



**ASIC**

Australian Securities & Investments Commission

# **Securities markets, participants and ASIC**

Paper by  
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## Introduction

Let me begin with a quote:

“The combination of intense selling pressure, market mechanism failures, and lack of information exhausted much of the available liquidity, caused substantial uncertainty, drove down prices, and generated unprecedented volatility in all the linked markets.”<sup>1</sup>

You may think this is a description of the recent market volatility. In fact, it is the Chairman of the US Securities and Exchange Commission describing what occurred on 19 October 1987. It serves to remind us (something all of you at this Conference know all too well) that markets are cyclical.

My topic today is *Securities Markets, Participants and ASIC*: a pretty wide topic I know, but with ASX (a body we supervise) speaking before me and the Minister for Superannuation and Corporate Law (in charge of ASIC) speaking after me, ‘flexibility’ is not a bad thing to maintain!

In fact, when I was asked to speak, around October last year, a flexible topic seemed the way to go as there was considerable time to go to the Conference and the storm clouds had started to build from August 2007 (with the US subprime fall out then beginning to emerge). Not to mention that at the time, the outcome of the Federal Election was unclear and the then Opposition had not announced its corporate law reform agenda.

Let me take advantage of that flexibility by covering, four topics which are not only current but are clearly relevant to you and to your industry and your business.

These are:

- First, to update you on ASIC at the end of the first 12 months since I was appointed Chairman.
- Secondly, to give you my views on the regulatory issues which have arisen out of the recent market volatility or turmoil.
- Thirdly, to outline to you what the forward agenda is for ASIC in the next 12 months, focusing particularly on what will be relevant to you – in the context of the ASX and other market operators, the listed markets and brokers and dealers who operate in those markets.
- Fourthly, to outline to you possible future developments and their relevance to you, your industry and ASIC in the next two to three years.

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<sup>1</sup> Securities and Exchange Commission, *Securities and Exchange Commission Recommendations Regarding the October 1987 Market Break*, February 2, 1988.

What I hope you get out of my presentation will be the following:

- first, an understanding of ASIC's priorities;
- secondly, how those priorities will have a direct impact on your business and your industry in the next 12 months, and possibly, in the next two to three years.

My overall message is this: ASIC's approach will continue to be measured as it was in response to the recent market volatility or turmoil. Our emphasis will continue to be to resolve issues within the existing regulatory framework and only seek legislative reform after we have pushed the existing regulatory regime to its limit.

This does not, however, mean ASIC is a passive regulator or that there will not be changes. As I will explain, we will continue the process we started in May last year of increasing resources in a number of areas which will impact on you and your industry – most notably in the greater protection of retail investors, increased effort to stamp out insider trading and market manipulation and to improve disclosure.

We will work with market operators, such as the ASX, and with industry associations such as the SDIA and with the industry to assist us in handling these issues.

## **I ASIC'S achievements in the last 12 months (first of my 4 topics)**

The past 12 months has seen ASIC very much position itself to be a more effective regulator than in the past – to move it from, what the results of our external surveys say, as quite good to a superior performer.

As happens when a new CEO joins (and the ASIC Chairman role is both CEO and Chairman, a different model to corporate models) a new set of eyes can be cast over an organisation and it provides the opportunity to push for improvements. (Some would say of course, I've done this before at ASX and at Mallesons so its not surprising!).

It would be wrong, however, to see the last 12 months just as a period of review and planning for ASIC. It has also been a period of delivering the sorts of achievements that will see us lift our performance.

Let me elaborate on that. In May last year, we outlined six priorities for ASIC - two in the Real Economy and three in the Financial Economy. The sixth was to complete a strategic review of the organisation.

We are delivering each of these priorities.

## Real Economy Priorities

We perform important functions in the real economy – we manage the legal infrastructure being the corporation and licensing of key players (e.g. brokers).

Our two priorities in the real economy, are to lift operational effectiveness and service levels to achieve cost reductions for all those who do business with ASIC. And we undertook to use our technology to improve existing services and introduce new services to unlock benefits for small and medium businesses. Both are about our contribution to reducing ‘red tape’.

