The new ASIC: Addressing today's challenges and building for the longer term

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Introduction

Let me begin with a quote from the Prime Minister of Australia, the Hon. Kevin Rudd MP:

> *The global economy today faces unprecedented challenges. We are in the midst of the worst financial crisis since the Great Depression. And that financial crisis is beginning to spill over into the real economy where it threatens to precipitate a deep and protracted global recession. A recession that will threaten growth and jobs in Australia and around the world.*[1]

The PM was speaking at the Business Council of Australia (BCA) Annual Dinner on 30 October 2008.

The crisis we are in is real. It started with over-extended sub prime mortgagors in the US causing a sharp upturn in mortgage defaults. It moved from there to a near meltdown in the global financial markets which is still impacting and it has now extended into the real economy with recession in a number of economies and challenging Australia as well.

We all can relate stories which bring these events to life. For me, ASIC's stakeholder meetings in Perth do that. Last year, at around this time, we met (the Commission periodically meets with stakeholders in each State and Territory) with the Perth business community.

The enthusiasm at the time was palpable. Western Australia's (WA) economy, it was said, was in for a sustained period of growth. The minerals and energy boom would continue, some said, for 20 years. It was not any longer a boom and bust economy for WA, as all commodities were in demand not just, for example iron ore, as may have been the case with past booms.

We had another stakeholder meeting in Perth the week before last. The mood was more subdued. Capital raisings, for example, which are needed to sustain energy and resources developments are all but dead. Some 'junior' miners may be starting to run out of cash. Some projects are being put on hold. The outlook is far less certain.

This change in mood over 12 months is all the more remarkable if we consider how much reliance we are placing on China to cushion the impact of the economic slowdown on us, and the WA economy is one of the primary beneficiaries from China's demand.

As corporate lawyers, you, like ASIC, are dealing with the issues which have arisen from this global financial crisis. Whether you are providing advice to your CEO's or Boards, involved in restructures or sell downs or refinancing, I am sure you are all busy. Over and above being busy, however, you carry important responsibilities as corporate lawyers. The giving of independent advice is important but never more important than when corporates are under financial and business pressure.

It may seem a little trite to say, but let me say it genuinely, that ASIC is here to assist you with these judgments. Corporate lawyers (indeed lawyers more generally) are an important stakeholder group for ASIC. Lawyers are an important group in helping to maintain market integrity.

My talk today is, of course, about ASIC. I will make and expand 3 key points:

- First, we have a new ASIC that is well positioned and resourced to meet the regulatory challenges which are ahead under the Corporations Act.
- Second, ASIC has a clear set of priorities, which we are executing against aimed at maintaining and building confidence in the integrity of our markets.
- Third, we are well positioned to participate in the regulatory reform agenda which will follow and, importantly, reforms that should nurture the recovery of our financial markets.

Over and above these 3 points, however, I would like to leave you with an important note of confidence. Our regulatory system is robust and ASIC, as the oversight body for the Corporations Act, is mature and has embarked on what we, at ASIC, believe will be one of our most productive periods, in exercising our powers and performing our functions. 'Exercising our functions to make a real difference in improving confidence in financial markets and protecting investors and consumers'—this is a benchmark against which we will assess ourselves periodically. We conducted our first stakeholder survey last year and published the results on our website and these results provide a base or a starting point.[2]

I have titled my talk 'The new ASIC: Addressing today's challenges and building for the longer term'. This is different to the title in your program. At the time I accepted the invitation to speak, the financial crisis was just starting to unfold. Although the program subject of 'The future direction of regulation in Australia' is quite relevant, and I will cover that direction, what is also important is how we are responding to the financial crisis and hence I have broadened the topic.

ASIC has a solid base to build on

ASIC is one of a number of important regulators in Australia, along with Reserve Bank of Australia (RBA), Australian Prudential Regulation Authority (APRA) and the Australian Competition and Consumer Commission (ACCC) and a number of other bodies[3] and, of course Government and Government departments such as Treasury.

