ASIC

Australian Securities & Investments Commission

Financial System Inquiry interim report: Submission by the Australian Securities and Investments Commission

August 2014

Contents

Executive summary

Financial System Inquiry

1 ASIC welcomes the publication of *Financial System Inquiry: Interim report* (interim report) and the opportunity to provide further input into the Financial System Inquiry's (this inquiry) examination of the financial system.

2 ASIC agrees with this inquiry's initial assessment that the financial system has performed well to date. We also agree that new and ongoing challenges and opportunities mean there are elements of the system that could be improved.

3 We see particular challenges arising from:

(a) structural change in our financial system through the growth of market-based financing, which is largely driven by superannuation;

(b) innovation-driven complexity in products, markets and technology; and

(c) globalisation.

4 Efficient and effective regulation provides the foundation for a financial system that funds sustainable economic growth and meets the financial needs of Australians. Consumer and investor trust and confidence in markets are critical to ensuring those markets operate efficiently. Fair, orderly and transparent markets in turn engender the trust and confidence of financial consumers and investors.

ASIC's main submission to the Financial System Inquiry

5 We submitted *Financial System Inquiry: Submission by the Australian Securities and Investments Commission* (main submission) to this inquiry in April 2014. That submission proposed a number of reform issues in light of:

(a) major developments in the financial system and the broader economy;

(b) lessons from financial regulation; and

(c) reconsidering regulatory philosophy.

6 The reforms we proposed involved:

(a) providing ASIC with an additional objective, which requires ASIC to consider the effect on competition when implementing policy (competition objective);

(b) enhancing ASIC's ability to meet the financial needs of Australians;

(c) ensuring the superannuation system better meets the needs of those consumers entering retirement;

(d) lifting standards in financial advice;

(e) participating strategically in global financial markets;

(f) managing systemic risk;

(g) improving conduct through a more flexible regulatory toolkit;

(h) prescribing penalties that provide the incentive for better conduct; and

(i) instituting a better funding model for ASIC.

ASIC's second submission to the Financial System Inquiry

7 This submission is ASIC's second public submission to this inquiry. It addressees those areas raised in the interim report where we see the greatest opportunity for changes to the current regulatory settings to:

(a) build a financial system that meets the financial needs of all Australians; and

(b) enhance ASIC's ability to deliver on our fundamental objective of enabling markets to efficiently allocate capital.

8 This submission provides additional evidence and observations from our regulatory experience to support this inquiry's consideration of the policy options identified in the interim report.

9 It sets out observations and issues for consideration in relation to:

(a) financial consumers (Section A)—including submissions to support:

(i) providing ASIC with a more effective regulatory toolkit;

(ii) a review of how general advice is described and regulated;

(b) role of the regulator (Section B)—including the benefits of maintaining ASIC's role as an integrated regulator with both consumer and investor protection functions and market integrity functions;

(c) systemic issues (Section C)—including our submission that the Council of Financial Regulators' current role should be maintained;

(d) funding (Section D)—including the impediments to the development of the corporate bond market; and

(e) international integration (Section E)—including opportunities for developing further 'passporting' arrangements (e.g. in relation to US retail securities).

10 The key themes in our submission are summarised in paragraphs 11–56.

Financial consumers

Disclosure and alternative regulatory tools

11 ASIC supports a shift to a regulatory philosophy and regime that acknowledges that different regulatory tools are needed to address different market problems. Such an approach would:

(a) focus on developing a detailed understanding of specific market problems as they arise;

(b) identify the appropriate regulatory tool to address those problems by choosing the least interventionist tool that would be effective; and

(c) facilitate competition by better addressing market failures.

12 Despite the stated regulatory philosophy that gives primacy to 'principles-based disclosure', other regulatory interventions (in relation to how products are distributed, marketed and in some cases, designed) are common across retail financial services in Australia. They have been introduced over time to address specific market failures and have resulted in improved consumer outcomes without negatively affecting innovation or competition. In fact, in many cases they have worked through enhancing competition.

13 Thus, more interventionist tools do not represent a break with previous regulation. What does need to change, however, is the speed and flexibility with which they can be applied. Legislative processes are too slow and cumbersome to deal with market problems (and opportunities) that the rapid pace of technological change and the advent of many new players are bringing and will continue to bring to Australian markets. Having such powers would mean that ASIC could respond to market problems more quickly and in a more targeted way, as well as making adjustments as change continues.

14 To facilitate this approach to regulation, ASIC supports the policy options raised in the interim report to provide additional powers to ASIC to create tailored regulatory solutions to address particular market problems. We envisage that such powers would:

(a) be more applicable to addressing systemic issues or issues of market-wide failures than many of ASIC's current powers;

(b) need to be exercised with transparency and accountability; and

(c) be subject to review mechanisms.

15 Other options for improving consumer outcomes include:

(a) the use of default options that are carefully scoped and supported by clear objectives;

(b) continuing to work on lifting levels of financial literacy; and

(c) promoting new sources of information for consumers, such as comparison websites and data aggregators.

Financial advice

16 The provision of appropriate and affordable financial advice remains a key concern for ASIC.

17 We generally support the policy options in the interim report that are designed to address concerns about the quality and accessibility of financial advice: see Table 2. For example, the policy option to enable ASIC to ban individuals from managing a financial services business would allow ASIC to more effectively regulate those who set the compliance culture within a financial services business and provide a strong incentive for those individuals to create good compliance cultures.

18 In relation to the policy option to raise the minimum qualification of advisers who provide personal advice, there may be merit in extending the requirement to advisers who provide general advice on more complex products.

19 In relation to the interim report's policy option to raise the minimum qualification of advisers who provide personal advice, there may be merit in extending the requirement to advisers who provide general advice on more complex products.

20 There is merit in significantly rethinking the current regulation of general advice, which currently applied to a range of disparate activities. This could involve a combination of the following:

(a) excluding some activities from certain licensing requirements under Ch 7 of the *Corporations Act 2001* (Corporations Act), while retaining appropriate alternative regulation that better targets potential consumer protection issues raised by general advice;

(b) applying a more tailored regulatory regime to certain types of 'general advice', rather than regulating them as a single class of activity;

(c) redescribing general advice that is primarily provided to generate sales as 'sales' or 'product' information; and

(d) ASIC intervening, using the potential new powers mentioned in paragraph 12, if conflicted remuneration were clearly producing market failures.

21 Regulation could also assist consumers in distinguishing between independent and aligned financial advisers—for example, by requiring clearer disclosure of the alignment between advisers and product manufacturers.

Consumer loss and compensation

22 Consumer trust and confidence in the financial services sector relies on an effective dispute resolution and compensation framework.

23 To address the relatively high levels of uncompensated loss in the financial advice sector, we support consideration of a limited last resort statutory compensation scheme to supplement professional indemnity (PI) insurance and the formal determination of claims by external dispute resolution (EDR) schemes.

Retirement and superannuation

Supporting the retirement phase of superannuation

24 ASIC would support consideration of default products in the retirement phase of superannuation. This would support individuals entering the retirement phase of superannuation, as they transition from a compulsory saving environment with relatively high levels of protection (e.g. through availability of default arrangements like MySuper or default investment options) to an environment requiring significant consumer engagement.

Fees and competition in the superannuation sector

25 We agree with the interim report that, while the full impacts of the Stronger Super reforms are yet to take effect, it may nevertheless be timely to review fees and costs and the operation of fee-based competition for superannuation.

26 ASIC recently published guidance to help industry implement the revised fee and cost disclosure requirements under the Stronger Super reforms and is continuing to consult with industry in this area.

Self-managed superannuation funds

27 We do not support introducing a mandatory minimum balance for self-managed superannuation funds (SMSFs), as we recognise that there are many situations in which establishing a low-balance SMSF may be in the best interests of members. However, there may be merit in introducing either a ‘soft’ minimum balance or guidance on an appropriate minimum balance. This may mean, for example, that a minimum balance applies unless certain requirements are satisfied. An alternative is to provide guidance on an appropriate minimum balance for SMSFs, which could be strengthened by applying an ‘if not, why not’ disclosure requirement.

Role of the regulator

ASIC's mandate

28 ASIC's remit should be narrowed by removing our registry responsibilities. Significant opportunities for economies of scale exist by combining other 'like' registers with ASIC's registry business.

29 However, we are firmly of the view that ASIC should remain an integrated regulator with consumer and investor protection functions and market integrity functions.

30 The principles that have led to a specific regulatory regime for financial products and services administered by ASIC as a markets and financial services regulator also support the integrated model. Financial services generate different and more complex risks than other markets. For this reason it is important to retain positive consumer protections measures beyond the general provisions of the Australian Consumer Law to ensure the financial system meets the financial needs of Australians.

31 The separation of ASIC's investor and financial consumer protection function from our market integrity function would raise significant practical problems and risks, including:

(a) the loss of the benefits of an integrated regime (e.g. the availability of a range of regulatory tools to ensure meaningful action can be taken to remedy consumer protection problems);

(b) regulatory fragmentation (including potential gaps, duplication and unclear accountability);

(c) the lack of a holistic approach to regulation (including that a single consumer protection regulator would not be able to regulate the whole product lifecycle, review the effect of regulation on the market as a whole, and balance consumer protection with market efficiency); and

(d) the challenges involved in building the organisational capacity of an additional regulator.