Examples of what we have done to improve service and reduce compliance costs are:

- (a) Our electronic lodgement capabilities to reduce paperwork and costs for Australian business. We introduced e-charges (i.e. charges over company assets) and developed a web-based software application to further streamline common transactions. Last year, 80 per cent of these e-enabled documents were lodged electronically.
- (b) We have made our regulatory system smoother and easier to work with regulatory documents, through measures like distilling 14 types of policy documents into five, introducing four-monthly reporting on regulatory decisions and conducting a review into the cost of regulation.

We are progressing a range of other initiatives in our real economy work to make it easier to do business with ASIC and reduce compliance costs.

## Financial Economy Priorities

In relation to the three priorities in the financial economy, our central objective has been to improve confidence in the integrity of the financial markets.

**The first of those priorities is helping retail investors protect their wealth.**

Some examples of the work in the past 12 months.

ASIC has worked to restore confidence in the unlisted and unrated debenture area – the area hit by failures such as ACR, Fincorp and Westpoint. We did this through initiatives to improve disclosure for retail investors including a new disclosure regime and a new advertising guide. We also reviewed the impact of these changes on issues and reported the results to the market (through better use of our website).

This work is now extending to other unlisted areas (e.g. mortgage schemes) and other managed investment schemes where (because there is no

secondary market) retail investors need additional assistance to assess risks. These are good examples of ASIC pushing the existing disclosure regime to the limit.

We implemented a series of initiatives to improve retail investors' understanding of investment strategies, so that they – the ones who must take the risks – could make better decisions. These included guides on investing in debentures, making superannuation decisions and living with reverse mortgages; and a report into refinancing in response to financial stress.

We have taken decisive action to recover compensation for investors who lost money in recent property collapses, by using Section 50 of the ASIC Act. In other words, recognising that in some situations, the public interest will be better served by ASIC taking the compensation actions for investors.

We developed a blueprint (Retail Investors Taskforce) to roll out over the next 12 months to better protect retail investors, using a special taskforce which we established for that purpose. This Taskforce was headed by our Deputy Chairman, Jeremy Cooper.

In the budget, the Government has handed ASIC the important work of the Financial Literacy Foundation. Financial literacy is an important underpinning for retail investors and financial consumers. We will be looking at an extensive expansion of investor and consumer education. I know both ASX and SDIA play important roles in investor education. We see our and your work as complimentary and we look forward to working with you.

### **Removing international barriers to capital flows**

The next priority in the financial economy has been our work to remove barriers to capital flows from and into Australia consistent with maintaining the integrity of our markets. This priority recognises the importance of the inflow of capital into our markets and what is now increasing, the outflow of funds into other markets. Our objective is to use our connections with other regulators to see what we can do to assist with the 'freer flow' of capital. Clearly important for Australia which is part of the global financial markets.

We are pleased that the Government has been progressing mutual recognition with both the US and New Zealand. Our role has been to assist Treasury and the Government.

### **Fighting market manipulation and insider trading**

The third priority which we announced last May in the Financial Economy was the creation of a special Taskforce (headed by our new Commissioner, Belinda Gibson) to determine what additional actions ASIC, in cooperation

with the ASX, could take to foster disclosure and fight market manipulation and insider trading.

We have worked with the ASX to speed up the notification of referrals and to minimise the time gap between the alleged conduct and action. We have set up a system under which we immediately review every referral from the ASX. Since January this year, the ASX has referred 40 matters to us. As of today we are investigating 11 of them for possible civil, criminal or administrative proceedings, 14 are under surveillance and 11 have been referred to our licensing unit for other possible action. Only four have been closed for insufficient evidence.

In addition, we have one insider trading matter before the courts and five with the Commonwealth Director of Public Prosecutions (CDPP), and two market manipulation matters the CDPP.

While all these have been going on, we have been successful in a number of prosecutions which have carried custodial sentences and fines.

[Table removed on 31 July 2020 in accordance with ASIC policy - see INFO 152 Public comment on ASIC's regulatory activities.]

## **Competition for trading services**

In capital markets, not only do we have enforcement functions, we also have important roles in licensing market operators.

During the year we received applications from three entities to compete for trading in ASX-listed securities. Whether competing markets are allowed to operate is a policy decision for Government, and it is the Minister who grants a market licence, not ASIC. Our role in these situations is to provide advice to the Government which we have done after external consultation with the market (two sets of consultation) and the retention of an independent economist to advise us and input in the consultation process.

We have now provided our advice (which is confidential) on this matter to the Government.