Speaking at the BCA on 30 October 2008, the Prime Minister said:

> *The Government is in daily contact with the Treasury, the Reserve Bank, APRA and ASIC … These institutions have performed well, giving timely advice and helping Australia stay ahead of the curve in addressing the crisis and maintaining confidence.* [4]

Our regulators, including ASIC, are assisted in their work by a number of other important features of our financial markets:

- A sound regulatory framework has evolved over successive Governments and its benefits are positively recognised internationally (e.g. by the in International Organization of Securities Commissions (IOSCO)).
- We have a strong culture of compliance and good corporate governance in Australia. We see this particularly with our larger companies and financial institutions. This strong culture is reinforced by the rule of law and the good work that you do as corporate lawyers.
- Our top CEOs and Boards (recognised internationally) have, by and large, pursued sound strategies and business models. The performance of our banks compared to their international peers is an example of that better performance. There are other examples. Of course, not all business models or strategies have worked. Nor would we expect them to. Free enterprise will always have successes and failures as the financial crisis has so forcefully reminded us. Overall, however, we have well qualified executives and well run companies.
- We have a robust legal infrastructure which regulates the markets. For example, our exchange traded market operators (most notably the Australian Securities Exchange (ASX)) have functioned well during the crisis both in relation to systems and processes and in maintaining confidence in the integrity of our markets. Our securities markets may have dropped significantly since their height, but confidence in the integrity of our markets remains sound when assessed against the events of the last 12 months.[5]

These positives not only assist the regulators but set the scene for recovery as well. These features of our financial markets will be important in keeping costs of capital low as our companies and financial institutions recapitalise.

ASIC is a new agency…

Let me now turn to the 3 points I said I would make and elaborate on each. The first is that we have a new ASIC that is well positioned and resourced to meet the challenges ahead under the Corporations Act.

ASIC has completed a strategic review of the organisation assisted by an external management consulting firm.

In addition we received input from business and consumer bodies through, for example, the external stakeholder survey I mentioned earlier. The outcomes of that review have been:

- a clear vision built on ASIC's statutory responsibilities—notably to make a real difference in improving the integrity of our financial markets and protecting investors and consumers[6]
- a clear set of priorities in pursuing that vision—notably market integrity in the capital markets, protection of retail investors and financial consumers and facilitating global capital flows[7]
- new leadership—notably changes at all leadership levels; Commission with new members (2 still in process of being appointed), collapsing of 2 layers of senior management into one, and 25 new leaders (9 appointed externally and 16 internal promotions)[8]
- a new structure that is outwardly market focused—12 stakeholder teams (industry based) and 8 deterrence (enforcement) teams[9]
- new investment in market research, and in the development of our people and leaders[10]
- a better balance between regional and national responsibilities through an expanded role of the Regional Commissioners. The office of Regional Commissioner will be available to you when you need assistance on local matters or generally as another point of entry into ASIC.[11]

The key differences between the old and new ASIC are:

- *Clearer vision against which we test and explain why we may intervene or commence proceedings*. For example, recently we commenced proceedings in the James Hardie case. We made it clear that the action was in the public interest as it would involve the responsibility of executives and non-executives when Boards of public companies make important or 'betting the farm' type decisions.[12]
- *Clearer priorities which are framed more narrowly around what matters*—what we say matters are capital markets and market integrity, retail investors, financial consumers and global capital flows. For example, we have made it clear that we consider that it is in the public interest to commence compensation proceedings for retail investors (for example, as in Westpoint) who have suffered loss and have limited means or access to relief.[13]
- *Greater investment in the development of our people and an increased number of leaders to take on responsibilities*. ASIC's new employee value proposition is simple: staff working for ASIC can expect challenging work

and going forward, credential building development. Our network leaders program and our ASIC Academy program are new and offer credential building opportunities. Put simply, we want people to work at ASIC because the experience and training they receive will build for them important and sought after credentials. Staff get experience and have more valuable credentials. For ASIC, a reputation for building excellent credentials will make ASIC a sought after place for new talent.

Now, we all know that making changes is one thing, delivering results through those changes is another. Many restructures fail because they do not deliver better results.

We are confident, however, that with the new ASIC, better results will be delivered. Let me illustrate this statement by talking about some of the results we are achieving (even though it is early days post our restructure).