32 Many overseas jurisdictions have integrated regulators; however, the different regulatory models used overseas suggest there is no one natural point of division of regulatory responsibilities.

Competition objective

33 The addition of an explicit competition objective to ASIC's statutory objectives under the *Australian Securities and Investments Commission Act 2001* (ASIC Act) would ensure that ASIC's regulatory actions are specifically informed by competition considerations, and that all

stakeholders understand the importance of competition as a factor in regulatory decision-making.

Penalties

34 We welcome this inquiry's interest in a review of the penalty regime in the Corporations Act. Such a review should extend to all ASIC-administered legislation, and should include penalties that remove the incentive for corporate wrongdoing by applying monetary penalties set at multiples of the financial benefit obtained or by removing that financial benefit (disgorgement).

Independence and accountability of regulators

35 There is potential to achieve better regulatory outcomes by adopting a more autonomous budget and funding process for ASIC. We outlined a user pays funding model in our main submission to this inquiry. This would result in greater cost accountability for ASIC and regular consultation with stakeholders to establish the funding level.

36 We also support the introduction of independent performance reviews for regulators at three-year to five-year intervals. In conducting such a review, performance metrics should:

(a) be specific and meaningful;

(b) go beyond financial efficiency and also encompass measures of ASIC's effectiveness in achieving Government objectives; and

(c) focus on ASIC's activities and objectives.

37 ASIC has highly qualified and experienced staff. Despite this, the requirement for ASIC staff to be engaged under the *Public Service Act 1999* (Public Service Act) presents challenges for ASIC. We consider that the ASIC Act should be amended to provide greater flexibility for ASIC to attract and retain staff.

Systemic issues

Mechanism to adjust prudential boundaries

38 An important aspect of the current role of the Council of Financial Regulators (CFR) is advising the Minister about areas where the prudential perimeter requires adjustment to address systemic risk.

39 It would be appropriate to establish a mechanism (such as a regulation-making power) to enable the Government to respond quickly to the advice of the CFR to extend the prudential boundaries.

Payment systems regulation

40 The current regulatory framework for payment systems encourages providers to engage in complex white labelling arrangements to sustain existing business models and avoid exceeding the low-value threshold for the purpose of regulation by the Reserve Bank of Australia (RBA) and the Australian Prudential Regulation Authority (APRA).

41 If the current regulatory framework or a similar framework is retained, we suggest that:

(a) the client money handling provisions in the Corporations Act should be significantly strengthened to ensure client funds are appropriately ‘ring-fenced’; and

(b) the regulatory protection applicable to the monetary value stored in retail payment products offered by authorised deposit-taking institutions (ADIs) should be clarified.

Self- and co-regulation in the financial services sector

42 Under the right conditions, self- and co-regulatory models can improve consumer outcomes through greater flexibility, responsiveness and oversight if appropriate industry settings are in place to support them. However, there are certain market conditions that are required for effective self- or co-regulation. These include industry cohesiveness, an active industry association with sufficient resources to enforce co-regulation, and a competitive market providing incentives for market participants to join and comply.

43 A user pays funding model could play a role in facilitating self- or co-regulatory frameworks—for example, by providing an incentive for industry to improve compliance in order to benefit from potential cost savings.

44 Where we see opportunities for the implementation of self- or co-regulatory models, we have noted this in our submission.

Funding

The corporate bond market

45 Market forces and tax barriers are the most significant deterrents to the development of a liquid retail corporate bond market, rather than existing

regulatory settings. In light of this, relaxing the disclosure requirements for corporate bond issues will not significantly stimulate Australia's retail bond market.

Equity market

46 We do not support the policy option to impose specific requirements on the structure of capital raisings, as this would reduce flexibility for boards to tailor the structure of fundraisings to their company's specific needs.

47 Changes to the information offer statement regime or expansion of the 20/12 exemption would not significantly increase equity investment in smaller companies, as the existing prospectus regime already provides flexibility for companies to adapt their disclosure documents to the circumstances of their offering.

Superannuation

48 There are barriers to an increased allocation of superannuation funds to Australian corporate bonds (e.g. inadequate superannuation savings and behavioural biases). Development of further annuity-style retirement income products is needed to overcome investor behavioural biases that currently limit the allocation of superannuation funds in annuity-style products.

International integration

49 To facilitate further international financial integration, we suggest that new passporting arrangements could be considered. A particular initiative that warrants further exploration and analysis is the possibility of passporting arrangements for US retail securities, including bonds.

50 Further, Australia would benefit from a coordinated approach to financial integration. Before determining the format and make up of a coordination body, the objectives of Australian financial integration and strategies to implement those objectives should be clarified.

Other issues

Conduct regulation for fund administrators and technology service providers

51 We support imposing Australian financial services (AFS) licensing requirements on the providers of investment administration and fund administration services.

52 We also support regulatory oversight of technology service providers of sufficient scale—regulatory options for these providers include the imposition of AFS licensing requirements, and the imposition of oversight responsibilities on the market participants and market operators who outsource material business activities to them.

Market integrity supervision for licensed securities dealers

53 ASIC should have the power to make market integrity rules for licensed securities dealers that provide investor services substantially similar to market participants of a licensed financial market.

Financial reporting and auditing of superannuation funds

54 The financial reporting and audit of large regulated superannuation funds, approved deposit funds and pooled superannuation trusts should be regulated to help ensure that investors are appropriately informed about the financial position and financial performance of the fund.

External administration

55 There is opportunity to streamline the winding up and restructuring processes for small- and medium-sized enterprises. A ‘one size fits all’ approach to external administration or reorganisation of failed and distressed entities may not be appropriate in light of the different characteristics of large companies and small- and medium-sized enterprises.

56 While we do not advocate a wholesale adoption of US Chapter 11 or other jurisdictions’ processes, these could be examined for aspects that may address the factors claimed to inhibit effective corporate restructure in Australia.

A Financial consumers

Key points

To improve outcomes for financial consumers, ASIC supports a shift to a regulatory philosophy and regime that acknowledges that different tools will be needed to address different problems, and focuses on the development of a detailed understanding of specific market problems as they arise. This is often referred to as a 'product intervention approach'.

Other important issues for financial consumers are:

- continuing long-term efforts to lift levels of financial literacy;
- addressing gaps in the regulation of the financial advice industry; and
- ensuring appropriate superannuation products are available, including for the retirement phase.

Table 1: Summary of policy options responded to in Section A

Policy option	Summary of response	Reference
Disclosure and alternative regulatory tools	ASIC considers that the current disclosure regime has significant limitations and that a more flexible regulatory toolkit comprising broad intervention powers is required. This would enable the most appropriate, least interventionist regulatory tools to be utilised to address diverse market problems as they arise.	Paragraphs 57–128
Financial literacy	Improving financial literacy in Australia is a long-term initiative and, while many benefits are already apparent, all the benefits of financial literacy programs and interventions will take time to be fully realised.	Paragraphs 129–137
Financial advice	There is a need to improve the quality and accessibility of financial advice to consumers, and to raise education and competency standards within the financial advice industry. Regulatory changes in this area could help achieve this.	Paragraphs 138–182
Consumer loss and compensation	Improvements to the current dispute resolution and compensation framework, through the introduction of a last resort statutory compensation scheme would build consumer confidence and trust in financial services.	Paragraphs 183–198
Retirement and superannuation	Changes could be considered to ensure consumers make the best decisions about retirement products and strategies, including introducing default products for the retirement phase.	Paragraphs 199–230

Policy option	Summary of response	Reference
Product rationalisation of legacy products	ASIC supports a streamlined process for product rationalisation that involves adequate disclosure and safeguards accompanied by significant consumer education.	Paragraphs 232–234

Disclosure and alternative regulatory tools

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Improve the current disclosure requirements using mechanisms to enhance consumer understanding, including layered disclosure, risk profile disclosure and online comparators.
- Remove disclosure requirements that have proven ineffective and facilitate new ways of providing information to consumers, including using technology and electronic delivery.
- Subject product issuers to a range of product design requirements, such as targeted regulation of product features and distribution requirements to promote provision of suitable products to consumers.
- Provide ASIC with additional product intervention powers and product banning powers.
- Consider a move towards more default products with simple features and fee structures.

The Inquiry seeks further information on the following areas:

- Do similar issues in relation to the PDS disclosure regime apply to prospectuses, and is there a need to review prospectus requirements?
- What evidence is there on the effectiveness of financial literacy strategies in enhancing consumer confidence and decision making at particular points in time, and in achieving increasing literacy over the long term?

57 ASIC supports a shift to a regulatory philosophy and regime that acknowledges that different tools will be needed to address different problems. This approach would involve focusing on the development of a detailed understanding of specific market problems as they arise, and identifying the appropriate tool to address them. The least interventionist tool that is effective should be chosen.

58 Market problems, such as information asymmetries, are particularly acute in markets for financial products and services, and disclosure has not always been effective to address them. While disclosure remains a central tool, and should be enhanced as far as possible, in some situations other tools would be more effective and provide scope to reduce disclosure requirements.