## **Strategic Review of ASIC**

So now we come to the last and most important of the original six priorities, the Strategic Review. We announced this review in May last year.

We drew heavily on our stakeholders to conduct this review, and the results are far-reaching. We have in fact, put the results of our extensive stakeholder survey on our website (last Friday).

The key benefits which will flow from the review will be for ASIC's external stakeholders. They will see an ASIC which:

- better understands the markets it regulates;
- is more forward-looking in examining issues and assessing systemic risks;
- is much clearer in outlining to the market why it has chosen to intervene and the behavioural changes it is seeking;
- has a clearer set of priorities (principal priorities being retail investors and insider trading, market manipulation and disclosure).

The changes ASIC is making to deliver these benefits are:

- additional investment in market research and analysis;
- appointment of an experienced External Advisory Panel drawn from sectors of the economy to advise ASIC's Commission on market developments and potential systemic issues;
- abolition of the four current 'silo' directorates of ASIC and replacement with 17 outward-focused stakeholder teams (e.g. for investment managers, investment banks, superannuation funds, financial advisors, retail investors consumers and others);
- additional resources for the supervision of brokers and intermediaries and operators of exchange traded markets and for the surveillance of exchange-traded markets;
- a better balance between national and regional initiatives (for example more resources for the Perth and Western Australian markets).

ASIC will deliver these changes through greater investment in people, in the training and development and credential building of existing staff and leaders, and in the recruitment of senior people from the market.

Initiatives which will assist ASIC to develop skills and credentials include:

- secondments;
- more senior-level recruitment from the markets;
- an ASIC Academy;
- greater on-the-job training (e.g. through mentoring and network leaders).

As part of the move to the stakeholder teams, ASIC will reduce two layers of management (Executive Directors and Directors) to one level called Senior Executive Leaders. The move to one level of senior management involves reducing 54 senior positions to 41. These Senior Executive Leader positions will be better paid and be filled in open competition, initially internally and then from internal and external applicants.

We think that these changes will lead to improvements and, with that, greater confidence in ASIC as an effective regulator.

As I said earlier, the past 12 months has been important for us in positioning ourselves to be more effective. We have not, however, just been preoccupied with reviews. Our achievements against our priorities have been significant as I have outlined.

## **II Responding to the current financial crisis (the second of my 4 topics)**

Let me now move to the second part of what I would like to cover this morning – the recent market turmoil or volatility and the regulatory issues it has thrown up and ASIC's response.

Some have classed the recent crisis as the greatest financial crisis since the Second World War. There has been significant destruction of shareholder wealth and no certainty yet that we have bottomed or that, with cyclical markets, another crisis may not emerge (at least that's the only responsible position for a market regulator to take).

The recent market turmoil or crisis has caused a certain amount of anxiety for investors and for companies. No-one likes to see their wealth fall or to receive margin calls.

When looked at overall, however, the inescapable conclusion is that the turmoil or volatility and share wealth destruction in Australia was largely



driven by economic factors or, to put it another way, characteristic of a cycle and marking the end of a (long) 'bull run'.

### **Anatomy of a crisis**

Let me explain this further by taking a brief look at how the crisis unfolded.

The market 12 months ago was enjoying a bull run. The ASX 200 was above 6300 points, having risen by almost 90 per cent in five years. We did, however, have problems in the unlisted and unrated (debenture area) of the market. We had the loss of retail investor funds with ACR and Fincorp, which followed Westpoint. These, however, as I indicated at Senate Estimates in May 2007, were confined and not an indicator of broader lack of confidence in our markets.

By the second half of 2007, the effects of over-extended subprime mortgagors in the US resulted in a sharp upturn in mortgage defaults. This sent the prices of subprime-related assets falling, and resulted in margin calls for leveraged holders of highly rated products backed by subprime mortgages; market uncertainty about the soundness of major financial institutions; and a number of other adverse consequences.

For Australia, the financial dislocation impacted in early 2008. Among the effects was that companies, stockbrokers and margin lenders whose business models were largely built on 'ever-rising' asset prices and extensive use of leverage came under severe stress (MFS (now Octaviar), Centro, Allco, Rubicon funds, Tricom, Opes Prime).

And banks which import a lot of capital were subject to increases in funding costs and concerns about the availability of liquid funds, with commentator talk of credit rationing.