Before December 2007

The first example of our new approach is in the period leading up to December 2007 before the current crisis. We restored confidence for investors in the unlisted unrated debenture area. We examined the whole sector and came up with a new disclosure regime against certain benchmarks. We also introduced a new advertising regime. Our focus was to provide better and informed disclosure so retail investors could make better decisions. We pushed the disclosure regime in the Corporations Act to the limit.[14]

Now what was different and new in this approach was that instead of only continuing with investigations after failures had occurred (e.g. Westpoint), we added another dimension to our work which took a forward look and examined the whole unrated and unlisted debenture sector. We focused on the underlying business models that debenture issuers were using. We used external experts to assist us with the new benchmarks for issuers to report against. In short, better results for the whole sector and retail investors.

From December 2007 to May 2008

Let me take another example. The financial dislocation which began in the United States (US) in late 2007, started to impact in Australia in 2008—the January drop in the stock market was the first clear outward sign.

In the February to April period we saw impacts on companies, stockbrokers and margin lenders (MFS, Centro, Allco, Rubicon Funds, Tricom, Opes Prime). We saw increases in funding costs and difficulties with the availability of liquid funds.

A test for the new ASIC concerned the calls for banning short selling. Covered short selling was attacked at a time when margin calls were being made for example, on director shares. Our judgment was that under our Corporations Act regulatory framework, there is a role for short selling (e.g. for liquidity and price discovery). Certainly if markets are orderly, in the sense that buyers and sellers operating confidently, there is a place for short selling.

When we examined what was happening at the time, we could not see a cause and effect between short selling and downward prices. Yes, prices were going down; however, in many cases downward price reflected the market being hard on companies with high asset values and high gearing. Our judgment was that in that part of the cycle, short selling was not creating a disorderly market.

Our main concern with covered short selling was disclosure. We agreed with the ASX that covered short selling should be disclosed and the Government took that on as an issue for reform.

Now what was different and new was that with the assistance of our new research unit and Chief Economist, we were able to follow market developments more quickly than in the past and we were able to make these assessments in 'real time' and not some time later with the benefit of hindsight.

What was also new in this period was our approach to so called 'rumourtrage' or potential insider trading and market manipulation.

We made our concerns in this respect clear to the market and we followed with significant investigations that are ongoing. The benefits from this approach are starting to emerge:

- The speed at which we investigate ASX referrals has increased. Since January 2008, ASX has referred 86 matters to ASIC. ASIC has acted on all of them:
  - 48 are in investigation
  - 18 have ongoing surveillance
  - 20 have been closed (at this point) for insufficient evidence.
- The number of matters before the courts and with the Commonwealth Director of Public Prosecutions (CDPP) have increased. Currently, we have 10 matters before the courts—we have 1 insider trading matter, 5 market manipulation matters, 2 on continuous disclosure, 1 on directors duties and 1 on misleading statements. In addition, we have 12 other matters with the CDPP.

As investigations take time, these statistics will increase over the coming 12 months. Our improved record in these areas of insider trading and market manipulation is a direct result of the restructure and changes we have made at ASIC.[15]

An important point we have made to the market is that our approach with insider trading and market manipulation is to emphasise the deterrence aspect by looking primarily at criminal proceedings above civil penalties.

Although the standard of proof is higher with criminal proceedings and actions can take more time, we see the deterrence impact from criminal prosecutions as the important in minimising this misbehaviour. We will nevertheless keep our options open in using civil penalties in appropriate cases.

From August 2008 to date

Another example of our new approach is the short selling ban (using our limited modification powers under the Corporations Act). The northern hemisphere summer came and those who returned to work after summer must not have had a good summer holiday because September unleashed the next wave in the financial crisis:

- The US government supported Fannie Mae and Freddie Mac—$200 billion.
- Lehman Brothers went bankrupt ($600 billion). Merrill Lynch was acquired by Bank of America.
- Central banks pumped billions into the financial economy.
- HBOS was acquired by Lloyds in a forced sale.
- President Bush announced $700 billion bailout. Rejected first and a week later passed.
- Goldman Sachs and Morgan Stanley converted to banks.
- And so it went on and it continues including cuts of interest rates in Australia and the stimulation package of $10.4 billion.
- And, of course, there has been extreme volatility in stock markets.

These events had a significant impact on confidence and with it, buyers stayed away from the market. With more sellers, prices declined although there was extreme volatility.

The key issue which re-emerged for our securities market and for ASIC and ASX was short selling. What we had was:

- a crisis of confidence
- 'rumourtrage' continuing
- heavy short selling, particularly of the financials. Financials are particularly vulnerable. If their share price drops enough, for example, their credit

rating can be downgraded with consequential further drop in share prices—something well known to the short sellers.