Having a broader and more flexible regulatory toolkit would enhance ASIC's ability to foster effective competition and promote investor and financial consumer protection.

59 A more flexible regulatory toolkit, or so-called 'product intervention' powers (i.e. regulatory powers that are alternatives to disclosure), is a commonplace feature of many of the statutory regimes governing retail financial markets in Australia, as described in paragraphs 71–78. For this reason, such a regime does not represent a complete break with previous regulation, given the non-disclosure based regulatory approaches that have historically been taken, particularly in relation to products and services that have been mass marketed over an extended period.

60 However, the difference in approach would be that some of these interventionist powers could be usefully incorporated into the regulator's toolkit, rather than always being introduced via legislative amendments, which may take a lengthy period of time to achieve. Continuing to have all actions to address market problems dependent on the legislative process will result in adverse outcomes in a time of rapid change. Legislative processes are too slow and cumbersome to deal with market problems (and opportunities) that the pace of technological change and the advent of many new players are bringing and will continue to bring. Having such powers would mean that ASIC could respond to market problems more quickly and in a more targeted way, as well as making adjustments as change continues.

61 ASIC therefore supports both:

(a) consideration of the introduction of additional regulatory powers beyond disclosure (intervention powers); and

(b) examining options to improve disclosure where it is the best available regulatory tool.

62 Other approaches that should be considered to improve consumer outcomes are:

(a) harnessing default options in situations where consumer decision making is not likely to achieve optimal outcomes;

(b) continuing to work on lifting levels of financial literacy; and

(c) promoting new sources of information for consumers, such as comparison websites and data aggregators.

The limitations of disclosure

63 In the context of the financial services regulatory regime, 'disclosure' refers to the various types of mandated documents that must be provided to consumers or their agents in situations involving a financial service. These include product-related disclosure (e.g. Product Disclosure Statements

(PDSs), prospectuses and key fact statements), disclosure about the financial services provider (e.g. Financial Services Guides) and advice-related disclosure (e.g. statements of advice and records of responsible lending assessment).

64 ASIC agrees with this inquiry's observation that the current disclosure regime has resulted in complex and lengthy documents that have not enhanced consumer outcomes in many cases, and have typically imposed significant costs on providers. In many cases, disclosure regulation has focused on what information about the product must be disclosed by issuers, rather than how the disclosure can help investors understand the product.

65 However, even where disclosure is well designed, ultimately it is more effective at addressing some market problems than others. Certain inherent limitations mean disclosure alone is not sufficient to enable consumers to make informed decisions and purchase financial products and services that meet their needs. These limitations include:

(a) decision-making preferences and biases;

(b) consumers' varied needs and experience; and

(c) market structures and conflicts.

66 Therefore, while enhancing disclosure is one aspect of improving consumer outcomes, it is not the only factor that needs to be addressed.

Decision-making preferences and biases

67 ASIC's regulatory experience and consumer and investor research, as well as established empirical evidence in the field of behavioural economics, tell us that effective consumer decision making about financial products and services is particularly challenging. Financial products are often inherently complex, decisions typically require an assessment of risk and uncertainty, and many products tend to be purchased infrequently (e.g. post-retirement products).

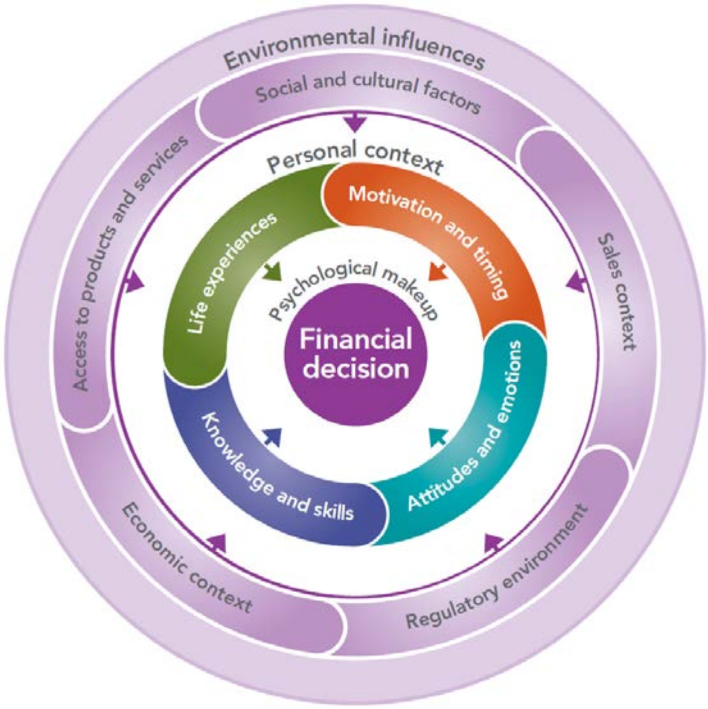
68 These conditions exacerbate inherent, widespread limitations in people's ability to process and respond to information—which lead people to rely on beliefs and preferences in decision making. It may also mean that people will not read mandated disclosure documents, or inadequately understand or even misunderstand those documents.

Consumers' varied needs and experience

69 Designing optimal disclosure documents is made more difficult by the fact that there is no 'average' consumer—people have different and changing needs, preferences and confidence levels. Financial decisions are influenced by a range of shifting and sometimes conflicting factors, including the

consumer's life stage and past experiences, psychological, social and cultural factors, and other external environmental factors: see Figure 1.

Figure 1: Influences on financial decision making



Source: ASIC, National Financial Literacy Strategy 2014–17, Figure 3.

Market structures and conflicts

70 Finally, disclosure alone is unlikely to correct the effect of broader market structures and conflicts that drive product development or distribution practices that result in poor investor outcomes (e.g. conflicted remuneration structures), especially where the interests of issuers and distributors are fundamentally misaligned with those of investors.

Interventionist powers in Australian retail financial markets

71 So-called 'product intervention' powers—those regulatory powers that are alternatives to disclosure—are a commonplace feature of many of the statutory regimes governing retail financial markets in Australia. Such regulation has improved consumer outcomes in a wide range of markets over many years without apparent impacts on the ability of financial service firms to innovate and grow—in fact, such forms of regulation have arguably facilitated growth by improving consumer trust.

72 Despite this, ASIC has seen commentary that indicates considerable confusion about these regulations and powers. In particular, there is a view that these forms of regulation would be novel in the Australian context. This is certainly not the case, as described in paragraphs 74–78. Furthermore,

there appears to be a view that such powers only involve intervening in product design, whereas in practice (both here and in other jurisdictions) they are just as likely to involve regulation of the distribution and sale process and/or the labelling of products. For this reason, this section provides some background on alternative regulation of retail financial markets, and as well as pointing to the additional elements that we believe would be useful to consider as part of the regulatory framework in the future.

73 The interim report notes that the approach of 1997 Financial System Inquiry (Wallis Inquiry) to consumer protection was based primarily on disclosure. However, even at the time the Wallis Inquiry's report was released, the position taken in that report did not accurately reflect the state of the law.

74 For products that had long been available as mass-market consumer financial products (e.g. various forms of consumer finance and general insurance), the law at that time contained a wide range of measures that went well beyond disclosure and intervened more directly into product design or product distribution. Those measures had been put in place to address significant market failures that had had widespread negative impacts on consumers.

Non-disclosure based regulatory measures prior to the Wallis Inquiry

Credit laws[1]

The credit laws existing at the time of the Wallis Inquiry prevented a number of practices that had caused a large amount of consumer detriment in the past. These had been banned or restricted because they were considered unfair and had persisted regardless of whether they had been adequately disclosed. For example:

- contract terms that prevented a consumer from paying out a loan early were prohibited, as were terms allowing a lender to impose a higher default interest rate on the whole balance of a loan when the borrower was only in default on one payment;
- the liability of guarantors was limited. There were extensive restrictions on what could be taken as security, including bans on third-party mortgages and restrictions on all-moneys mortgages and mortgages over future goods. A whole range of household and essential property could not be taken as security. There were also restrictions on the financing of add-on products like insurance;
- disclosure was not regulated on a 'principles' basis but was regulated in detail, with particular emphasis on ensuring standardisation of the method of calculating and imposing interest charges; and
- when and how a contract could be enforced and action taken against a consumer or against secured property was regulated in detail. Borrowers had a right to seek and obtain hardship relief.

Insurance laws

The laws in relation to insurance products were similar to those for credit. However, instead of being developed over a period of decades, as was the case for the consumer protections in credit, most of the key measures were adopted in

[1] Including the Uniform Consumer Credit Code, and various separate pieces of state and territory credit regulation.