The equities wealth destruction that has been seen in Australia since the market peak in November 2008 has been significant. At its lowest point, the fall in the market capitalisation of the Australian stock market was the equivalent of about one-third of one year's GDP, or around seven per cent of household net worth.

The S&P/ASX 200 index has fallen back to levels previously seen between January and March 2007. At its lowest this year, the S&P/ASX 200 was back at levels seen in April 2006.

The wealth destroyed during the recent market turmoil was – at its worst – slightly less than the crash of 1987. That crash occurred over a much shorter time frame and represented a more significant proportion of household wealth than the recent turmoil.

A point of distinction between 1987 and today is that in the previous crisis we had a string of corporate disasters<sup>4</sup>. As Trevor Sykes wrote (in relation to the 1987 crash) in his book *The Bold Riders*:

“This was the biggest string of corporate disasters in Australian history. The companies controlled almost the entire Australian beer industry, the country’s largest industrial group (Adsteam), the largest pastoral company (Elders), the second largest retail chain (Woolworths, inside Adsteam), the largest food and textiles groups, the largest car renter, the largest mortgage trust group and a substantial slice of the commercial property market”<sup>5</sup>.

It has been different this time. The focus has been on companies with leveraged business models. At its low, Centro Properties Group lost \$5.5 billion in market capitalisation, Allco Finance Group and ABC Learning Centres both lost almost \$2.5 billion. Securities firms Opes Prime Stockbroking Ltd and Lift Capital Partners Ltd are now both under administration. In the case of Opes, its clients (according to the Administrators) lost in excess of \$200 million in market value resulting in net losses to clients of \$514 million (before any proceeds from the administration), and total owing by the company of \$550 million. The total claims of creditors of Lift Capital (according to its Administrators) are \$270 million.<sup>6</sup>

When markets experience shocks such as these, it can test investor confidence in the integrity of those markets. The good news for our system is that, overall, this confidence has been maintained. Why do I say that?

In general, investors are still transacting with confidence. The average daily turnover of equities on the ASX in March 2008 was over A\$7 billion<sup>7</sup>, making it one of only four months ever to reach this level. In April it averaged A\$5.4 billion<sup>8</sup>. This drop reflects a bear market rather than confidence in the integrity of the markets. On a financial year-to-date basis, total value traded is 31 per cent up on the previous year.

Households are still pouring savings into our financial system. In the December quarter of last year, households contributed a net A\$12.0 billion to pension funds and life insurance companies, only very slightly less than the A\$12.5 billion in the same quarter a year earlier.<sup>9</sup>

Importantly, our financial system has stood up well. As Glenn Stevens, Reserve Bank Governor, has put it:

“Major banking institutions have been able to provide support for sound borrowers, and have stepped into the gap left by the withdrawal of funding

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<sup>4</sup> See Appendix 1 for details.

<sup>5</sup> Sykes, T., *The Bold Riders: Behind Australia's Corporate Collapses*, 1994 at p 570.

<sup>6</sup> See Appendix 2 for details.

<sup>7</sup> Source ASX.

<sup>8</sup> *Ibid* n2.

<sup>9</sup> ABS National Accounts: Financial Accounts (ABS 5232.0 - attached, see Table 31, page 56.

from the capital markets. They have been able to do this because of their own balance sheet strength.”<sup>10</sup>

## **What gives our markets their strength?**

We have been able to maintain confidence in the integrity of our markets through a combination of:

- A strong culture of compliance and good corporate governance in Australia. We see this particularly with our larger companies and financial institutions. We also see it with our intermediaries, those who operate (like you) in our financial markets.
- With some exceptions, sound business models in our financial sector and our larger corporations. (In short, well-run companies with top executives and Boards.)
- Sound policies from Governments and regulators
- Effective regulators like APRA, the Reserve Bank, ASIC and the ASX (Supervisory).

## **ASIC’s role in the crisis**

This last point is important. Our regulators have worked effectively to maintain confidence in the integrity of our markets.

In ASIC’s case, our focus has been on the more difficult insider trading, market manipulation and disclosure issues. We made this a priority last May and have added significant resources since. Earlier I covered our work on ASX referrals since January 2008.