International markets (UK and US) and others closed their markets to short selling in relation to financials. Australia looked like being one of the markets left open for hedge fund short selling activity. We decided to close the market for short selling. Initially, we thought that banning of naked short selling and more disclosure for covered short selling would suffice but it became clearer to us on the weekend of 20 and 21 September that more was needed. We extended the ban on naked short selling to covered short selling.

We have now indicated to the market that:

- covered short selling for non financials is expected to reopen from 19 November 2008
- covered short selling for financials (because of the potential systemic issues) will remain closed until January (in line with the Financial Services Authority(FSA)).

We saw this circuit breaker as important in assisting with confidence. The reopening of the market will be coupled with new disclosure of short selling which the ASX will administer.[16]

Were we correct? We believe we were and with the benefit of hindsight a significant part of the market thinks so as well. An example to illustrate why we needed to take action is the Italian stockmarket. There, when we banned both naked and covered short selling, they banned only naked short selling. One of their largest banks was the subject of heavy selling and lead to a ban on covered short selling. This was soon followed with a ban on all short selling. We believe we avoided similar disruption on our market by placing the ban on when we did.[17]

Our approach has not been without controversy:

- Unannounced sharp changes in the law are not good for markets. They can drive more loss of confidence.
- It is not good for regulators to make decisions without consultation.
- Unintended consequences can occur: in our case, the stock market delayed opening for an hour while we sorted out exemptions for hedge positions.

Nevertheless, we felt protecting the Australian market (and our financials) from attack was the higher priority to assist with confidence. This is another example of the new ASIC and decision making which, in response to the market issues, needed to be quick and decisive.

Our actions on short selling are not only in relation to a ban. Yesterday, for example, Mr Spagnolo appeared in the Melbourne Magistrate's Court on five short selling charges. ASIC alleges that Mr Spagnolo sold shares and options he did not own contrary to s1020B(2) of the Corporations Act.

It is early days for the new ASIC. However, we believe we are demonstrating that our changes following the strategic review are delivering improved performance in the way we are now handling issues such as Westpoint, James Hardie, short selling, unlisted unrated debentures and so on.

ASIC has clear priorities…

My second point is that ASIC has a clear set of priorities, that we are executing against, and which have the objective of maintaining and building confidence in the integrity of our financial markets. These priorities, as I said earlier, centre on our capital markets, retail investors and consumers and international capital flows.

In addition, we will continue to deal with issues as they arise and with what we call business as usual. You can, for example, still expect to come to ASIC for waivers and modifications and deal with us on breaches and so on as you have in the past.

An example of ASIC moving quickly to deal with emerging issues was the announcement we put out last Friday on 'hardship' and mortgage trusts.[18]

In the case of mortgage trusts, we have indicated to the market that we are prepared to allow trustees to apply hardship relief to give members earlier access to funds in the 'frozen' trusts. In forming that view, we consulted and assessed that sector and balanced hardship against equality of treatment of members of these trusts.

As I said, however, we have a clear set of priorities which we are executing against. ASIC's 12 stakeholder teams and 8 deterrence teams, have focused their business plans on what we think will matter over the next 12 to 18 months and beyond.

Expanding that, earlier I spoke about the work we are doing on the subject of 'rumourtrage' and the work on insider trading and market manipulation. These are good examples of the work that our deterrence teams which will continue over the next 12 to 18 months and beyond. Other areas where our deterrence teams have similar objectives relate to such matters as illegal managed investment schemes, bannings, breaches of directors duties and breaches of continuous disclosure.

A new feature for these teams will be to take on difficult cases where, whether we may win or lose, we use the case to test important principles which clarify the law on issues. Where clarity in the law is in the public interest (e.g. directors duties) we will run test cases; always, of course, complying with our model litigant responsibilities.

