ASIC Chairman's address to FINSIA Conference 2012

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

Financial Services Institute of Australasia Conference 2012,
Sofitel Sydney Wentworth

10 October 2012

Good morning, everyone.

Today, I'd like to outline three areas that are front of mind for ASIC.

However, before I do so, I think it's worthwhile touching on the recent Fortescue decision by the High Court.

- It provides some important guidance to the market on misleading and deceptive statements.
- Because the court found there weren't any misleading or deceptive statements made by Fortescue, the decision did not need to consider the continuous disclosure provisions in the Listing Rules or the Corporations Act in any detail.
- ASIC continues to see continuous disclosure by listed entities as a bedrock of market integrity and a central tenet of fair and efficient markets.
- The ASX is updating its guidance on continuous disclosure. We think this is important and we encourage people to provide comments on the draft guidance that the ASX releases for consultation.

But today, I'd like to focus on three areas:

- retail complex products;
- high frequency trading and dark pools; and
- education.

I will start with retail complex products.

Retail complex products

What is the issue?

One of ASIC's strategic priorities is to promote confident and informed investors and consumers. Products that are sold to retail investors and are more complex in terms of structure or features will, therefore, receive additional scrutiny from the regulator.

Why raise this issue now? There are two reasons.

The first is the current state of the financial markets. We are in a period of lower investment returns. Yields are down and volatility is up. This means retail investors are more likely to be attracted by claims of higher returns that can be achieved through complex products.

The second reason is the growth in Australia's superannuation sector. Super is at $1.3 trillion and forecast to grow to $3 trillion in the next decade. At the same time, self-managed super funds are growing as a proportion of the sector, from 33% to 40%. These self-managed super funds will need to invest that money somewhere, and complex products which offer higher yields in the current environment could look very attractive.

There is a real risk of complex products being mis-sold to retail investors. Products that are mis-sold are dangerous for investors because they don't understand the risks. But it is also bad for the product issuer because their reputation is on the line. Issuers are likely to pay for investors' losses to either protect their reputation or due to legal action.

For example, the recent Federal Court decision found Lehman Brothers liable for the losses on CDOs [collateralised debt obligations] incurred by Australian councils, charities and churches.

It's not a sustainable business model if your customers don't understand the product and lose money.

It's better to be proactive if you are a product issuer or distributor, and ensure your products aren't mis-sold to investors in the first place.

What is ASIC doing?

We will be focusing on gatekeepers (issuers, advisers, distributors etc), who are involved in the manufacture and sale of complex products.

This includes reviewing the marketing of products, such as advertising and disclosure documents, which may be misleading and deceptive as to the nature or features of the product.

We will also be considering the appropriateness of advice given to investors, including self-managed super funds, to invest in complex products.

I encourage you to consider what steps you can take to avoid complex products being mis-sold to retail investors.

As an example, when I talk about complex products I mean things like synthetic ETFs (exchange-traded funds), capital-protected products and capital notes, also known as 'hybrids'.

High-frequency trading and dark pools

The next area I wanted to raise has been receiving a lot of press these past few months. They are global issues and they have the attention of regulators all over the world.

I'm talking about high-frequency trading and dark pools.

These issues are relevant for ASIC's second strategic priority, fair and efficient financial markets.

What is the issue?

The rise of high-frequency trading and dark pools has brought forth new challenges for ASIC.

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.

Recent events in the US are a reminder of the speed and automation of markets and the importance of having robust controls over those systems. In the US, this new type of trader is estimated to be responsible for 50% to 60% of market trading. And while some say high-frequency trading provides liquidity, I know some very senior bankers that privately describe it as providing only 'phantom liquidity'.

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.

High-frequency trading has been one of the factors for the recent increase in dark pools.

Trades in dark pools are getting smaller and more frequent. We have even seen retail order flow being put into dark pools.

If too much liquidity is moved off the lit markets, it can impact the bid–offer spread.

What is ASIC doing?