In addition, during the turmoil, with the ASX, we reminded the market of a number of obligations. We gave guidance on the disclosure of material information relating to the financing arrangements of listed entities and the margin loans held by company directors; and guidance on the disclosure obligations of listed entities when they seek a trading halt or suspension of their securities.<sup>11</sup>

We gave warnings to market users against starting false or misleading rumours and the consequences of such activities.<sup>12</sup>

As a result of these moves, we saw increased disclosure in the area of margin lending and a better understanding of the substantial shareholder notice provisions.

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<sup>10</sup> Glenn Stevens, Governor of the Reserve Bank of Australia, Opening Statement to the House of Representatives Standing Committee on Economics, 4 April 2008.

<sup>11</sup> ASIC Media Release [MR 08-37] *Disclosure Guidance for listed entities*.

<sup>12</sup> ASIC Media Release [MR 08-47] *False or misleading rumours*.

We have extensive inquiries and investigations on foot relating to allegations of false rumours, which may have involved insider trading and market manipulation. To explain further, we have been and are:

- speaking with company officers who have raised concerns about trading in their stock and acting on our surveillance;
- obtaining and analysing information about those stocks received as a result of notices served on major broking firms;
- analysing scrip ledger information received from those broking firms and also ASX;
- obtaining data from the stock lending association and other sources about various short selling transactions; and
- interviewing a range of people.

Just to give you a feel for the seriousness of our inquiries we issued to market participants 71 first round notices, 32 second round notices and a further 21 notices under other provisions of the Corporations Act.

### **Should we have done more ...**

You or at least some commentators will be thinking, how can ASIC say that the regulatory regime and ASIC performed well when we had issues with short selling, margin lending and stock lending as well as allegations of targeting of companies with false rumours.

Let's go through those issues.

First the role short selling has played. There have been suggestions that short selling may have caused the market to fall more than it would otherwise have. The targeting of particular stocks may have driven them down.

The evidence so far seems to confirm that there is a legitimate role for short selling and that the regulation of naked short selling seems adequate, but that there should be a review of the ASX list of stocks which can be sold short.

With covered short selling, the concern has been disclosure. Both the Government and the ASX (with ASIC's support) have agreed that disclosure of covered short selling is necessary. Whether or not this would have made a difference to the fortunes of certain companies is far from clear. Another explanation is that the downturn exposed companies with weak (leveraged) business models and the market took advantage of those weaknesses.

Nevertheless, the case for greater disclosure of covered short selling is sound.

Secondly, margin lending. According to the latest available RBA data, there were 200,000 investors owing \$37.77 billion in margin loans at the end of

December 2007, a 34.94% increase year-on-year.<sup>13</sup> The main issues with margin lending have concerned:

- disclosure, particularly where directors may have been involved;
- lodgment of substantial shareholder notices.

We worked with ASX to issue a joint media release advising directors of their continuous disclosure obligations where they have entered into margin loan or similar funding arrangements for a material number of securities.

We have (as has ASX) requested that the ASX Corporate Governance Council consider adopting a principle as part of its Corporate Governance Principles and Recommendations recommending listed entities have a policy on:

- whether margin loans should be permitted, and if so whether there should be any constraints; and
- disclosure of the terms to the entity when a margin loan arrangement is entered into.

We have referred some disclosure issues around margin lending to the Productivity Commission which has recommended that responsibility for consumer credit and related advice be transferred to ASIC.

Thirdly, stock lending. Stock lending as you know has been around at the wholesale and institutional level for some time. I have just commented on its use in relation to covered short selling.

We have also seen its use extended to the retail level of the market (as compared to wholesale at the institutional level) and this, we believe, is new. An example of that has been Opes Prime. ASIC's focus on retail sector stock lending is on whether there has been compliance with the Corporations Act. Our investigations continue and we will update the market shortly.

While the failure of Opes Prime will impact investors, to say that ASIC should have banned the business model is not credible. ASIC simply does not have the power to dictate which business models companies choose to operate.

There have also been suggestions that when ASIC conducted a review of Opes Prime's liquidity return for 12 and 13 February 2008, it should have discovered the so-called "flawed" business model. The liquidity ratio of Opes was slightly lower than required on those 2 days. But from 13 February until it was placed in voluntary administration, its ratio was above what was required by ASX.

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<sup>13</sup>

Reserve Bank of Australia *RBA Bulletin Table D10* December 2007.