You will hear a lot more from our stakeholder teams as they implement their business plans as they will continue to consult widely. Let me however cover some examples of their work programs to give you a flavour:

- Our accountants and audit group will focus on audit quality and on the new accounting issues (e.g. fair value) which are emerging from the current crisis.
- Our insolvency group will do more on improving quality with administration and liquidation and early detection of companies who may be in difficulties.
- Our emerging mining and resources group will focus on particular issues (e.g. difficulties in raising capital or valuation of interests) in that sector.
- Our investment banks, exchange traded markets, and broker and market participants groups will concentrate on supervision of the markets and on the brokers and market participants. Another focus for them will be the OTC markets and issues concerning hedge funds and credit rating agencies.
- Our credit group will be particularly busy as we transition into ASIC its new credit responsibilities.[19]
- We have a number of groups involved in the important issues of retail investor protection in superannuation and funds management.
- The financial advice industry is important to provide access to quality advice for retail investors. We have a group dedicated to examining the issues in this sector and assisting investors with access to quality advice.
- Our consumer protection group will continue to develop investor and consumer education tools and develop projects for improving financial literacy.
- We have a number of special project teams including one examining the lessons for us from major corporate collapses.

The leaders of our stakeholder groups and deterrence groups are really like partners in a professional services firm. They have prime areas of responsibility but essentially they will come together and form teams to handle transactions as they arise. For example, our Westpoint team is drawn from across a number of teams as is our Opes Prime team.

This has important benefit for our stakeholders. It will enable us to assess a matter and use a wide range of response tools we may have (e.g. from discussion to litigation and to law reform). For example, a matter may start off as deterrence but the team may well move it out of a court case into another way of resolving the issue.

From the examples I have given, you can see that we have clear priorities and have developed business plans for the stakeholder and deterrence teams. Importantly, we have the flexibility to respond to issues as they arise.

ASIC is well positioned…

My third point is that as part of its international work, ASIC is well positioned to provide input to other global regulators and to the Australian Government on the reform agenda. There seems little doubt that a financial markets reform agenda is developing in the US and in Europe. This is inevitable given the significant nature of the problems that the financial markets have experienced in those places.

And while Australia's system is more robust, Australia is part of the global capital flows and it will need to engage (as both the Treasurer and PM have said) in this reform agenda. For example, the Government has committed Australia to contributing to the work of the Financial Stability Forum (FSF).

The reform of the regulatory system is primarily a matter for Government. Our role along with other regulators in Australia is to assist Treasury in the advice it provides to Government.

ASIC is well placed to provide that assistance through its position on IOSCO (the international body of securities regulators) where it is represented on the 2 key committees (the Technical Committee[20] and Executive Committee) and, as well, is on a number of important working groups. ASIC is also a member of the Joint Forum of Financial Regulators that brings together representatives of the international associations of banking, securities and insurance regulators.

Not only are we well placed on bodies such as IOSCO, but we have been with Government and Treasury and other regulators, achieving successes on international matters (so we come to these issues with good credentials). Examples of recent successes are:

- *A major focus of our work has been with the US*. The US Securities Exchange Commission (SEC) entered into a Framework Arrangement with ASIC and the Minister for Superannuation and Corporate Law on 25 August 2008. This was the first of its kind that the US entered into. This mutual recognition arrangement will—over time—translate into lower transaction costs when dealing on each other's markets and improved liquidity. The aim is to complete the implementation of this process and issue the relevant exemptions as early as possible in March 2009.[21]

- *ASIC (with Treasury) played an important role in formalising an agreement that allows greater investment from China in Australian markets*. On 10 June 2008, we accepted a Letter of Exchange with the China Banking Regulatory Commission (CBRC) that recognises Australia as an approved investment destination under the Chinese Qualified Domestic Institutional Investor (QDII) scheme.

  As a result, Australia will now be a greater destination for China's capital investment, leading to more liquidity in our markets and new investment opportunities for Chinese institutions and investors. Qualified Chinese commercial banks will now be able to engage the services of Australian investment managers.[22]

- *On 7 July 2008, ASIC signed the Declaration on Mutual Recognition of Cross-Border Offering of Collective Investment Schemes with the Hong Kong Securities and Futures Exchange (SFC)*. Under this agreement, the SFC agreed to allow certain managed investments registered with ASIC to offer in Hong Kong and certain collective investments authorised by the SFC to offer in Australia. This is the first time the SFC has granted this type of recognition to foreign schemes and is a clear manifestation of the high standing of our regulatory system.[23]

- *The Trans-Tasman Mutual Recognition Scheme came into force on 7 July 2008*. Under this agreement, Australia and New Zealand (NZ) agreed to mutually recognise securities offerings. This means issuers can now use one prospectus to offer shares, debentures and/or managed or collective investment schemes to investors in both countries, subject to certain agreements. To date, one NZ issuer (a collective investment scheme) has used the scheme to fund raise in Australia using an NZ prospectus and there have been 35 Australian issuers (24 from 1 group) who have used the scheme to fund raise in NZ.[24]

As you can see, our relationship and work in the international area is producing results. We will use these relationships and connections to assist us to understand the issues which are emerging and their potential impact in Australia.

