ASIC's challenges in the years ahead

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Introduction

Thank you Elmer, and good morning everyone.

Today, I'd like to set out the key challenges that ASIC faces in the years ahead, with a specific focus on our exchange markets.

For those who aren't familiar with ASIC, I'll give you the two-minute version.

What is ASIC and what do we do?

We are the securities and markets regulator. However, we also regulate financial products and services in general, corporations, credit, auditors and insolvency practitioners.

We are focused on three strategic outcomes, and these basically sum up our role as an organisation.

Our first strategic outcome is: confident and informed investors and financial consumers. This can be split into three parts: education, gatekeepers and consumer behaviour.

ASIC's second strategic outcome is: fair and efficient financial markets. This can be split into three parts: market supervision, market competition and corporate governance. This outcome would be of most relevance to you.

Our third strategic outcome is efficient registration and licensing.

ASIC's registries include:

- over 1.8 million companies;
- over 6000 credit licensees;
- over 4000 financial service licensees; and
- almost 6000 auditors and liquidators.

Each year, we facilitate over 2.1 million registry updates, register over 150,000 new companies, and handle over 1 million public enquiries.

We have an ongoing commitment to reduce red tape when doing business with us, with a particular focus on small business. And this reflects the broader commitment of the Government. We want it to be as easy as possible to do business in Australia.

Three key challenges in the years ahead

I've been speaking recently about ASIC's three key challenges that we need to meet in achieving our three strategic outcomes.

Briefly, these are:

First challenge: ASIC's growing regulatory perimeter.

- It is estimated that funds under management in the superannuation sector will rise from $1.3 trillion to nearly $3 trillion over the next decade and then $5 trillion by 2030.
- More products, more investors and more money to invest increases value to the economy and capital for exchanges, but increases overall risk in the financial system.

Second challenge: Complexity in the financial system is growing.

- Advances in technology have led to increasingly complex financial products, information channels, and financial markets. Technology is advancing at a rapid rate and the complexity it brings also increases risk in the system.
- I'll talk more about this in a moment.

Third challenge: The final challenge is for ASIC to leverage its resources and be proactive, because it is through proactive regulation that we build resilience in the system.

- Benjamin Franklin once said, 'an ounce of prevention is worth a pound of cure'.
- Stakeholder engagement, surveillance, education and guidance are central to being proactive and maintaining confidence in Australia's financial system.

These three key challenges need to be met in achieving our 3 strategic outcomes.

I've raised these three challenges because it puts in context the increase in complexity in technology and the financial markets. It's one of the top three challenges that ASIC faces, and one that I'm sure you're quite aware of in your own business.

Market structure

Market competition

As you know, Australia now has competition in its exchange markets.

- Established Market Integrity Rules – April 2011
- Chi-X soft launch – 31 October 2011
- Chi-X expanded its offering to ASX 200 and ETFs – 16 November 2011
- Purematch soft launch – 28 November 2011.

Equity markets globally are undergoing considerable change. They are now overwhelmingly electronic, and predominantly automated.

- Technology has increased the speed, capacity, automation and sophistication of trading for market operators and market participants.
- It has also opened the door for new types of market participants with innovative trading strategies.
- We are also seeing significant growth of dark pool trading, particularly in relation to smaller orders, including trades on behalf of retail investors.

These developments are also occurring in other international markets.

- High frequency trading and algorithmic trading is more prevalent.
- There is a growing prominence of dark venues and internalisation.
- There is a move by exchanges to faster trading capabilities.

They raise a number of issues that can impact on the fair, orderly and transparent operation of the financial markets. These are important issues which ASIC is taking seriously.

In October 2011, we consulted on equity market structure issues – Consultation Paper 168 (CP 168) (submissions closed 10 Feb 2012).

This follows an earlier consultation we conducted in 2010.

CP 168 covers a number of issues including:

- automated trading, including high frequency trading;
- volatility controls for extreme price movements;
- enhanced data for supervision;
- the product scope of best execution; and
- pre-trade transparency and price formation in the market.