Non-disclosure based regulatory measures prior to the Wallis Inquiry

the *Insurance Contracts Act 1984* (Insurance Contracts Act) after two extensive Australian Law Reform Commission reports. The stated purpose of the Insurance Contracts Act was to reform the law 'so that a fair balance is struck between the interests of insurers, insureds and other members of the public and so that the provisions included in such contracts, and the practices of insurers in relation to such contracts, operate fairly'.[2]

Consistent with that purpose, the provisions of the Insurance Contracts Act intrude extensively into the terms of insurance policies and the manner in which they are entered into, interpreted and enforced. This approach was implemented in order to address what had been concluded were unfair practices resulting in consumer detriment and poor consumer outcomes. As with credit, the formation of contracts was regulated, particularly in relation to the insured person's obligation of disclosure. Actions the insurer could take when the insured person had failed to disclose or otherwise breached the terms of the contract were greatly restricted. The circumstances in which and the amount by which payment of a claim could be refused or denied were circumscribed.

Beyond the Insurance Contracts Act, the law had also intruded where problems were identified with particular insurance market sectors, including interventions on how products were distributed. Thus, mis-selling of consumer credit insurance in the late 1980s resulted in the eventual imposition of a cap on commissions paid to intermediaries. While problems undoubtedly remain in the consumer credit insurance market, it seems likely that the commission cap played a role in limiting excessive mis-selling in Australia relative to other jurisdictions (e.g. the United Kingdom, where billions of pounds of compensation have been, and continue to be, awarded in relation to the mis-selling of pensions).

In both cases, these requirements do not appear to have impeded the growth of the consumer credit or retail insurance markets in Australia.

75 Following the Wallis Inquiry's report, subsequent regulatory change generally adopted its philosophy of the primacy of disclosure. Nevertheless, the process of seeking to address persistent problems of poor consumer outcomes arising from market failure has continued, including cases where disclosure has proved an inadequate remedy. This has included:

(a) the development of the responsible lending and product suitability regime for margin lending facilities and credit products;

(b) a cap imposed on charges for short-term 'payday' loans;

(c) the banning of early termination fees on home mortgages;

(d) the ban on door-to-door sales of financial products and services;

(e) the FOFA reforms, including the restriction on conflicted remuneration; and

(f) more broadly the adoption of the prohibition on unfair contract terms for financial products.

[2] Insurance Contracts Act, preamble.

76 The philosophy of the Wallis Inquiry tended to overlook the many more interventionist measures that already existed in the broader financial services market. This was in part because those measures, while interventionist, had been closely targeted, had addressed issues or practices that had been exposed as being unfair or persistently problematic, and had become widely accepted by all stakeholders and thus non-controversial. There was no indication in the Wallis Inquiry, or the submissions to that inquiry, that these particular forms of regulation were inhibitions to competition or innovation.

77 Another reason was that most of the interventionist measures related to the long-established mass-market consumer product areas of credit and general insurance, where the focus at the time of the Wallis Inquiry was more on investment products. Because investment products have only become broadly used by a wide range of consumers more recently, the process of identifying and addressing the consumer problems not addressed by disclosure is in its infancy, although the FOFA reforms are one step along that path.

78 It could be argued that this lack of understanding and discussion of the detail of retail financial regulation by the Wallis Inquiry led to a one-dimensional approach to regulation. That is, the error of the Wallis Inquiry was in universalising one regulatory tool—disclosure—and giving it too great a degree of primacy across all products and services, for all market problems and at all times.

Flexible regulatory toolkit

79 ASIC supports a shift to a regulatory philosophy and regime that acknowledges that different regulatory tools will be needed to address different market problems. This approach would involve broader intervention powers and:

(a) focus on the development of a detailed understanding of specific market problems as they arise; and

(b) identify the appropriate tool to address those problems, choosing the least interventionist tool that would be effective to address a given problem.

80 This approach would facilitate better competition by addressing market failures. It would be more applicable to addressing systemic issues or issues of market-wide failures than many of ASIC’s current powers.

81 The regime would need to be flexible enough that the effectiveness of any measure would be monitored and if a measure proved ineffective (or despite being effective proved to have negative side effects), then the position would be re-examined.

82 A more flexible approach to the regulatory toolkit could avoid imposing regulation across all firms at all times in a ‘one-size-fits-all’ system, but instead could be applied once significant market risks emerged in particular sectors and in response to market failures. Importantly, such tools can enhance competition by addressing market failures more effectively than disclosure.

83 In such a regime, principles-based disclosure would remain the right tool in many cases, either on its own or in combination with other tools. This might include measures to improve or prescribe disclosure, as occurred over a long period in credit and has occurred more recently with the superannuation dashboard: see paragraph 106. Depending on the market failure involved, other interventions could address the method by which a product was distributed and marketed—for example, restrictions on commissions, or the mandated uses of particular warnings, or restricting distribution to a personal advice model. Such approaches would be more likely to be identified as the best and least interventionist approach to address a particular problem than, for example, focusing on product design.

84 As described above in paragraphs 71–78, such a regime does not represent a complete break with the past, given the non-disclosure based regulatory approaches that have historically been taken, particularly in relation to products and services that have been mass marketed over an extended period. However, the difference in approach would be that some of these interventionist powers could be usefully incorporated into the regulator’s toolkit, rather than always being introduced via legislative amendments. From past experience, the problem is that, when market failures have occurred:

(a) it has often taken a long time for measures to be developed and put in place through legislation; or

(b) market problems in a particular sector are less likely to be addressed, because they may not have the broader significance necessary to put an issue on a very busy reform and legislative agenda. This can result in persistent problems that affect particular sectors or groups of consumers.

Example 1: Problems of delay in achieving regulatory solutions through legislation

Addressing mis-selling of consumer credit insurance

Consumer credit insurance provides cover if something happens that affects a person’s capacity to meet the payments on a loan. Consumer credit insurance usually covers risks such as illness, death, disability or involuntary unemployment.

For many years, the market for consumer credit insurance was characterised by problems of mis-selling of policies that included significant exclusions that limited their usefulness. The selling of such policies was driven by large commission payments for brokers.

In 1987, a report, *Need or greed?: a report on consumer credit insurance*, was published by the Australian Financial Counselling and Credit Reform Association identifying these problems. The widespread nature of the problem was soon confirmed by the work of regulators. However, law reform to introduce caps on commission levels was not introduced until 1996, through the Uniform Consumer Credit Code. Even then, such reform to address problems with consumer credit insurance only made it on to the legislative agenda due to the fact that the entire regulation of credit was being reviewed.

In the interim period, it is likely that many consumers suffered loss from paying insurance premiums for policies that were not useful to them and went uncompensated.

While it is difficult to quantify these losses, we do know that, if things go wrong in relation to financial products and services, the consequences can be severe and losses can be high. For example, mis-selling of consumer credit insurance in the United Kingdom has resulted in losses for a large number of consumers. Since its establishment in 2000, the UK Financial Ombudsman Service has received over 500,000 complaints relating to payment protection insurance,[3] with industry payouts totalling over £12 billion to date.[4]

Addressing problems in the under-regulation of mortgage brokers

An additional example of delay is the time taken to address problems in the under-regulation of mortgage brokers, even after they became a prominent component of the home lending market. Problems were known and discussed for many years before reforms were developed and legislated in 2010: see Section J of our main submission to this inquiry for further details.

85 This problem of delay in addressing the negative effects of market failures is exacerbated in an environment where there is greatly increased use of financial products and services, some of it mandated by law, where those products and services are both increasingly complex and increasingly central to consumers' financial wellbeing, and where losses to consumers can affect the whole of their lives. Changes in technology and increasing globalisation mean changes in financial markets that can generate systemic negative outcomes more rapidly.

86 It is also not realistically possible for industry itself to pre-empt Government to address most such problems. There are issues or practices that exist today that cause consumer detriment, and that most if not all stakeholders

[3] UK Financial Ombudsman Service, *Annual review of consumer complaints about: Insurance, credit, banking, savings and investments*, report, May 2013, www.financial-ombudsman.org.uk/publications/ar13/index.html.
[4] FCA, *Payment protection insurance complaints: Report on the fairness of medium-sized firms' decisions and redress* (TR13/7), thematic review, September 2013, p. 3, www.fca.org.uk/static/documents/thematic-reviews/tr-13-07.pdf.

recognise as problematic. Nevertheless, because of the inherent difficulties of collective action, even those in industry who would like to see the practice end, cannot act—the ‘first mover’ disadvantage of doing so would be too great and competition laws may be a barrier to industry acting collectively in some cases.

87 It is for this reason that ASIC supports the policy option raised in the interim report to provide additional powers to ASIC to create tailored regulatory solutions to particular market problems.

Safeguards and accountability in the use of product intervention powers

88 Such powers would be limited in application to systemic issues of established market failure and would not relate to individual instances of misconduct. They would only be applied after a thorough review of the problem and the issues involved. We envisage that, if such powers were provided to ASIC, they would:

(a) need to be exercised with transparency and accountability—for example, through ASIC releasing details of the analysis and reasoning that had led to the use of the power; and

(b) be subject to review mechanisms applicable to other ASIC powers (e.g. through the Australian Government and Parliament).

89 This will provide a more flexible and responsive regime, and result in a greater likelihood financial markets will deliver products and services to consumers that meet those consumers’ needs. Effective disclosure would play an important role in such a regime.

Example 2: How ASIC might use broader intervention powers

Insurance premium renewals

For example, there could be a sector of the insurance market where insurance policy renewals were offered at far higher premiums than the cost of taking out a new policy, but consumers continued to renew without shopping around for a policy at a more competitive price. This might be because of either lack of awareness or inertia, but would result in unnecessary cost to consumers. This is an example of where demand-side competition is not working adequately in a financial services market.