The key to the reform agenda will be to strike a proper balance between protection of investors and allowing markets to operate to deliver low cost of capital for companies operating in the real economy.

Let me expand a little on the global reform agenda.

Regulatory architecture

First, let me talk about regulatory architecture.

The global nature of the current crisis is causing countries to ask the question of whether the current international regulatory structure of cooperation needs to move to more direct global regulation. For example, should credit rating agencies be the subject of more global oversight (as we are seeing with auditors) because the products they rate impact number of markets? In the case of short selling, the movement of money by hedge funds caused responses from a considerable number of markets in a short time. The responses differed and were not always uniform. Did this matter and, if it did, can anything be done internationally about that?

ASIC will seek, within its responsibilities, to be across these issues and input as necessary to Government. A practical example of what we are doing in this regard is to use our Summer School next February to focus on the regulatory issues which have emerged and bring together leading international and local thinkers to promote debate and discussion in Australia. The focus will be very much on the big reform issues which are emerging, including regulatory architecture.

In addition to discussion on regulatory architecture, there are a number of issues which are emerging and which are being carried forward at an international level. These are at different stages of discussion and ASIC will participate (within its responsibilities) and provide input to Government. Let me mention a few of those issues.

Credit rating agencies (CRAs)

There have been calls for a re-examination of the regulatory framework for credit rating agencies (CRAs). Concerns have arisen in the way CRAs rated some of the products where there have been difficulties in the current crisis. Examples of issues being addressed are:

- overall quality and reliability of ratings, especially for structured products—this includes issues of transparency and accountability for the ratings process and conflicts of interests
- related to these is the responsibility of investment managers when using ratings and their related due diligence.

At the international level these issues are being progressed by FSF and IOSCO. In May 2008, in response to an FSF recommendation, IOSCO issued a revised Code of Conduct Fundamentals for CRAs aimed at improving the quality of the rating process and to address conflicts of interest in the rating of structured products.

In September 2008 IOSCO completed an assessment of methods for checking compliance with the Code and set out measures that it believes will contribute to the international monitoring of CRAs. IOSCO is also coordinating supervision of globally significant CRAs.[25]

In Australia, the Government set up a joint working party of ASIC and Treasury to work on credit rating agency issues and advise Government.

Over-the-counter (OTC) markets

Over-the-counter (OTC) markets are an important factor of our markets. In Australia, OTC markets cover trade in foreign exchange, government and non-government securities, repurchase agreements, interest rate swaps and forwards, credit derivatives and others, accounting for two-thirds of daily trading in Australian financial markets. These markets are not regulated in the same way as exchange traded markets and operate without the standardisation and transparency of exchange traded markets. In some respects, their very lack of transparency is a beneficial factor of these markets for traders (i.e. able to keep their deals confidential).

An example of an OTC market which is under review in the US and Europe is the credit default swap (CDS) market. CDSs are derivatives used to transfer risk of default on debt from a buyer to a seller of the CDS. The majority of CDSs are executed in OTC markets. Counterparty risk is one of the key risks in the market if there is a default.

The FSF has recommended that market participants should act promptly to ensure that the settlement of the legal and operational infrastructure underlying the OTC derivatives market is sound.

In June 2008 the Federal Reserve Bank of New York and a group of primary OTC derivatives dealers and supervisors agreed on an agenda to improve the OTC derivatives market infrastructure. This includes the possibility of more exchange traded OTC products with proper counterparty risk protection and increased market transparency.[26]

On 31 October 2008, the Federal Reserve Bank of New York reported the market is pursuing the implementation of a central counterparty in CDSs. It is expected that a central counterparty will clear CDS index transactions during November and some single name CDSs by January 2009.[27]

In Australia, ASIC, APRA and the RBA have established a working group to monitor international industry developments, to review how the Australian practices compare, and to see what opportunities exist to harness these international developments to improve the efficient and transparent operation of Australia's CDS market.