Our job here was, on referral from ASX, to look at compliance with ASX's capital liquidity requirements. That ratio is essentially to do with counterparty risk for an ASX Market Participant. It was not a solvency test. As ASX has said,

“The fact that a trading participant that does not clear its own trades becomes insolvent within days of having represented that it satisfies such a liquidity requirement does not represent a regulatory failure.”<sup>14</sup>

Fourthly, the allegations of misbehaviour which could amount to insider trading as market manipulation or breaches of the false statement provisions of the Corporations Act<sup>15</sup>. These allegations are for example, framed this way:

- false market rumours coupled with covered short selling;
- information on possible margin calls coupled with short selling

If there is a basis to these allegations, and we have extensive inquiries going on, they are likely to involve insider trading or market manipulation and if they do, we have said and let's be clear, we will institute proceedings. In addition, if our enquiries reveal the need for legislative change to strengthen the laws, we will provide advice to the Government.

Fifthly, the Tricom issue of delayed settlements. ASX has responded to this and while the delayed settlement unsettled the market for a very short time, confidence was quickly restored. ASIC is satisfied with the actions ASX took in that situation. We are now working with ASX on some adjustments to the system to ensure that similar events, particularly where only one participant is experiencing problems, are not able unduly delay settlement for the whole market.

While the issues which have arisen in the market have required ASIC taking action and, in the area of covered short selling, legislative change, overall the regulatory framework, stood up well and ASIC has played its proper role and continues to play its proper role with its supervision of the markets and in using its powers to conduct inquiries and investigations.

### **III Forward agenda for ASIC and the industry (third of my 4 topics)**

Now, let me move to the third part of this presentation. Looking forward for the next 12 months.

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<sup>14</sup> ASX Position Paper, *ASX's Role in Australia's Financial Regulatory Framework*, May 2008 at p 5.

<sup>15</sup> Section 1041E of the *Corporations Act 2001*.

You will or may have picked up in what I said in relation to our priorities and the outcome of the strategic review that:

- We have, since last year, been directing more resources to insider trading, market manipulation and disclosure.
- We will add resources (two expanded Stakeholder teams in our new structure) to market operators, and market participants.

Effectively, ASIC will be allocating more of its existing resources to these matters – a significant increase.

You may be asking that if the regulatory framework is working well (as I have just said), why the increase?

Our thinking on adding these resources began from May last year with the Strategic Review and the correctness of that thinking was confirmed by the recent turmoil.

Let me explain this more. Our thinking on needing to add resources (redirected from other areas of ASIC) as our strategic review unfolded was driven by three factors:

- **First, changes to the ASX markets**  
These changes have flowed from the merger of ASX-SFE, the new products listed (e.g. CFD's) and the sheer increase in trading and clearing volumes and with that management of risks. These changes have led to an assessment of the level of resources we need to supervise ASX and other market operators.
- **Secondly, changes to the broking industry**  
These changes have been, in more recent years, manifesting themselves in expanded product ranges, customer base (e.g. hedge funds, private equities and self managed super funds), in technology (e.g. computerised trading, interaction and direct market access) and in the emergence potentially of alternative trading systems and alternative clearing systems (and the increase in third party clearing).

We are also seeing examples of wholesale products being taken into the retail sector. For example in Opes Prime we have seen the use of stocklending in the retail sector.

The expansion of product ranges and the businesses of market participants have caused us to rethink and broaden our role. For example, with breach reporting (licensee breach reporting required under the Corporations Act), we note that brokers refer less breaches to us than other licensees of the financial economy. We would like to understand whether or not this is explained by having better compliance

systems. We also want to improve our supervision of how compliance departments in the broking houses handle market rumours. Balance sheet strength, particularly where retail investors may be involved, will be another area we wish to examine.

- **Thirdly, changes to listed companies in Australia**

We have not had an extensive review of the listings and liquidity of our listed companies for some time. We have in excess of 2,000 companies listed, yet liquidity is confined to largely to the top 100 or 200. In WA, we have significant increase in 'junior miners'. All may be fine but with a regulator such as ASIC, it needs, from time to time, to examine these developments and see if there is a proper balance between access to low costs of capital and the interests of the market and the protection of investors. Hence, our additional resources for WA.

So you can see that the additional resources recognise the developments which were occurring in our markets and are designed to enable us to better understand and regulate those markets.

The recent turmoil or volatility has confirmed that we were heading in the right direction in adding these resources. Two additional points have, however, emerged which reinforce our direction.