If ASIC were able to apply intervention powers to address this situation, we could, for example, introduce a requirement for insurers to disclose the cost of the previous year’s premium next to the premium for the coming year on the renewal notice sent to consumers. While a simple measure, this would generate greater consumer awareness of the rising premiums, and encourage them to seek a better deal with their current insurer or move to a new one.

Car financing: Flexi commissions

In some cases when car finance is arranged directly through car dealers as intermediaries, financiers allow dealers to set the interest rate for the finance, within a range of permissible rates. Dealers receive commissions from the financier for arranging such finance, and the higher the interest rate set, the higher the commission received by the dealer. Such arrangements are referred to as 'flexi commissions'. Consumers are generally unaware of the arrangement.

Flexi commissions create an incentive to supply car finance at higher interest rates to consumers. This is an example of a market that is characterised by supply-side competition and where the dealer intermediaries have significant conflicts of interest. While the arrangements may also be costly for financiers, and some financiers may be uncomfortable with them, it is difficult for any one financier to end flexi commission arrangements with dealers, as they risk losing market share.

If ASIC were able to apply broad intervention powers to address this situation, we could, for example, seek to prevent flexi commissions from operating or apply a cap on the commission payments payable to dealers by financiers.

International interest in product intervention

90 This approach is being considered by overseas regulators looking for a broader toolkit to address market problems; for example, the International Organization of Securities Commissions (IOSCO) has published a report on retail structured products, which proposes that financial regulatory systems incorporate a regulatory toolkit organised along the financial product value chain, covering product design and issuance, disclosure and marketing, distribution, and post-sale practices.[5] There are also industry-led initiatives to develop principles around product development and distribution—for example, the Australian Financial Market Association's *Principles relating to product approval—retail structured financial products*.

91 The spectrum of temporary product intervention powers given to the Financial Conduct Authority (FCA) in the United Kingdom also includes rules:[6]

(a) requiring that certain products are only sold by advisers with additional competence requirements;

(b) preventing non-advised sales or marketing of a product to some types of consumer;

(c) requiring providers to amend promotional materials;

(d) requiring providers to design appropriate charging structures; and

(e) banning or mandating certain product features.

[5] Board of IOSCO, *Regulation of retail structured products* (IOSCOPD434), final report, IOSCO, December 2013.
[6] Financial Services Authority, *The FCA's use of temporary product intervention rules*, PS13/3, policy statement, March 2013.

92 The box below provides a recent example of the FCA's use of its product intervention powers.

FCA's use of product intervention powers: CoCos

In the United Kingdom, the FCA has recently used its new temporary product intervention powers to secure appropriate protection for consumers from the risks posed by contingent convertible instruments (commonly known as 'CoCos'). CoCos are hybrid capital securities that absorb losses when the capital of the issuer falls below a certain level. They are highly complex instruments and pose particular risks of inappropriate distribution to ordinary retail consumers.

Using its new product intervention powers, the FCA has stepped in to temporarily restrict firms from distributing CoCos to the mass retail market from 1 October 2014 ahead of consultation on permanent rules later this year. Firms will only be able to distribute CoCos to professional, institutional and sophisticated or high net worth retail investors.

Default options

93 In addition to a more flexible regulatory toolkit, it is also worth considering the potential for harnessing default options and standardised product design to help improve consumer outcomes in complex markets where consumers face difficult choices. However, to be effective, defaults need to be carefully scoped and have a clear objective.

94 Defaults are tools that recognise and harness common behavioural biases such as inertia and procrastination. Inertia and procrastination can result when people become bewildered by too much information and choice or where they want and intend to take a specific action yet simply do not get around to it. This can mean that, even when education or disclosure motivates a person to act, they can fail to convert their good intentions into positive outcomes.

95 Defaults already exist in the Australian superannuation regulatory system. The newest default arrangements ('MySuper' products) recognise that member engagement is often low, because of the compulsory nature of superannuation, and are designed to ensure that disengagement will not result in a poor outcome at retirement. The MySuper approach applies a default setting that ensures that those who do not actively choose a superannuation fund will automatically have their contributions paid into a MySuper product. They are designed to have a simple set of product features, irrespective of who provides them. This is to make it easier to compare funds based on a few key differences, but also to ensure members do not pay for any features they do not need or use.

96 While defaults are promoted by behavioural economists as potential policy tools, they are also used in commercial and other settings (e.g. online subscriptions, product application forms, and renewal notices often use pre-

ticked boxes and other types of opt-out features to 'nudge' people into particular outcomes).

Addressing the detrimental impacts of default settings

In some cases, default settings adopted by industry can operate against the best interests of the consumers involved. Broader intervention powers would allow ASIC to address the detrimental impact of such default settings in appropriate cases.

For example, ASIC has done extensive work on the significant detriment caused to consumers by the combination of default rollovers and dual pricing of term deposits (see Report 185 *Review of term deposits* (REP 185), and Report 353 *Further review of term deposits* (REP 353)). ASIC's initial review found that high volumes of consumer funds were renewing by default into lower rate deposits, with rates on renewal in some cases below inflation. ASIC had no formal power to address the situation. However, through a combination of public reporting and persuasion, industry agreed to make widespread (though not universal) changes to their practices, including better and more timely disclosure and a standardised grace period.

On its subsequent review ASIC found that consumers were better off by billions of dollars as a result of the changes, including changing or withdrawing $97 billion in deposits during the grace period over the seven-month period of the review. While this was a good outcome, the absence of an intervention power meant that the improvements took much longer to implement, could not necessarily be achieved across the board, and was always uncertain and dependent on industry goodwill.

Currently, in the general insurance market, ASIC is aware of a default setting that is having a significant impact on consumers. It relates to an insurance product that is an add on offered in the course of the online purchase of a primary non-financial services product. When in the online form for purchasing the primary product the box to take up the add on insurance was pre-ticked, rather than being left blank for the consumer to tick if they wanted the product, the 'take-up' of the insurance increased by over 100%. There was no other apparent reason for the dramatic increase in sales.

If such an opt-out setting was put in place for a product that was otherwise problematic, (e.g. it was objectively poor value for money with very low levels of successful claims and high levels of complaint, including by consumers that they were not aware that they had purchased the product), ASIC should have power to intervene to ensure that only consumers who really want the product are receiving and paying for it. ASIC has no current powers to address this issue.

97 There are a few other areas where default options could be used. For example:

(a) *Funeral insurance*—This type of insurance is likely to be inappropriate for consumers where they may pay, over the term of the policy, several times the amount of the insured benefit, or where the premiums increase to the point the consumer may no longer be able to afford the payments (for example, where the consumer retires and is dependent on the aged pension).

(b) *Indefinite term leases*—These are likely to be inappropriate where the consumer must pay as long as they have possession of the goods, and where the payments will exceed the cash price of the goods (e.g. where the consumer leases, for an indefinite term, low-cost household items, such as furniture).

98 For such products, defaults could be used to steer consumers away from the product, if it is not likely to be appropriate for their circumstances.

99 While defaults have advantages, their design must consider the appropriateness of the default for the target audience, and monitoring is often required to check that the 'set and forget' settings are appropriate over time. For example, the settings could be staggered over the lifetime of the product by following the initial defaults with further stages of engagement and defaults around life stage milestones).

Enhancing disclosure

100 Disclosure will remain a key part of any financial services regulatory toolkit, so it is important to look at how it can be best applied and what steps can be taken to enhance consumer understanding.

101 Disclosure is more likely to resonate with, and be useful to, consumers where:

(a) the source of the information is both trusted and trustworthy;

(b) the product and its features are simple enough to be able to be presented, understood and compared in an easy, clear and balanced way (e.g. consistent and digestible format and structure, no need for jargon, accessible numeric indicators such as dollars rather than or in addition to percentages);

(c) appropriate consumer testing is conducted to refine the design elements of the disclosure to test that the product and its features are appropriately presented and understood by the majority of the target audience;

(d) the disclosure occurs at an appropriate time and in an appropriate manner during the decision process so that it has the best chance of having an influence on the decision; and

(e) the information and engagement is partnered with reliable 'nudges' or defaults that either harness or help overcome inertia and other behavioural biases (e.g. automatic reminders, comparison tools and opt-out contribution settings).

102 Additionally, our experience is that well-designed disclosure can be a useful mechanism to explain the costs and fees of using a product if the fee structure is not too complex and key contractual terms and features are simple.

103 There are some situations in which disclosure by itself is less likely to be effective, such as when:

(a) the product is complex (e.g. it has complicated features, exclusions or risks, multiple fee and cost structures, or requires people to consider uncertainty and probability);

(b) the disclosure cannot be accessed by the product's target audience (e.g. in the format or language required);

(c) the design elements of the disclosure cannot be consumer tested among the target audience and are not refined to maximise consumer understanding and minimise consumer confusion;

(d) the sales process undermines consumer's engagement in or understanding of the disclosure material; and

(e) accompanying nudges or defaults have the capacity to misinform consumers or cause them to disengage entirely when future actions are necessary.