Hedge funds

Hedge funds, funds which engage in different form of trading on the markets, provide an important source of liquidity and price discovery. Hedge funds are generally supported by larger prime brokerage houses operating out of the investment banks.

The future regulation of hedge funds is a subject of discussion internationally and consideration of these issues is being led by IOSCO.

Current issues include:

- *Valuation of hedge funds portfolios*—hedge fund strategies can involve exposure to complex financial products and difficulties can arise around valuing their investment portfolios. In November 2007, IOSCO released a final report on setting out valuation principles for hedge funds that are applicable internationally.[28]

- *Regulatory standards for funds of hedge funds*—hedge funds raise capital from both the institutional and retail sector. Their complexity raises particular issues for the retail sector. IOSCO has recently issued a consultation paper examining regulatory standards in relation to such matters as liquidity risk and due diligence processes.[29]

ASIC is involved in the supervision and oversight of hedge funds. Over the coming months, ASIC will be consulting with industry and assessing what additional steps we need to take with the supervision and oversight of hedge funds.

These are 3 examples of the types of issues which have and are emerging globally. There are others:

- accounting and disclosure standards for off balance sheet activities[30]

- fair valuation of financial instruments when markets become inactive and fair value disclosures in such situations[31]

- issues to do with oversight of financial strength, liquidity and risk management, for example:

  – liquidity and balance sheet strength for investment banks, stockbrokers and clearing and settlement participants

  – adequacy of internal control policies and systems

  – remuneration arrangements aligned with risk management settings.[32]

You will see that collectively the reform agenda involves significant potential changes to financial markets.

Although Australia has a sound regulatory system, it nevertheless needs to be engaged in these issues because Australia's financial markets are global markets. It will be important for those, like ASIC, who represent Australia at international meetings such as IOSCO that we participate in the discussions and bring our experiences to bear. In addition, through participation we can improve the quality of advice we provide to Treasury and Government.

As I said earlier, what will be important as this reform agenda develops will be to balance the benefits that efficient financial markets can provide in nurturing recovery against investor protection and potential systemic problems.

Conclusion

Let me conclude by thanking you for allowing me to speak to you this morning. I hope that what I have conveyed to you is that we have a robust regulatory system in Australia and a new ASIC which is focused on the right domestic issues. And, importantly, an ASIC which has a greater understanding of its markets and their global connections. An ASIC which will use that understanding and those connections to follow the reform agenda as it develops and advise Government and Treasury on the potential impact of that reform agenda on Australia. And in providing that assistance seek to strike the right balance between efficient markets which will assist recovery and investor protection.

End notes

[1] The Hon. Kevin Rudd, MP, Prime Minister of Australia, '*Addressing today's challenges and building for the long term', Annual dinner of the Business Council of Australia*, Sydney, 30 October 2008.

[2] The Allen Consulting Group, April 2008, *'ASIC Stakeholder Survey—Quantitative Report'* <Hhttp://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/Stakeholder_survey_2008.pdf/$file/Stakeholder_survey_2008.pdfH>.

[3] Other regulators include the Australian Transaction Reports and Analysis Centre (AUSTRAC) and the Financial Reporting Council (FRC).

[4] The Hon. Kevin Rudd, MP, Prime Minister of Australia, *Addressing today's challenges and building for the long term'*.

[5] Since peaking on 1 November 2007, the ASX/S&P has dropped by 44% (on 28 October 2008).

[6] ASIC also performs an important role in the real economy (e.g. registrations and licensing). Its vision for that part of its operation is to deliver outstanding and cost effective services. ASIC's two overarching priorities in the real economy are to help small and medium business and to lift operational effectiveness. Information on these priorities can be found in the ASIC Annual Report '*A Year of Change*' 07-08 <Hhttp://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/Full Annual report 0708.pdf/$file/Full Annual report 0708.pdfH>.

[7] ASIC's 3 priorities in the financial markets were articulated in May 2007 at Senate Estimates: Australia, Senate 2008, Standing Committee on Economics, Estimates, 30 May 2007, pE91-E94.

[8] Appointments spread across Sydney and Melbourne and smaller offices across Australia. In terms of gender 15 male and 10 female.

