



ASIC

Australian Securities & Investments Commission

A better toolkit for ASIC

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*Thomson Reuters Regulatory Summit 2017 (Sydney, Australia)
6 June 2017*

CHECK AGAINST DELIVERY

Introduction

The financial services sector has been the subject of unprecedented public scrutiny in recent years following numerous examples of poor consumer outcomes, misconduct and poor culture.

There is an extensive set of reforms that have recently been introduced, or are under way, across the banking, wealth management and insurance sectors – both in Australia and abroad. These are designed to lift standards and improve market outcomes in a sector that has too often failed to meet community expectations, with subsequent erosion in trust and confidence.

We are also seeing changing expectations of regulators, including ASIC. Part of this is about ensuring that regulators have the powers and capacity to act more effectively to identify and address market problems. In other words, regulators need a better toolkit. Preventing all failures or collapses will never be possible, but there is a clear expectation that standards and outcomes can and should be lifted.

Both ASIC and financial services and credit providers need to be in a position to meet these changing expectations, to rebuild confidence and trust in the financial system.

In this setting, today I will discuss progress towards a better toolkit for ASIC. There are three aspects of this topic I wanted to touch on:

- what has been identified as missing from ASIC's regulatory toolkit

- what steps have been taken towards a reform agenda
- important characteristics of a better toolkit to achieve the desired outcomes for the financial system and consumers.

What is missing from ASIC's toolkit

Most of you will be familiar with the Financial Systems Inquiry (FSI), chaired by David Murray, which made a [final report in December 2014](#). ASIC welcomed the FSI and its objective of examining what was needed to position Australia's financial system to meet evolving needs and economic growth.

The FSI made findings about the limitations of the current regulatory framework, including areas in ASIC's regulatory toolkit that should be improved to meet current and future challenges.

As I'm sure you're also aware, the FSI has not been the only inquiry to take this approach. A large number of other reviews have come to the same conclusion. Numerous Parliamentary Committees, including the House of Representatives Economics Committee, whose chair, David Coleman, you have heard earlier today, have recommended regulatory reform. In areas as diverse as mortgage broking, life insurance, small business lending and dispute resolution, inquiries have identified areas where the current regulatory regime is not up to scratch.

So what are the limitations with the existing approach? The FSI emphasised that the regulatory framework has relied very heavily on individual disclosure to deal with potential market problems. Conflicts of interest in remuneration, complex high risk products, fees and charges of every conceivable type – until recently the answer has been more and more disclosure. There has also been an expectation that financial advice and financial literacy would support disclosure.

However, it is clear that disclosure has been expected to do more than it is capable of doing to fix market failures. While disclosure is important, it can be ineffective for a range of reasons, such as consumer disengagement, behavioural biases or misaligned interests between providers and consumers.

The disclosure regime has too often resulted in complex and lengthy documents that do not enhance consumer understanding of financial products and services, and impose significant costs. This also shifts the risk to the consumer. Additionally, having to assess the quality of advice – if it was sought – as well as the product provided, adds another layer of complexity for consumers.

Ultimately, there have also been problems with products not meeting the needs of consumers who purchased them, with the potential for improvement in the product design phase. This is one reason why the FSI strongly emphasised the importance of fair treatment of consumers and other end-users.

In relation to ASIC, FSI observed that the public expectation is that ASIC will be a proactive regulator in supervising financial services providers. ASIC should focus more attention on industry supervision, including more proactively identifying and weeding out misconduct. However, in practice, there are limitations to ASIC's regulatory toolkit that have stymied this objective.

ASIC's regulatory framework also places too much emphasis on investigation and punishment after the event, with few tools to address problems as they emerge or before major losses are suffered. Further, the only available remedy has often been criminal prosecution, again limiting options for ASIC for a range of misconduct.

Inadequate penalties have meant that misconduct which caused significant losses and consumer harm may be only lightly punished or penalised.

Steps towards reform

The Government has shown support for moving forward with recommendations from the FSI and from a range of other inquiries to improve financial services conduct.

In relation to the FSI's recommendations about ASIC's powers, I wanted to highlight two aspects of this reform program today:

- the ASIC Enforcement Review Taskforce
- the proposed introduction of design and distribution obligations and a product intervention power.

ASIC Enforcement Review Taskforce

In October 2016, the responsible [Minister Kelly O'Dwyer announced the ASIC Enforcement Review Taskforce](#), to examine the suitability of the existing regulatory tools available to ASIC to perform its functions adequately. As Minister O'Dwyer said, the taskforce would be looking at 'whether there is a need to strengthen ASIC's enforcement toolkit and if so, what that might look like.'

The taskforce is examining the adequacy of ASIC's enforcement regime to deter misconduct and foster consumer confidence in the financial system.

We have a number of priorities in this review, including:

- addressing the type, level and consistency of penalties available to us
- making a provision for disgorgement of profits, to ensure penalties relate to the financial benefit from wrongdoing
- enhancing the role of firms in identifying problems through the breach reporting regime, and
- introducing a power to ban individuals from managing financial services firms, making management accountable for poor conduct within a firm.

So far, the taskforce has consulted on possible enhancements to the breach reporting regime, and will consult on other targeted areas of ASIC's regime in the future. We are very engaged in this process, and look forward to the recommendations. I would also encourage those at this conference to engage with this review.

Design and distribution obligation and product intervention power

In December 2016, the Government released a [consultation paper](#) seeking feedback on two key proposals from the FSI: a design and distribution obligation, and a product intervention power.

The design and distribution obligations on issuers or distributors, known as product governance obligations, would be imposed at the stage of product design and distribution, and after the sale of the product. Product issuers and distributors would be obliged to consider the type of consumer whose financial needs would be addressed by buying the product in question, and the channel best suited to distributing the product.

