, unless otherwise specified)	Superannuation funds (obligations that apply under the SIS Act, unless otherwise specified)
Small-scale offerings	A small-scale offering operates as an unregistered scheme, and is therefore not subject to the requirement to be registered, where (s601ED): • there are less than 20 members; • the scheme is not promoted by a scheme promoter; or • where a PDS is not required under Div 2 of Pt 7.9 (e.g. for small-scale offerings).	Self-managed superannuation funds are subject to a different regulatory regime, where (s17A): • the fund has less than 5 members; • each member is a trustee, or a director of a corporate trustee; • no member is an employee of another member, unless the members are unrelated; and • no trustee receives remuneration for trustee duties.
Indemnity	The constitution of the scheme must provide for the responsible entity to be indemnified out of scheme property in relation to the performance of its duties: s601GA.	Governing rules are void so far as they purport to preclude a trustee of the entity from being indemnified out of the assets of the entity in respect of any liability incurred while acting as trustee of the entity, or the amount of such an indemnity is limited: s56.
Audit	For the audit of the compliance plan (s601HG): • there must be independent auditing of compliance with the plan within 3 months after the end of the financial year; and • the auditor must report significant breaches to ASIC.	Accounting records must be maintained (s35A) and an auditor appointed when applying for an RSE licence (under an approved APRA form). The auditor must inform the trustee of contraventions of the law and must also inform the regulator where the breach affects the interests of members or beneficiaries.
Breach notifications	The responsible entity is subject to breach notification requirements to ASIC in s912D as an AFS licensee (breach, or likely breach, that is significant).	If the trustee holds an AFS licence, the trustee must notify breaches to ASIC under s912D of the Corporations Act. The trustee also must notify APRA of breaches, or likely breaches, of prudential requirements where the breach is significant: s29JA. In some instances, a trustee may need to notify both regulators (e.g. unit pricing).

Type of obligation	Managed investment schemes (obligations that apply under the Corporations Act, unless otherwise specified)	Superannuation funds (obligations that apply under the SIS Act, unless otherwise specified)
Other compliance	The responsible entity must establish a compliance committee if less than half of the directors are external directors: s601JA. A compliance committee must have at least 3 members, and a majority must be external members: s601JB. Its functions are to (s601JC): • monitor compliance with the compliance plan; • report breaches of the Act or constitution to the responsible entity; • report to ASIC where the responsible entity does not take appropriate action to deal with a matter reported to it; and • assess the adequacy of the compliance plan at regular intervals and recommend changes as necessary. The duties of members are to (s601JD): • act honestly; • exercise due skill and diligence; • not make improper use of information; and • not make improper use of their position.	Under s34C, APRA may impose prudential standards. Prudential Standard SPS 510 sets out governance requirements, including that a Board Audit Committee must be established and that the RSE licensee must have a dedicated internal audit function. The Board Audit Committee must assist the Board by providing an objective non-executive review of the effectiveness of the RSE licensee’s financial reporting and risk management framework. The Committee must review internal and external audit plans and review the findings of audits to ensure that matters are being managed and rectified in a timely manner.
Liability to members for contraventions	A member is able to recover losses resulting from a contravention of Ch 5C from the responsible entity: s601MA.	A person who suffers loss or damage as a result of conduct of another person that was engaged in, in contravention of the governing rules, may recover the amount of the loss or damage by action against that other person or against any person involved in the contravention: s55(3).
Complaints handling	The responsible entity must generally have in place complaints handling procedures associated with their AFS licence: s912A(2) and 1017G(2). Complaints can be escalated to ASIC-approved external dispute resolution schemes: see Section H.	Trustees must also comply with s101 of the SIS Act and establish arrangements for dealing with inquiries or complaints. Complaints in superannuation are referred to the Superannuation Complaints Tribunal (a statutory body): see Section H.

Key terms

Term	Meaning in this document
13-010MR (for example)	An ASIC media release (in this example numbered 13-010MR)
ACCC	Australian Competition and Consumer Commission
ADI	Authorised deposit-taking institution—has the meaning given in s5 of the *Banking Act 1959*
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services Note: This is a definition contained in s761A.
AFS licensee	A person who holds an AFS licence under s913B of the Corporations Act Note: This is a definition contained in s761A.
ANZ	Australia and New Zealand Banking Group Limited
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ASIC Act	*Australian Securities and Investments Commission Act 2001*
ASIC stakeholder survey	The regular independent survey of ASIC's stakeholders commissioned by ASIC. To date, ASIC has commissioned surveys to be undertaken in 2008, 2010 and 2013
ASIC's Service Charter	ASIC's policy on our service delivery targets for our most common interactions with the community
automated order processing	The process by which order are registered in a market participant's system, which connects it to a market. Client or principal orders are submitted to and order book without being manually keyed in by an individual (referred to in the rules as a DTR). It is through AOP systems that algorithmic programs access our markets.
ASX	ASX Limited or the exchange market operated by ASX Limited
ASX 24	The exchange market formerly known as Sydney Futures Exchange, operated by Australian Securities Exchange Limited
ATO	Australian Taxation Office