We have proposed new rules for dark pools to apply in mid-2013, for example:

- If you want to trade in a dark pool, there must be meaningful price improvement (i.e. one tick size or mid-point), unless it's a block trade. We think that this provides the right incentives to limit the amount of dark trading.
- We will lower the block trade threshold from $1 million to $200,000 for the vast majority of stocks. This will significantly benefit the fund management community and participants that facilitate trades.
- We will also track trades in dark pools so we can look at trading behaviour in real-time.

In relation to high-frequency trading, we've proposed rules and guidance on automated trading. Our proposals will apply in early 2014 and will build on existing requirements such as participant filters, exchange level order entry controls and extreme cancellation ranges.

The proposals include:

- A kill switch to immediately disable rogue algorithms; and
- A form of circuit breaker to prevent trades from occurring and to reset the market where unusual volatility occurs.

ASIC will continue to seek out poorly-designed algorithms through ongoing surveillance.

We have also established ASIC taskforces on both dark liquidity and high-frequency trading to consider whether the regulatory framework is appropriate. We will look at things like greater transparency, conflict management and monitoring obligations for dark pool operators and consider whether the current concept of market manipulation is valid in this new electronic world.

Our view is that we should have a level playing field: whether it's a dark market or a lit market, essentially the same type of market infrastructure should apply.

Education

The last area I wanted to cover is education.

While ASIC will do all it can from a regulatory perspective, to quote Benjamin Franklin, an ounce of prevention is worth a pound of cure.

If we can improve the financial literacy of consumers and investors, they can make better decisions about when to invest and better understand the risks they're taking.

Recent survey results showed young Australians aged 18 to 24 have some of the lowest levels of financial literacy compared to other age groups.

This is disturbing, because young people are exposed to the financial world from an earlier age than ever before. Using your mobile phone, let alone purchasing products using your mobile, requires financial discipline. Access to credit is easier, with credit cards and home loans now prevalent.

In fact, ASIC's credit card debt clock shows Australians have $37.6 billion debt on their credit cards that is accruing interest. This is an average debt of $4,800 per credit card. At credit card interest rates of 15% to 20%, this is a significant issue.

There are two key parts to ASIC's work in improving Australia's financial literacy.

MoneySmart

The first part is our website, MoneySmart. MoneySmart is only 18 months old and has received over 2.9 million unique visitors.

It covers topics such as budgeting and managing money, borrowing and credit, superannuation and retirement, and investing basics and scams. It has more than 400 pages of content, and 26 interactive financial calculators and tools, many available for mobile phones and tablets.

It's won multiple awards, but more importantly our research tells us that 89% of users have taken specific action with their finances as a result of visiting MoneySmart. It's a very powerful tool for informing consumers about how they can manage their finances.

We have a range of tools to get the public engaged with MoneySmart. We are on Twitter, Facebook and YouTube with:

- 2,000 Twitter followers;
- 1,200 Facebook likes; and
- 198 YouTube videos which have been viewed 62,000 times.

Our latest smartphone app called 'Track my spend' helps users have an up-to-the minute snapshot of their spending habits. Our MoneySmart apps have been downloaded 160,000 times.

Last month, ASIC took part in MoneySmart Week. MoneySmart Week was about encouraging Australians to take action to improve their personal finances and do a Money Health Check.

We had 20,000 people undertake the Health Check.

Helping Our Kids Understand Finance

The second part to ASIC's work in the financial literacy space is the Helping Our Kids Understand Finance initiative.

This initiative is aimed at embedding financial literacy in the Australian school curriculum from Kindergarten to Year 10. It's a long-term strategy to ensure our children have the skills and knowledge to deal with financial issues.

ASIC is developing a MoneySmart Teaching package to help teachers teach financial literacy. We have released resources for primary school teachers and expect to release resources for high school teachers by the end of the year.

We are trialling the Helping Our Kids Understand Finance initiative in about 90 schools nationally, before we roll it out. As part of this, we will be providing face-to-face training to over 6,000 teachers in the next few months.

So they are the three areas that ASIC is focused on currently: retail complex products, high-frequency trading and dark pools, and education.

They fit under ASIC's strategic priorities to promote confident and informed investors and consumers, and fair and efficient financial markets.

Thank you for your time.