104 ASIC considers that the disclosure regime can be enhanced by other regulatory tools in these situations. In particular, we support facilitating new ways of providing information to consumers, including using technology and electronic delivery. While current disclosure requirements allow product providers flexibility in the format of disclosure documents (e.g. allowing disclosure to be made online and using interactive features, potentially incorporating new media), impetus from industry to explore these ideas is yet to grow to significant levels. The framework should provide incentives for product providers to be more innovative in providing product information in different forms and channels, so long as this assists consumer understanding.

105 Other approaches that may be used to promote consumer understanding (and meet the needs of advisers) include layered disclosure, greater transparency of key product features (e.g. short-form upfront statements that describe key features from a consumer perspective), standardised risk indicators and comparable fee structures. Facilities for investors to test their understanding of a product before investing may also help; however, to be reliable they must be credible and robust.

106 The MySuper product dashboard and Choice product dashboard provide an example of an effective innovative enhancement of disclosure.

MySuper and Choice product dashboard

The MySuper product dashboard and Choice product dashboard are part of an initiative designed to enhance consumer engagement with their superannuation by providing simple, easy-to-understand information that will promote comparison between superannuation products. MySuper product dashboard requirements commenced on 31 December 2013 and Choice product dashboards are

MySuper and Choice product dashboard

scheduled to start on 1 July 2015 (after ASIC delayed the regime by class order to provide further time for the Government to consult on Choice dashboard regulations). The MySuper product dashboard currently provides basic information about return targets, returns, fees and risk.

The consumer testing of the MySuper product dashboards that was undertaken in 2013 found that the dashboards had real potential to provide simple and comparable information for consumers about their superannuation. Spontaneous response to the preliminary design was positive. However, consumers felt that the dashboard and the language could be simplified further. Consumers also had specific comments about the particular elements of the dashboard, including in relation to risk and fees. In the case of fees, consumers were interested in being able to tailor the information to their account balance rather than using the representative investor model.

In relation to the disclosure of risks, a number of different models were tested, including a model that tried to address the issues associated with longevity risk. Generally, the simplified model of risk addressing volatility was better understood. However, the product dashboard is not the only disclosure material that a consumer receives about their superannuation and more detailed information is available in the PDS. The testing of the product dashboard also found that consumers liked to receive information in a variety of forms and places: see p. 13 of Report 378 *Consumer testing of the MySuper product dashboard* (REP 378), which states ‘Consumers expect and want the Dashboard to be available in annual statements and on super fund, Government (ATO, MoneySmart) and comparison websites (in a similar way to insurance)’.

Disclosure in PDSs and prospectuses

107 In its interim report, this inquiry specifically raised the question of whether similar issues in relation to the PDS regime apply to prospectuses, and whether there is a need to review prospectus requirements.

108 The prospectus and PDS regimes operate in a very similar fashion. Both are centred on providing sufficient disclosure to investors or retail clients so that they may make an informed investment decision. However, while the PDS and prospectus are generally similar, there are differences in the financial products offered under the two systems. The prospectus disclosure regime under Ch 6D applies to securities like shares, options or debentures and focuses on providing disclosure to investors and their advisers. The PDS regime applies to a wider range of financial products such as insurance, with a focus on providing disclosure to retail clients.

109 Investors under the PDS do not acquire an equity stake in the entity offering the product and most commonly will be more interested in the features of the product rather than the product issuer.

110 Conversely, the decision to invest in an offer of securities will generally have a strong link to the value and performance of the entity offering the securities. Often much of the information relevant to the investment will only be known from disclosures made by the entity about matters such as the

entity's financial position and performance, internal operations, and future plans.

111 Accordingly, the content that investors will generally need, and that the respective regimes necessarily require an issuer to disclose, differs somewhat between the PDS provisions and the prospectus provisions.

112 Although the prospectus and PDS regimes differ in terms of the focus and underlying purpose of the disclosure they require, in each case they are fundamentally disclosure based. While ASIC acknowledges this inquiry's comments in the interim report that submissions to date have not strongly proposed a review of the prospectus regime,[7] ASIC notes that many of the inadequacies of disclosure as the sole basis for regulating investment and product offerings highlighted in submissions to this inquiry, and some of the criticisms of the PDS regime, may also apply in the context of the prospectus requirements.

113 Appendix 1 provides further detail about the prospectus regime, and options for enhancing prospectus disclosure.

Comparison websites

Access to data by consumers

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Ensure aggregators are able to use automated processes to seek quotes from general insurance websites.
- Create comparison categories for insurance products that aggregators could use to compare the value of different products.

The Inquiry seeks further information on the following areas:

- How could insurance aggregators provide meaningful comparisons of policies with different levels of coverage?
- What options could be explored for providing consumers with more control over use of their data and/or better access to their own data in useful formats to improve decision making and consumer outcomes?

114 ASIC considers that there is real potential for comparison websites to supplement mandated disclosure and to help consumers make better financial decisions.

115 Consumers are increasingly seeking web-based information and third-party reviews when making purchasing decisions (including the purchase of

[7] Interim report, p. 3–55.

financial products and services). Further, reliance on web-based information is expected to increase over time.

116 Comparison websites can empower consumers by providing an interface for consumers to more easily compare products and interpret disclosure information. They help to address the limitations of the disclosure regime by providing a snapshot comparison of financial products and services without requiring consumers to examine multiple (potentially lengthy and complex) disclosure documents. Where designed responsibly, comparison websites can also increase competition between product and service providers by giving consumers potentially greater choice, better quality and competitive pricing.

117 However, the effectiveness of comparison websites will depend on good design. For example, the FCA's thematic review of price comparison websites in the general insurance sector found that such websites did not always provide sufficient, clear and consistent information on the level of cover, key features, exclusions and limitations to enable consumers to make an informed decision.[8] Further, where the price and quality of cover are compared, the review found that price was more prominently displayed than the other information provided.[9]

118 To ensure that comparison websites provide information that is meaningful and useful to consumers, ASIC sees the provision of comparison information as an area that may require specific regulation.

119 Internationally, governments and regulators are increasingly considering ways to enhance consumer outcomes and drive competition by requiring product and service providers to make machine-readable data available to third parties, who may then be able to aggregate such data into useful 'choice engines'. For example, in Norway, insurers (apart from life insurers) are required to disclose information, including price information, on Finansportalen, a comparison website established by the Consumer Council of Norway.[10]

120 There is merit in evaluating the need to maintain a minimum standard of comparison services through specific regulation. Any such regulation could address the quality of comparison information and the management of conflicts that have the potential to affect the quality of comparison information. Regulation may be justified by the potential impact of comparison services on consumers' financial decision making, the importance of the decisions being made by consumers, the difficulty in

[8] FCA, *Price comparison websites in the general insurance sector* (TR14/11), thematic review, July 2014.
[9] FCA, *Price comparison websites in the general insurance sector* (TR14/11), thematic review, July 2014.
[10] EIOPA, *Report on good practices on comparison websites,* January 2014, https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/reports/Report_on_Good_Practices_on_Comparison_Websites.pdf.

making financial decisions without assistance in certain cases, and the barriers (e.g. costs) to accessing personal financial product advice.

121 However, we also think there is opportunity for industry-led regulation. For example, industry standards may prescribe additional requirements relating to the presentation of information on comparison websites that go beyond the requirements of any explicit regulatory regime.

122 In Europe, the European Insurance and Occupational Pensions Authority (EIOPA) has developed best practice principles for comparison websites. Examples include the following:[11]

(a) Comparison websites should explain what featured recommendations, such as 'editor's choice' and 'best buy' mean, and the basis of these recommendations, including whether these are taken from a selection of affiliates only.

(b) Comparison websites should enable consumers to select a balanced listing of product features other than price (such as type of guarantee, exclusions or limitation clauses).

(c) General information about a comparison website (e.g. privacy policy and information on ownership) should be easily identifiable.

While the EIOPA is not an industry-led organisation, there is opportunity for industry to similarly develop additional requirements for the operators of comparison websites in Australia.

123 Another option for facilitating the provision of meaningful comparison information is to compel industry to provide data that would facilitate more sophisticated comparisons in a usable format. Mandated data could relate to product terms and price; however, it could also extend to important product features that could facilitate more powerful and useful comparisons. For example, issuers of insurance products could be required to provide data on the level of cover (e.g. high, medium and low), claims ratios, withdrawn claims, and complaint and EDR disputes data. Such data would be a far more direct and powerful indicator of the quality or value for money of a financial product or service than a detailed comparison of lengthy disclosure documents.

124 The development of standard definitions for product features is another tool that could improve the quality of comparison information. Standard definitions help to ensure that the data supplied by financial product issuers to the operators of comparison websites are comparable. For example, the standard definitions developed for private health insurance products under

[11] EIOPA, *Report on good practices on comparison websites,* January 2014, https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/reports/Report_on_Good_Practices_on_Comparison_Websites.pdf.

the *Private Health Insurance Act 2007* are used as the basis for the Private Health Insurance Ombudsman comparison tool.