- **First, confidence in the regulators**

At its height, when the market was in "free fall" so to speak, there was (understandably) considerable anxiety among investors and intermediaries. Some commentators expressed doubts on the effectiveness of ASIC as a market regulator.

This concerned us as we believe we were handling the issues in a measured but firm way.

For us, the lesson we have taken from the events is that we need to work harder at demonstrating that we are an effective regulator and certainly so when we have markets in 'free fall'.

Adding resources in the areas I mentioned will, we believe, make us more effective and put us in a better position, in market downturns, to be seen as an effective regulator and one which the market can rely on to maintain confidence in the integrity of the markets.

We also have the role of supervising ASX and, for example, assessing how it manages conflicts. The additional resources we are adding will also be directed at working more closely with ASX so that we can provide reassurance to the market (through the formal assessment process) that ASX is 'adequately managing its conflicts'.



- **Secondly, ASX's position paper**

Our judgement to add resources in the areas I have mentioned is also supported by the recent position paper placed by the ASX on its web site. The following illustrates the narrowness with which ASX now sees its role.

“ASX is not obliged to, and nor does it, oversee all aspects of a Participant or listed entity's business.

Thus, where a broker engages in OTC activity and enters into third party contracts – stock borrowing/lending (for equities or fixed income securities), re-purchase arrangements, margin lending, etc, these are not activities that are supervised or monitored by ASX.”<sup>16</sup>

Whether or not this is a restatement by ASX or narrowing of its role (as it sees it) is not really to the point. ASIC cannot take risks on regulatory gaps and hence adding resources as I have explained is sensible.

In the next 12 months (and beyond that), with the additional resources, we will work with you, investors and market operators (such as the ASX) to more specifically identify issues which we will focus on to improve confidence in the integrity of our markets.

You may be thinking that there will be a risk of duplication with some of the work which the ASX may do with ASIC's work. While we will seek to minimise that, our judgement is that the balance on the issue of duplication should be in favour of investors and the community. In other words that the potential additional costs from any duplication (which may ultimately feed into a cost of capital) are warranted.

This is because confidence in the integrity of our markets is vital and our objective will be that, when tested in market downturn, not only will our regulatory system be seen as robust, but that ASIC is viewed as a first rate regulator in handling issues which any downturn is likely to throw up and ASX is seen to have properly performed its supervisory functions.

## **IV International developments and next two to three years (last of my 4 topics)**

What I have said so far has been very much about adding resources to ASIC to deal with the changes I have outlined. There are another set of regulatory issues which are emerging (globally at this point) and which will be relevant to your industry and more generally to our financial markets.

What we have seen with the recent crisis overseas has been the US Federal Reserve stepping in and underpinning a major investor, Bear Stearns. What

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<sup>16</sup> Ibid n14 at p 7.

seems to have troubled regulators around the world has been the potential systemic issues and should these events occur again, whether the regulators will be in the position of knowing and predicting the consequences. Some may put it more cynically that the cost in the underpinning of Bear Stearns will be greater regulatory oversight. For me, it is common sense. We have had a situation where, if you liken it to throwing a stone in a pond, we have not been able to see clearly the ripples created. The international regulatory community is likely to push for greater transparency and change. So we can more easily see those ripples for similar crisis in the future.

ASIC, as part of its international capital flows priority, will monitor and assess the impact of these developments on its responsibilities and, as necessary, provide advice to Treasury and Government on the possible need for legislative intervention.

What are these issues likely to be? The ones which seem to be emerging are these:

- **Credit Rating Agencies (where we are working with IOSCO):**  
Concerns have been expressed about credit rating agencies' accountability, transparency and the competitiveness in the industry. The issue for us is to promote an environment that creates credit ratings that are well understood and are of the highest quality and independence as possible.
- **Disclosure issues:**  
Disclosure of risk exposures has caused concern. What we are seeing a market and regulatory expectations for financial institutions to provide more useful disclosure about risk exposures, risk management policies and accounting policies, particularly in respect of off-balance-sheet exposures.  
An important issue for your industry will be the extent to which ASIC will need to examine balance sheet strength for all areas of your activities. The Opes Prime and Lift matters will provide us with insights into whether we need to look closer at balance sheet strength when you carry on businesses beyond the usual broking business.
- **Audit and accounting issues:**  
Issues have been raised on the present valuation methodologies and disclosure for complicated financial assets. The use of marking-to-market is the subject of discussion in the markets, for example, where there are no markets.