Term	Meaning in this document
Australian Consumer Law	Cooperative legislation implemented through the Council of Australian Governments and set out in Sch 2 of the *Competition and Consumer Act 2010*
authorised representative	A person authorised by an AFS licensee, in accordance with s916A or 916B of the Corporations Act, to provide a financial service or services on behalf of the licensee Note: This is a definition contained in s761A.
best interests duty	The duty to act in the best interests of the client when giving personal advice to a client as set out in s961B(1) of the Corporations Act
BOQ	Bank of Queensland
Business Names Register	The register of business names established and maintained under s22 of the *Business Names Registration Act 2011*
CALDB	Companies Auditors and Liquidators Disciplinary Board
CAMAC	Corporations and Markets Advisory Committee
CBA	Commonwealth Bank of Australia
CCP	Central counterparties
CFO	Chief Financial Officer
CFPL	Commonwealth Financial Planning Limited
Chi-X	Chi-X Australia Pty Limited or the exchange market operated by Chi-X Australia Pty Limited
[CO 07/428] (for example)	An ASIC class order (in this example numbered 07/428)
clearing and settlement facility licence	An Australian CS facility licence under s842B of the Corporations Act that authorises a person to operate a clearing and settlement facility in Australia.
Corporations Act	*Corporations Act 2001*, including regulations made for the purposes of that Act
Corporations Regulations	Corporations Regulations 2001
COSL	Credit Ombudsman Service Limited
CP 209 (for example)	An ASIC consultation paper (in this example numbered 209)

Term	Meaning in this document
credit licence	An Australian credit licence under s35 of the National Credit Act that authorises a licensee to engage in particular credit activities
credit licensee	A person who holds a credit licence under s35 of the National Credit Act
dark liquidity	Orders that are not pre-trade transparent (i.e. not known to the rest of the market before they match): see paragraph 22 of REP 331 for the full meaning of this term
dark pool/venue	Electronically accessible pools of liquidity that are not pre-trade transparent, including crossing systems and dark venues operated by exchange market operators
direct electronic access	Electronic access to markets visa the electronic infrastructure of a market participant. It is the process by which an order is submitted by a client, agent or participant representative into a market participant's AOP system. It enables a client to access a market without being directly bound by the operating rules of the market they are accessing
DTR (designated trading representative)	Representative of the market participant that has been authorised by the participant to submit trading messages to the execution venue on behalf of the participant
EDR	External dispute resolution
EFT Code of Conduct	Former name of the ePayments Code, prior to its review in 2011
ePayments Code	The ePayments Code regulates consumer electronic payment transactions, including ATM, EFTPOS and credit card transactions, online payments, internet and mobile banking, and BPAY
equity market	A market on or through which offers to acquire or dispose of equity market products are made or accepted, the operator of which is an equity market operator
FCA	Financial Conduct Authority (UK)
FEX	FEX Global Pty Ltd or the exchange market operated by FEX Global Pty Ltd
FOFA	Future of Financial Advice
FOI Act	*Freedom of Information Act 1982*
FOS	Financial Ombudsman Service
FSA	Financial Services Authority (UK)

Term	Meaning in this document
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
G20	Group of 20
GDP	Gross domestic product
high-frequency trading	There is no internationally agreed, formal definition of high-frequency trading. For the purposes of this document, we have used the description provided by IOSCO: see paragraphs 23–26 of REP 331
IDPS	Investor directed portfolio service, as defined in [CO 13/763]
IDPS-like scheme	Investor-directed-portfolio-services-like scheme, as defined in [CO 13/762]
IDR	Internal dispute resolution
IMF	International Monetary Fund
INFO 153 (for example)	An ASIC information sheet (in this example numbered 153)
IOSCO	International Organization of Securities Commissions
lit exchange market	An exchange market where orders are displayed on the order book of a market operated by a market licensee and the order are therefore pre-trade transparent
low doc loans	Loans where the lender does not collect documents to verify the financial position of the borrower
market participant	A participant of a licensed market
Markets Disciplinary Panel	ASIC's Markets Disciplinary Panel, through which ASIC exercises its power to issue infringement notices and to accept enforceable undertakings in relation to breaches of the market integrity rules
MoneySmart	ASIC's website for consumers and investors (www.moneysmart.gov.au)
MoneySmart Teaching	An ASIC program for the provision of consumer and financial literacy education materials to young people in schools and tertiary education
MOU	Memorandum of understanding