Access to data by consumers

125 Access to data can facilitate more meaningful comparisons. Increasing consumers' access to data can help consumers better assess and manage risks, and help them to make better decisions.

126 Giving consumers access to information specific to their area of residence (e.g. notifying them of risk factors such as proximity of trees to property or what their Bushfire Attack Level, based on Australian Standard AS 3959 *Construction of buildings in a bushfire-prone area*, is for their individual dwelling), can help them make informed decisions about home insurance, and take steps to mitigate risk and reduce the likelihood of making a claim; the same applies to driving and road information (e.g. road 'black spots' and safety characteristics of particular vehicles) and motor vehicle insurance.

Data to make better decisions on natural disaster insurance

If comprehensive data in relation to natural disaster risk (e.g. risk of floods, bushfires, and cyclones) were made available by the relevant agency or government (at the local, state or federal level) at a dwelling level, this would enhance the consumer's ability to make an informed decision about the peril risk of the property. Consumers could then use this data to ascertain the level of cover needed and make more meaningful comparisons between policies.

Data about natural disaster risk could be made available to consumers in a standardised form (e.g. ranking or rating the risk). For example, a property's bushfire risk could be rated according to a Bushfire Attack Level rating. Flood mapping could potentially provide a standardised risk rating for areas or individual properties.

At present, no single agency holds comprehensive or standardised natural disaster risk data, but efforts are being made by a number of agencies (insurers, local governments, private firms) to obtain this data at dwelling level. If this data were linked to the insurance calculators provided by insurers, then consumers could make an informed decision about how much to insure their property for, taking into account the costs of rebuilding to the building code standard affecting their property.

This could have the benefits of both reducing levels of underinsurance and if insurers had access to this information in a consistent and reliable way, they could advise consumers about their insurance needs.

127 This data can be used with behavioural insights to help consumers reduce and better manage their risks and can also help insurers price more individually. For example, the use of new in-car 'black box' devices that monitor driving behaviour and usage, known as 'telematics', enable insurers to more accurately determine a driver's premium based on their behaviour. Younger drivers who are typically charged a higher premium based on a generalised estimation of risk could benefit from personalised data being

provided to the insurer. It can also help consumers change their behaviour—for example, adopting safer driving practices if they are aware of the tracking.

128 Greater access to this data by insurers could also increase the risk that such data is not always used for the purposes for which it is collected. The benefits of such data collection would therefore need to be weighed against privacy interests of the consumer.

Financial literacy

The Inquiry seeks further information on the following areas:

What evidence is there on the effectiveness of financial literacy strategies in enhancing consumer confidence and decision making at particular points in time, and in achieving increasing literacy over the long term?

129 Financial literacy has been described as a 'consumer "responsibilisation tool" that empowers and educates consumers'.[12]

130 There is already a wide range of anecdotal and circumstantial evidence of the benefits of financial literacy programs or interventions. However, as many of these are relatively recent initiatives, the longer term benefits will require further time to evaluate.

131 Financial literacy, in the sense of a defined policy and regulatory tool, is a relatively new concept in Australia and internationally. The first survey of adult financial literacy in Australia was only conducted in 2003. It is only since the Global Financial Crisis in 2008, when ASIC was given portfolio responsibility for financial literacy, that financial literacy has gained policy prominence on the agenda of many world economies and, according to the Organisation for Economic Co-operation and Development (OECD), has become an 'important complement to market conduct and prudential regulation'.[13]

132 Furthermore, as noted in the National Financial Literacy Strategy, improving financial literacy is a long-term behavioural change initiative.[14]

133 While the importance of evaluation and measurement is widely recognised, and there is a growing field of research in the area, this is still a relatively young field of study. Furthermore, best practice for evaluating financial

[12] P Ali, M Anderson, C McRae and I Ramsay, 'The financial literacy of young Australians: An empirical study and implications for consumer protection and ASIC's National Financial Literacy Strategy', *Company and Securities Law Journal*, vol. 32, 2014, p. 334.
[13] OECD International Network on Financial Education, *High-level principles on national strategies for financial education*, principles, OECD, August 2012.
[14] Report 403 *National Financial Literacy Strategy 2014–17* (REP 403).

literacy programs is still emerging. For example, the national stocktake of financial literacy programs conducted by ASIC in 2013 found that only 26% of initiatives had been independently evaluated, with the majority (57%) not evaluated in any way.[15]

134 For these reasons, it is too soon to be able to measure the effectiveness of financial literacy strategies over the long term.

135 Furthermore, it is difficult to isolate the impact of financial literacy interventions in terms of overall financial behaviour. While financial literacy (i.e. the ability to apply knowledge, skills, attitudes and behaviours to make sound financial decisions that support financial wellbeing) is an important factor in an individual's ability to make financial decisions, it is not the only factor. As noted in the National Financial Literacy Strategy, the multiple factors influencing financial behaviour and outcomes make it difficult to measure actual changes in behaviour.[16]

136 Also as noted in the National Financial Literacy Strategy, financial literacy is only one factor that contributes to an individual's financial wellbeing. Other complementary factors include financial inclusion, appropriate consumer protection mechanisms and fair and efficient markets.[17]

137 That said, there is a wide range of anecdotal and circumstantial evidence of the benefits of financial literacy programs or interventions. For example:

(a) The latest research into awareness and usage of ASIC's MoneySmart website conducted in January 2014, found that 8.3% of Australian adults had visited the website, with a total of 2.28 million unique visits in the six months since July 2013. Of those who had visited the website, 83% said MoneySmart was useful or extremely useful, and 93% of visitors found the MoneySmart online calculators useful or extremely useful.[18]

(b) The same research also found that 86% of ASIC's MoneySmart website users had taken some action in relation to their finances after visiting the MoneySmart website, with the most popular actions being keeping a closer eye on spending (41%), preparing or updating a budget (35%), shopping around for a better deal (28%), reviewing their financial situation (26%) and increasing the amount in saving (26%).[19]

(c) *MoneyMinded report 2013*, the latest in a series of reports designed to assess the reach and impact of the ANZ's MoneyMinded financial

[15] Report 375 *National Financial Literacy Stocktake Survey 2013* (REP 375).
[16] REP 403, p. 16.
[17] REP 403, pp. 6–7.
[18] Sweeney Research, *Awareness and usage of MoneySmart website: Wave 6 research report,* report commissioned by ASIC, February 2014.
[19] Sweeney Research, *Awareness and usage of MoneySmart website: Wave 6 research report,* report commissioned by ASIC, February 2014.

education program, found that program facilitators and clients reported a range of positive effects including the development of more effective budgeting skills, better saving habits and reduced spending leaks.[20] Some participants in the program also participate in a related matched savings program.

(d) The results of the first financial literacy assessment of 15-year-olds conducted in 2012 as part of the OECD's Programme for International Student Assessment (PISA), found that of the six countries that performed statistically higher than expected, five (including Australia) have started to develop school curricula for financial literacy, including the development of learning frameworks.[21]

(e) The OECD, which has taken a lead internationally in developing policy and good practice guidelines for financial literacy education, points to a range of international studies that provide evidence of the potential benefits of financial literacy in terms of a greater propensity to save and plan for retirement, build assets and manage debts.[22]

(f) In the United Kingdom, a research report prepared for the Consumer Financial Education Body by researchers at the University of Essex indicates that improving a person's financial management skills also has a positive effect on their mental health, living standard, savings behaviour, and household income.[23]

(g) In Australia, research has also found that one of the benefits of having higher levels of financial literacy is that under certain conditions it creates an awareness of the need for specialised advice, which is particularly important in the context of retirement planning.[24]

Financial advice

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Raise minimum education and competency standards for personal advice (including particular standards for more complex products or

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[20] R Russell, M Steward and R Green, RMIT University, *MoneyMinded report 2013*, report commissioned by ANZ, July 2014, www.anz.com/resources/e/6/e61d57f8-36cf-403f-9704-04e24a53db98/moneyminded_report_2014.pdf?MOD=AJPERES.
[21] S Thomson, *Financing the future: Australian students' results in the PISA 2012 Financial Literacy assessment*, report, Australian Council on Educational Research, August 2014, p. 38, www.acer.edu.au/files/PISA_2012_Financial_Literacy.pdf.
[22] OECD, *PISA 2012 Financial Literacy Assessment framework*, framework, April 2012, p. 8, www.oecd.org/pisa/pisaproducts/46962580.pdf.
[23] Consumer Financial Education Body, *The long term impacts of financial capability: Evidence from the BHPS* (CR03), research report, February 2011.
[24] P Gerrans and DA Hershey, *The role of financial literacy and financial adviser anxiety in older Australians' advice seeking*, report, National Seniors Productive Ageing Centre, January 2013, www.productiveageing.com.au/userfiles/file/Final%20version%20Financial%20Literacy.pdf.

structures such as self managed superannuation funds), and introduce a national examination for financial advisers providing personal advice.

- Introduce an enhanced public register of financial advisers (including employee representatives) which includes a record of each adviser's credentials and current status in the industry, managed by either Government or industry.
- Enhance ASIC's power to include banning individuals from managing a financial services business.
- Rename general advice as 'sales' or 'product' information and mandate that the term advice can only be used in respect of personal advice.