As a complement to these obligations, the Government has also consulted on a product intervention power for ASIC, that would enable us to intervene where a product is identified as creating a risk of significant consumer detriment. [As the Minister observed at the time](#), 'These measures will improve outcomes for consumers and make ASIC a more proactive regulator.'

I will say more about the detail of these proposals shortly but, before doing so, I'd like to briefly reflect on why these reforms should improve ASIC's toolkit.

A better toolkit for ASIC

So why would these reforms improve ASIC's toolkit?

For a start, they would enable ASIC to go beyond individual disclosure in addressing market problems where a traditional disclosure approach is not working. This includes instances where consumer behavioural biases and information imbalances have negative results.

A stronger regime of penalties and powers would provide better incentives for the right sort of conduct and culture. They would enable ASIC to more effectively target those firms and individuals that do the wrong thing and thereby harm not only consumers, but responsible, compliant competitors.

A more flexible toolkit should also be forward looking, with the flexibility to cope with the changes arising out of new technology and financial innovation. This includes enabling the regulator to effectively use big data, artificial intelligence, and other 'reg tech' initiatives. ASIC should be able to deal with emerging products and services, without stifling competition and innovation, so as to target areas where emerging risks are likely to produce poor outcomes.

ASIC would also have greater ability to address market-wide problems and competition issues, including by working with industry. This is important, as many of the failures encountered in financial markets are characterised by first-mover problems.

I would also like to emphasise that the FSI – as well as many of the other reviews of recent times – underlined the importance of firms needing to take steps to create a culture that focuses on consumer interests. By working at improving customer relationships, and finding the right way to build trust in the emerging environment, firms should align their own interests with those of consumers, increasing the potential for better consumer outcomes.

With this in mind, I wanted to make some comments about the product governance obligations and product intervention power, on which the Government has recently consulted.

Product governance obligations

As I have stated, ASIC has very much welcomed the Government's decision to introduce product governance obligations and product intervention powers. We are actively participating in the consultation process around these reforms that is being handled by Treasury, and we have identified some areas where we see that improvements could be made to the models that have been issued for consultation.

The proposed product governance obligations would bring accountability to issuers and distributors of products by requiring them to establish processes and controls for ensuring products are designed with consumer needs and understanding in mind, and are marketed to the section of the population for whom they are useful and appropriate.

ASIC would like to see these obligations extended to the full range of *Australian Securities and Investments Commission Act 2001* products available to consumers, to ensure a broad and flexible regime supporting fairer outcomes for consumers. As currently proposed, the obligations would not apply to credit products, or products that are not regulated by the *Corporations Act 2001* or *National Consumer Credit Protection Act 2009*.

The rationale here is that responsible lending obligations cover credit products. However, in our view, responsible lending obligations are not equivalent to, nor a substitute for, the proposed product governance obligations. Most pointedly, responsible lending is directed at each individual transaction, whereas the new obligations apply across product governance processes and controls.

Product intervention power

Turning to the product intervention power, again there are areas where ASIC sees scope for improving the proposed model that is the subject of consultation.

As currently proposed, there are limits placed on:

- the products and services that can be covered by an intervention

- the range of interventions that can be made
- intervention timeframes.

In relation to coverage, products such as funeral insurance, some short-term and continuing credit products, investment and small business loans would not be covered by this power. In the course of our regulatory work, we have identified significant consumer detriment in some of these areas. An improved toolkit would enhance consumer outcomes in these markets.

In relation to the range of interventions, our view is that the product intervention power should allow for a flexible approach. In particular, the remuneration that is linked to a product should be subject to the intervention power, which is not the case in the current proposal.

It is worth noting that much of the significant consumer detriment we've seen in financial services has arisen from remuneration that incentivises the sale of products that are inappropriate for consumers. In some cases, a product is reasonable for more financially experienced consumers, but sales incentives see it ending up in the wrong hands.

It would be beneficial – and would best meet ASIC's strategic objective of encouraging trust and confidence in the financial system – for the product intervention power to be comprehensive and flexible enough for us to tailor interventions to address market-wide issues in the range of circumstances.

Without a flexible power that includes remuneration, we may not be able to choose a targeted option, and would be in the incongruous position of having to consider a blunt, wide-reaching tool – such as an outright ban – even when a less interventionist approach would be more appropriate.

Finally, ASIC sees limitations with the proposed timeframe for the product intervention, being 18 months at most before it lapses. In our experience, many important market issues take longer than this to resolve or address, and having the ability to extend the timeframe would allow for a more considered process.

Enforcement and penalties

Before I conclude, I want to emphasise the importance of a regulatory toolkit that also allows us to take appropriate actions against senior executives and managers. Effective regulation depends on achieving enforcement outcomes that act as a genuine deterrent to misconduct, including at the top of organisations.

The public rightly expects we will take strong action against corporate wrongdoing. We firmly support a power to ban individuals from managing financial services firms. The Government has supported this recommendation from the FSI, and it will be consulted on during the Enforcement Review.

Conclusion

There are real reasons for optimism. Australia has done the work to identify and develop a broad program of reforms to ensure we are better placed to regulate the fast pace of change in our financial system. Government, regulators, industry and consumers have all played a role.

The reforms are well targeted, and hold the potential for better outcomes for all – as long as we get the detail right. This requires thorough consideration of the final detailed formulation in Parliament, and of course effective use by ASIC.

We at ASIC look forward to the reforms taking shape, and the opportunity to work with industry to improve standards and behaviours, and build consumer trust and confidence in line with their expectations.