[9] Stakeholder teams: Insolvency practitioners & liquidators, Corporations, Exchange market operators, Investment banks, Investment managers, Consumers & investors, Accountants and auditors, Emerging mining and resources, Market participants and stockbrokers, Super funds, Deposit takers, credit and insurance providers, and Financial advisers. Deterrence teams: Market integrity 1&2, Corporations/Corporate governance 1&2, Financial services 1,2&3, and Major fraud/international.

[10] New Strategy unit; appointment of Chief Economist to head market research; External Advisory Panel to provide advice on business and consumer matters to the Commission.

[11] Regional Commissioners are there to assist you on State or Territory or general matters. The regional commissioners and their office locations are: Maree Blake (Brisbane), Warren Day (Melbourne), Delia Rickard (Canberra), Julie Read (Hobart), Bruce Dodd (WA), Mark Bielecki (SA), Duncan Paulson (NT).

[12] *James Hardie Group civil action*, media release 08-201, ASIC, 5 September 2008.

[13] *ASIC to pursue compensation for Westpoint investors*, media release 07-291, ASIC, 8 November 2007.

[14] ASIC, Regulatory Guide 69 *Debentures—improving disclosure for retail investors* (RG 69), April 2008 and Regulatory Guide 156 *Debenture advertising* (RG 156), December 2007.

[15] The Capital Markets Taskforce, led by Commissioner Belinda Gibson, was established in 2007 to oversee ASIC work on insider trading and continuous disclosure, and to look more broadly at future developments in capital markets and how ASIC can contribute to market integrity.

[16] *Requirements for disclosure and reporting of short sales from 19 November 200*8, media release 08-211, ASIC, 28 October 2008.

[17] For example see <Hhttp://www.cnbc.com/id/27114282/H>.

[18] *ASIC facilitates withdrawals from frozen funds*, media release 08-214, ASIC, 31 October 2008.

[19] K Rudd (Prime Minister), C Bowen (Assistant Treasurer and Minister for Competition Policy & Consumer Affairs), *New measures for Australian financial services*, joint media release, Australian Government, 3 October 2008.

[20] The IOSCO Technical Committee comprises 15 securities regulators from larger, more internationalized markets that meet to review major regulatory issues related to international securities and futures transactions and to coordinate practical responses to these concerns. Members are: ASIC, Autorité des marchés financiers (France), Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), (Germany), Securities and Futures Commission (Hong Kong), Commissione Nazionale per le Società e la Borsa (Italy), Financial Services Agency (Japan), Comisión Nacional Bancaria y de Valores (Mexico), The Netherlands Authority for the Financial Markets, (Netherlands), Ontario Securities Commission (Ontario), Autorité des marchés financiers (Quebec), Comisión Nacional del Mercado de Valores (Spain), Commission fédérale des banques, (Switzerland), Financial Services Authority (United Kingdom), Commodity Futures Trading Commission (United States of America), Securities and Exchange Commission (United States of America).

[21] *Australian authorities sign mutual recognition agreement*, media release 08-193, ASIC, 26 August 2008.

[22] *ASIC welcomes agreement as real win for the market*, media release 08-126, ASIC 16 June 2008.

[23] *Australia and Hong Kong sign deal to allow cross-boarder marketing of retail funds*, media release 08-152, ASIC, 7 July 2008.

[24] N Sherry (Minister for Superannuation & Corporate law), *World first in comprehensive mutual recognition of securities offerings*, media release, Australian Government, 13 June 2008.

[25] *IOSCO urges greater international coordination in the oversight of credit rating agencies*, media release 011/2008, IOSCO, Madrid, 17 September 2008.

[26] Financial Stability Forum, *Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience—follow up on implementation*, 10 October 2008 p14.

[27] See <Hhttp://www.newyorkfed.org/newsevents/news/markets/2008/regulators_letter.pdfH>.

[28] *IOSCO Finalizes Principles for Valuation of hedge Fund Portfolios*, media release, IOSCO, Madrid, 19 November 2008.

[29] *IOSCO consults on regulatory standards for Funds of Hedge Funds*, media release, IOSCO, Madrid, 6 October 2008.

[30] Relevant international bodies considering this issue include the FSF, IOSCO and the International Accounting Standards Board (IASB).

[31] Relevant international bodies considering this issue include the FSF, IOSCO and the International Accounting Standards Board (IASB).

[32] Relevant international bodies considering this issue include the FSF and the International Institute of Finance (IIF).