I won't go into these in detail – CP 168 is available on ASIC's website. However, I will note that these proposals are consistent with the International Organization of Securities Commissions (IOSCO) recommendations in this area.

We received 28 submissions in response to the Consultation Paper which we're currently considering. We may consult again later this year before releasing final guidance by the end of the year.

Our regulatory approach will reflect recent developments in market structure, including lessons learned overseas, and will build on the robust regime already in place.

Consistent with our second strategic outcome, we are aiming to maximise market efficiency and opportunities for innovation, while mitigating risks to price formation and delivering the best outcome for investors.

We will continue to focus on the interests of listed companies, investors and Australia's competitiveness as a regional financial centre.

Strengthening our regulatory framework

The Government is considering reforms to strengthen Australia's regulatory framework.

This followed the decision to prohibit the acquisition of ASX Limited by Singapore Exchange Limited, based on unambiguous and unanimous advice from the Foreign Investment Review Board that the proposal was contrary to the national interest.

The regulators advised that reforms were necessary to ensure we can preserve the integrity of our financial infrastructure and the strong ability of our supervisors to maintain robust oversight in all market conditions, including the prospect of any future foreign ownership or alliance of the ASX.

Accordingly, in April last year, the Council of Financial Regulators, which is comprised of Treasury, the prudential regulator Australian Prudential Regulation Authority (APRA), the central bank The Reserve Bank of Australia (RBA) and ASIC, was asked by the Treasurer to provide advice on measures that could be introduced to ensure that Australia's regulatory framework for financial market infrastructures (FMIs) continues to protect Australia's interests.

We use the term FMI to describe market operators and clearing and settlement facilities.

In October last year, the Council issued a consultation paper for FMIs with a number of proposals in relation to:

- the adequacy of regulatory oversight;
- powers of direction; and
- crisis-management arrangements.

There were 22 submissions – many of them were public submissions and are available on Treasury's website.

We expect Government to announce the next steps in the coming months.

I should also mention that the Council has been working with the Australian Competition and Consumer Commission (ACCC) to consider issues relating to competition in clearing and settlement of the cash equities market. The Council is looking to release a consultation paper on this shortly.

Also affecting this space are reforms in the over-the-counter (OTC) markets.

- The Council has been assessing how Australia should go about implementing its G20 commitment relating to trade reporting, central clearing and trade execution.
- The Council released a consultation paper last year and held a number of roundtables with industry. We are currently considering next steps.

Market supervision

Competition in exchange markets has naturally affected market supervision.

In preparation for competition, ASIC was given full responsibility for monitoring trading on the ASX in August 2010.

Since taking on responsibility for market supervision, there has been a significant reduction in the time taken to commence investigations into suspicious market conduct.

ASIC has no tolerance for any form of market misconduct, including market manipulation, irrespective of whether it originates from HFT or other participants.

We monitor HFT and algorithmic trading activity as part of our surveillance function.

- In addition to our focus on insider trading and market manipulation, we are also focusing on matters concerning order management, including problematic algorithms.
- We are working with market participants and their clients to reduce the risk of algorithms having a negative impact on market integrity.

Conclusion

Investors now have much more choice as to how to conduct their business.

Advances in technology and systems enable investors to buy securities on exchange or through dark pools.

- They can choose to use automated or algorithmic forms of trading, or lend their securities to earn income.
- They can access a huge range of products, information and research on the internet and make investment decisions in a few mouse clicks.

The operations of markets themselves are increasingly technical and complex.

- Trades have moved from taking one or two seconds to milliseconds to microseconds.
- High frequency traders using this new technology have added to exponential increases in global order books.

ASIC needs to keep pace with these rapid changes in technology to ensure markets are fair and efficient and investors get a fair price when trading on an exchange.

This is a key challenge for ASIC and industry over the next decade and a challenge that many regulators around the world are facing.

Organisations such as IOSCO, are crucial in terms of ensuring regulators are coordinated and regulatory arbitrage is minimised.

ASIC is heavily involved in IOSCOs work in this area and we're looking forward to working with industry in meeting this challenge.

Thank you for your time.