Term	Meaning in this document
MySuper	A new, simple and cost-effective superannuation account type introduced by the Stronger Super reforms, which will eventually replace existing default superannuation accounts
National Credit Act	*National Consumer Credit Protection Act 2009*
National Credit Code	Sch 1 of the National Credit Act
National Financial Literacy Strategy	A strategy published by ASIC in 2011 to promote a national approach to improving the financial wellbeing and literacy of all Australians
OTC	Over the counter
PDS	Product Disclosure Statement
PI insurance	Professional indemnity insurance
PJC	Parliamentary Joint Committee on Corporations and Financial Services
PRA	Prudential Regulation Authority (UK)
Product Disclosure Statement	A document that must be given to a retail client in relation to the offer or issue of a financial product in accordance with Div 2 of Pt 7.9 of the Corporations Act Note: See s761A for the exact definition.
Pt 9.4AAA (for example)	A part of the Corporations Act (in this example numbered 9.4AAA), unless otherwise specified
RBA	Reserve Bank of Australia
reg 7.6.02 (for example)	A regulation of the Corporations Regulations (in this example numbered 7.6.02), unless otherwise specified
REP 240 (for example)	An ASIC report (in this example numbered 240)
RG 148 (for example)	An ASIC regulatory guide (in this example numbered 148)
Ripoll Inquiry	PJC Inquiry into Financial Products and Services in Australia (2009)
RSE licence	Registrable superannuation entity licence (granted by APRA)
s961B (for example)	A section of the Corporations Act (in this example numbered 961B), unless otherwise specified

Term	Meaning in this document
securities dealer	An entity that is an AFS licensee but is not in itself a market participant and that accesses the market on behalf of its clients through a market participant
Senate inquiry	Senate Economics References Committee inquiry into the performance of the Australian Securities and Investments Commission (ASIC)
shadow banking	Activities that are banking business or have a similar function to banking business, principally involving credit intermediation, by entities that are not regulated in a way that is substantially similar to banks
shorter PDS	A PDS that is required to comply with the shorter PDS regime
shorter PDS regime	The requirements set out in Div 3A of Pt 7.9 of the Corporations Act as modified by Subdivs 4.2 to 4.2C and Schs 10B, 10C, 10D and 10E of the Corporations Regulations, which prescribe the content and length of the PDS for first home saver accounts, margin loans, superannuation products and simple managed investment schemes
SIS Act	*Superannuation Industry (Supervision) Act 1993*
SIFI	Systemically important financial institution
SMSF	Self-managed superannuation fund
SMSF auditor	The auditor of an SMSF responsible for the financial and compliance audit of the fund's operation
Storm Financial	Storm Financial Limited
Stronger Super reforms	Reforms implemented in response to the Super System Review and contained in the following Acts (and associated regulations): • *Superannuation Auditor Registration Imposition Act 2012* • *Superannuation Laws Amendment (Capital Gains Tax Relief and Other Efficiency Measures) Act 2012* • *Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Act 2012* • *Superannuation Legislation Amendment (MySuper Core Provisions) Act 2012* • *Superannuation Legislation Amendment (Service Providers and Other Governance Measures) Act 2013* • *Superannuation Legislation Amendment (Stronger Super) Act 2012* • *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012*

Term	Meaning in this document
	• *Superannuation Supervisory Levy Imposition Amendment Act 2012*
T+1	Refers to the business day following the transaction date
Tier 1 products	All financial products except those defined in Regulatory Guide 146 *Licensing: Training of financial product advisers* (RG 146) as Tier 2 products (i.e. general insurance products, except for personal sickness and accident (as defined in reg 7.1.14); consumer credit insurance (as defined in reg 7.1.15); basic deposit products; non-cash payment products; and first home saver accounts) Note: See RG 146 for more details.
UCCC	Uniform Consumer Credit Code
unconscionable conduct	Conduct that is prohibited by s12CA and 12CB of the ASIC Act
Wallis Inquiry	Financial System Inquiry (1997)
Westpoint	The Westpoint group of companies, which collapsed in January 2006