- **Derivatives:**  
Another issue is collateralised debt obligations, or CDOs, which have proliferated on a large scale. The process has seen some low-quality assets transformed into leveraged credit products to which ratings agencies assigned high ratings. Concerns have been expressed that originators and mortgage brokers adopted poor underwriting standards, offering unsuitable products to borrowers who could not afford them.
- **Hedge funds:**  
While the market liquidity provided by hedge funds can be a stabilising force, there is a perception that given their size and appetite for leverage they contribute to volatility. The other perception is that hedge funds – particularly those operating offshore – are the market users most likely to interfere with market integrity through practices they may adopt.

All I am doing here is to provide a list of issues which are emerging and will be the subject of discussion in the next period and may well lead to changes relevant to you and your industry. Clearly our role, as I said earlier, is to assess the impact on our responsibilities and provide, as required, advice to Treasury and Government.

## Conclusion

Let me conclude ... Let me start the conclusion with another quote from 1987, this time from our predecessor organisation the NCSC:

“Despite unprecedented pressure, markets generally performed well during the crash and drastic regulatory changes are not warranted. Few market intermediaries collapsed and market structures remained intact and operational.”<sup>17</sup>

This quote is equally applicable today. As I said in the second part of my presentation, our regulatory framework has responded well.

Nevertheless, I hope that what I have also shown you today is that what ASIC has done in the last 12 months and (during the recent turmoil) has:

- demonstrated that we have the right priorities (most notably around retail investor and insider trading and market manipulation);
- shown that we were adding (or redirecting) additional resources in these areas before the recent crisis and the recent crisis has reinforced that we are on the right path;
- shown that overall we handled the recent crisis well;

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<sup>17</sup> National Companies and Securities Commission, *Report on issues arising out of the sharemarket crash of October 1987*, May 1988.

- shown our resolve to improve our performance (through the strategic review) and adding resources.

We believe we have in the last 12 months laid the groundwork to enable us to improve our performance in maintaining confidence in the integrity of the financial markets. I look forward to speaking to you on a future occasion to report on our progress and to mark our scorecard as we progress from good to a first rate regulator.

Thank you.

## Appendix 1: Australian companies, late 1980s–early 1990s

Australian companies Late 80s–early 90s (these collapses occurred over several years from 1987)	Loss \$A million
Adsteam	2100
Bond Corp	5330
Budget	86
Compass I	290
Compass II	78
Deposit & Investment	100
Duke	30
Estate Mortgage	700
Hooker	1390
International Brewing	1530
Interwest	300
Linter	750
National Safety Council	250
Pyramid, Geelong, Countrywide	980
Qintex	1260
Rothwells	600
Spedley	400
TEA	20
Western Women	6
Westmex	350
<b>Total</b>	<b>\$16.5 billion</b>

Source: Tables 17.1 and 17.2 of *The Bold Raiders* by Trevor Sykes

## Appendix 2: Australian companies, 2007–2008

<b>Australian companies 2007-2008 Big fallers</b>	<b>Capitalisation loss \$A billion Peak to trough (ASX)</b>
<b>Corporates</b>	
Centro Properties Group	5.515
Centro Retail Group	2.801
Allco Finance Group	2.496
MFS Ltd (now Octaviar Ltd)	1.968
ABC learning Centres Ltd	2.439
<b>Subtotal Corporates</b>	<b>\$15.2 billion</b>
<b>Total client/creditor claims</b>	
<b>Intermediaries</b>	<b>\$Amillion</b>
Opes Prime Stockbroking Ltd (Administrators appointed)	\$550*
Lift Capital partners Ltd (Administrators appointed)	\$270**
<b>Amount invested to recapitalise</b>	
Tricom Securities Ltd	\$30***
Chimaera Capital	\$65***
<b>Subtotal Intermediaries</b>	<b>\$915 million</b>
<b>Grand total</b>	<b>\$16.6 billion</b>

Source: ASIC

\* The net amount due to Opes Prime clients is \$514 million. Inclusive of other creditors, the total amount owing is approximately \$550 million. (per Ferrier Hodgson creditors meetings 8 April 2008)

\*\* Claims owed to clients of Lift Capital. (per AFR 23 April 2008)

\*\*\* Reported amount of funding used to recapitalise the business after recent difficulties.