Australian Securities & Investments Commission

The Financial System Inquiry: A regulator's perspective

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CHECK AGAINST DELIVERY

Introduction

Thank you Nuncio, and thank you everyone for having me here today.

It's great to be here and a pleasure to speak in front of this audience.

Today I will be speaking about the Financial System Inquiry. I will talk about it from a regulator's perspective – in fact, from ASIC's perspective.

ASIC's fundamental objective is to allow markets to fund the real economy and, in turn, economic growth.

This contributes to improved living standards for all Australians.

Markets cannot perform their fundamental purpose – funding the real economy and, in turn, economic growth – if investors and issuers do not have trust and confidence in them.

This was a clear lesson from the global financial crisis.

Making sure investors and issuers have trust and confidence in our markets is at the heart of everything we do. It is reflected in our twin regulatory strategic priorities of:

- investor and consumer trust and confidence
- fair, orderly, transparent and efficient markets.

Financial System Inquiry recommendations

Delivering its final report to Government in December last year, the Financial System Inquiry (FSI) has been of central importance to the financial system and its users, and to the broader Australian economy.

ASIC has welcomed the FSI and its report. It has provided an important and timely opportunity to sit back and take stock of where we are in Australia and to look at whether the current framework meets our needs.

A well-functioning regulatory framework is a necessary prerequisite to investor trust and confidence.

The FSI made 44 recommendations overall. Some of the FSI recommendations focus on resilience, which is of course fundamental to ensuring trust and confidence.

The FSI also made recommendations on innovation. ASIC has a strong focus on promoting and facilitating innovation.

We do this through initiatives such as our Innovation Hub, which is designed to make it quicker and easier for innovative start-ups and fintech businesses to navigate the regulatory system that we administer.

Key FSI recommendations for ASIC

However, today I would like to talk about three particular recommendations of significance to ASIC.

1. for ASIC to have a new 'product intervention' power
2. to introduce a new product design and distribution obligation on product issuers, and
3. that penalties should be increased to act as a credible deterrent, and that ASIC should be able to seek disgorgement of profits gained by wrongdoing.

I would like to spend a little time now speaking about each of these recommendations in turn.

Product intervention power

Firstly, turning to the product intervention power.

Globally, regulators are looking for a broader toolkit to address market problems, including moving away from purely disclosure-based regulation. For example, the International Organization of Securities Commissions (IOSCO) has recommended that regulators look across the financial product value chain, rather than simply disclosure at the point of sale. In the United Kingdom, the Financial Conduct Authority has a product intervention power in place.

A product intervention power would give ASIC a greater capacity to apply regulatory interventions in a timely and responsive way. It would allow ASIC to intervene in a range of ways where there is a risk of significant consumer detriment.

ASIC would be able to undertake a range of actions, including simple 'nudges', right through to product bans.

I know that some commentators have been worried that ASIC would use its powers to ban products – and that this would affect innovation and competition.

We think that such a power would not stifle innovation that has a positive impact on consumers. In fact, banning products would be very rare and would only occur in the most extreme circumstances. Both industry and regulators have a common interest in seeing innovation that fosters investor and financial consumer trust and confidence – innovation that helps investors, but does not harm them.

Most interventions would likely fall well short of product banning. For example, we might be able to require amendments to marketing materials, or additional warnings. In more extreme cases, we might be able to require a change in the way a product is distributed or, in rare cases, ban a particular product feature.

We agree that the use of intervention powers by ASIC would naturally need to have transparency, clear parameters and accountability mechanisms.

However, let me say that a 'product intervention' approach – that is, regulation that is not purely based on disclosure – is not new in the regulation of retail financial markets in Australia.

This kind of regulation has improved investor outcomes in a wide range of markets over many years, for example:

- the Future of Financial Advice (FOFA) reforms, including the restriction on conflicted remuneration, and
- more broadly, the prohibition on unfair contract terms for financial products.

The FSI's recommendation would mean that ASIC itself would have greater capacity to apply such non-disclosure based approaches in a timely and responsive way.

This would be an alternative to waiting – sometimes many years – for legislation to address the problem.

Product design and distribution obligation

I will now turn to the recommendation to introduce a product design and distribution obligation for product issuers.

For this recommendation, I want to set the context from ASIC's perspective. There are three cornerstones of the free market-based financial system. These are:

- investor responsibility

- gatekeeper responsibility, and
- the rule of law.

The ability of the free market-based system to function effectively and efficiently, and to meet investor and financial consumer needs, is greatly influenced by the real behaviour of its participants.

Investor responsibility is key in our free market-based financial system. It is important that losses remain an inevitable part of this market system. ASIC will not, and cannot, be expected to prevent all consumer losses.

In addition, it is important that gatekeepers take responsibility for their actions.

Recently I have talked a lot about the culture of our gatekeepers. The culture of a firm can positively or negatively influence behaviour. Poor culture – such as one that is focused only on short-term gains and profit – often drives poor conduct. Conversely, good culture will drive good conduct.

I see a good culture as one that puts the customer's long term interests first.

So the FSI recommendation – that a broad, principles-based obligation be placed on financial institutions to have regard to the needs of their customers in designing and targeting their products – is a recommendation that puts the interests of the customer at its centre.

In my view, the FSI's recommendation aligns very closely with the theme of culture. Product manufacturers should design and distribute products with the best interests of the investor or financial consumer in mind. This is part of having a customer-focused culture.

In fact, the FSI has noted that the kinds of practices required by a design and distribution obligation would already be in place in many institutions that already invest in customer-focused business practices.

Firms that already have a customer-focused culture would not need to significantly change their practices.

Penalties

Finally I would like to turn to the recommendation on penalties.

The FSI recommended that penalties for contravening ASIC legislation should be substantially increased, and that ASIC should be able to see disgorgement of profits obtained as a result of misconduct.

Comparatively, the maximum civil penalties available to us in Australia are lower than those available to other regulators internationally. And they are fixed amounts, not multiples of the financial benefit obtained from misconduct.

In order to regulate for the real behaviour of gatekeepers in the system, penalties need to be set at an appropriate level. And we need a range of penalties available, to act as a deterrent to misconduct.

Penalties set at an appropriate level are critical in the 'fear versus greed' calculation of the potential wrongdoer.

Penalties need to give market participants the right incentive to comply with the law. They should aim to deter contraventions and promote greater compliance, resulting in a more resilient financial system.

Conclusion

I see that these three FSI recommendations are all complementary.

Product intervention powers would complement and reinforce the good practices and controls required by product design and distribution obligations. Where product design and distribution obligations were in place, and were effectively being complied with, there would be less need for ASIC to intervene. Adequate penalties provide a deterrent for gatekeepers against engaging in misconduct, and this in turn influences their behaviour.

Gatekeepers who already have a solid culture have nothing to fear from these recommendations. For those who fall short, ASIC will continue to use the right nudge to change their behaviour.

The introduction of a product intervention power, design and distribution obligation and appropriate penalties will assist ASIC in providing the right nudge.

In conclusion, the three important FSI recommendations I've discussed today are an important next step towards ensuring trust and confidence in the market.