The Inquiry seeks further information on the following areas:

- What opportunities exist for enhancing consumer access to low-cost, effective advice?
- What opportunities are there for using technology to deliver advice services and what are the regulatory impediments, if any, to those being realised?
- Is there is a case to more clearly distinguish between independent and aligned advisers, and what options exist for doing this?
- Would consumers be likely to understand the difference between aligned and independent advisers and, if so, to what extent would this be likely to factor into a consumer's decision to take the advice?

138 ASIC agrees with the conclusion of this inquiry that having conflicted remuneration structures in financial advice undermines the principle of consumers being able to access advice that meets their financial needs. ASIC outlined these issues in detail in our main submission to this inquiry.

139 The financial advice that consumers need and would like to receive does not come in one model or level of complexity—consumers benefit from receiving financial advice and information through a range of channels, and in the form of piece-by-piece advice as well as holistic or comprehensive advice. The varying forms financial advice and information can take raise different issues, all of which are important to consider.

140 To improve the quality and accessibility of advice available to consumers, ASIC considers that the key issues are those set out in Table 2.

Table 2: Key issues and proposals to improve the quality and accessibility of financial advice

Area of financial advice	Issue	Proposal
Personal advice	Higher competency levels than are currently mandated are needed to provide quality personal advice. The current minimum education and competency standards for advisers providing personal advice need to be raised.	A minimum degree qualification for advisers giving personal advice. The introduction of mandatory ongoing training requirements and mandatory supervision of new advisers. A national examination for financial advisers providing personal advice.
General advice, sales and product information	The current definition of general advice in the Corporations Act is extremely broad. A licensing requirement may not be the best regulatory approach for all forms of general advice. In particular, licensing may give consumers a false impression of independence where the advice given is essentially provided to generate sales.	Consider a more effective form of regulation for general advice than the current licensing regime, while retaining consumer protections. Redescribe some kinds of general advice that are primarily provided for the purpose of generating sales as 'sales' or 'product' information.
Distinguishing between independent and aligned advisers	It is likely that many investors believe that they are dealing with an independent advice business when in fact the business is related to or owned by a product manufacturer.	Require the inclusion of a prominent, simple statement about the relationship of the adviser to the issuer and the limited range of products the adviser is able to recommend. Require an advice business that is tied to an issuer to call itself a 'restricted advice' business.
Accessibility of financial advice and information	The accessibility of advice is an ongoing issue. In particular, the provision of general advice or factual information is less extensive than it could and should be.	Technology can be harnessed to provide advice in new and more efficient ways. Governments can play a greater role in filling accessibility gaps by delivering independent and unbiased information, including in partnership with other entities.
Better regulating the financial advice industry, generally	Due to its complex nature, it can be difficult for a consumer to independently assess the quality of financial advice. Therefore, it is important that the financial advice industry be well regulated with high standards of conduct. However, there are current gaps in the regulation of this industry.	An enhanced public register of financial advisers. Enabling ASIC to ban individuals from managing a financial services business.

Raising minimum education and competency standards for personal advice

Minimum standards

141 ASIC supports a minimum degree qualification for advisers who give personal advice on investment products. This is higher than the proposal ASIC consulted on in CP 212, which supported an increase to degree-level qualifications (but not a full degree).

142 We support this training standard because these products are complex and not well understood by consumers and investors. Therefore, good-quality advice about these products is particularly crucial.

143 In July 2014 the Parliamentary Joint Committee on Corporations and Financial Services announced an Inquiry into professional, educational and ethical standards for financial planners. ASIC welcomes that inquiry and looks forward to discussing the proposals outlined above as part of this inquiry process.

National exam

144 In addition to raising the standard of competence required of advisers, a separate important issue is how to test whether an individual adviser has attained that standard. To address this issue, ASIC also supports a national examination for financial advisers. In Consultation Paper 153 *Licensing: Training and assessment framework for financial advisers* (CP 153) ASIC formally consulted on a proposal to introduce a mandatory examination for financial advisers. ASIC's view is that this is the best way to stop a 'race-to-the-bottom' between training providers who compete to attract students.

145 ASIC modelling estimates that the exam would be fully funded after three years, through recovery from exam fees.

Rethinking the regulation of general advice

146 The current definition of general advice in Ch 7 is extremely broad. It captures any recommendation or statement of opinion that is intended to influence a person in making a decision about a financial product or class of products, except where the provider of the advice has considered one or more of the person's objectives, financial situation and needs (in which case, the advice is regulated as personal advice): see s766B.

147 The effect of imposing a licensing regime in relation to the broad class of persons and activities captured by this definition includes that:

(a) in some cases, licensing may be a disproportionately heavy regulatory burden given the very general nature of the advice provided, and regulatory settings more tailored to the nature of the activity may be more appropriate; and

(b) in other cases, licensing may give consumers a false impression of independence where the advice given is essentially provided to generate sales: (see the box below for examples).

General advice provided for the purpose of sales

General advice seminars

An investment seminar is advertised as providing free training in foreign exchange trading or online trading. The presenter is licensed to provide general financial product advice and gives the appropriate warning regarding the limitations of this advice at the seminar. However, the primary purpose of the seminar is as a promotional vehicle for sales of foreign exchange accounts or online trading accounts.

An investor attends an advice seminar explaining how to invest in residential property through SMSFs. The advice given at the seminar is general advice only. The presenter holds an AFS licence and runs a related property development businesses. The objective of the seminar is to channel clients into 'one stop shop' advice to recommend setting up an SMSF, brokering finance and investing in property.

In both examples, rather than being general advice or investor training sessions, the seminars might more accurately be described as sales presentations. Nevertheless, under the current regulatory regime, they would be described and regulated as 'general advice' seminars.

Over-the-counter advice

Staff at a bank branch recommend a life insurance product to a customer. This is general financial product advice and the appropriate warnings are given. Whether the life insurance product is right for the customer's particular circumstances is not considered. The customer does not realise the bank only sells its own brand of insurance products that are not necessarily the cheapest in the market and bank staff are encouraged by the bank to sell insurance to meet their sales targets.

A bank teller asks a customer about investment of her savings and whether she would like to speak with a financial adviser. The customer is provided with a general advice brochure listing the bank's financial products. The customer does not realise that the bank only arranges financial advice in relation to sales of its own brand of products.

148 There is merit in significantly rethinking the current regulation of general advice. This would involve re-examining the broad, and, in some cases, disparate range of activities caught under the current definition and exploring the possibility of more effective regulation. This could involve a combination of the following:

(a) excluding some activities from certain licensing requirements under Ch 7, while retaining appropriate alternative regulation that is better targeted at the potential consumer protection issues raised by general advice;

(b) applying a more tailored regulatory regime to some types of 'general advice' rather than regulating all as a single class of activity;

(c) redescribing some kinds of general advice that are primarily provided for the purpose of generating sales as 'sales information'; and

(d) ASIC intervening, using the potential new powers mentioned in paragraphs 79–87, if conflicted remuneration were clearly producing market failures.

149 An alternative regulatory regime for general advice could involve, among other things:

(a) general conduct standards;

(b) a prohibition on misleading and deceptive conduct; and

(c) the requirement to provide consumers with access to dispute resolution arrangements, including being a member of an EDR scheme.

150 While the general advice definition currently combines a broad range of activities, a review is likely to identify some types of activities that should be separated out and regulated under a tailored regulatory regime. For example, we have suggested that potential consumer protection issues associated with data aggregators and comparison websites could be appropriately addressed by a set of conduct rules specifically targeted at the nature of the service provided: see paragraph 120.

151 Finally, renaming general advice that is primarily directed at generating sales would better reflect that nature of the activity, and would assist in clarifying its purpose for consumers.

Distinguishing between independent and aligned advisers

152 It is likely that many investors believe that they are dealing with an independent advice business when in fact the businesses is related to or owned by a product manufacturer. For example, Roy Morgan Research found that 55% of surveyed consumers receiving financial advice from an entity owned by a large financial institution, but operating under a different brand name, considered it to be independent—in contrast, only 14% of consumers considered financial planners working under the brand of the same financial institution to be independent.[25]

153 Vertically integrated businesses, which combine product manufacturers with advice groups, have always been a feature of the financial advice industry. Vertical integration is common in the financial system, particularly in the banking and funds management industries.

[25] Roy Morgan Research, *Confusion with financial planner independence continues* (Finding No. 5716), 4 August 2014, www.roymorgan.com/findings/5716-confusion-with-financial-planner-independence-201408040221.

154 There is no requirement in Australia for advisers to offer independent advice, or for advice groups to be structurally separate from product manufacturers. While required to act in the best interests of clients when providing personal advice, advisers are not required to review all products available in the market before making a recommendation and are not restricted from advising on a limited range of house products under an approved product list.

Note: The AFS licensing obligations include a requirement to manage conflicts of interest: see Regulatory Guide 181 *Licensing: Managing conflicts of interest* (RG 181). Some AFS licensees that are also regulated by APRA may also be required to meet APRA's prudential standards for managing conflicts of interest.

155 The inherent conflict of interest created by vertical integration may not be readily apparent to clients, particularly if the product manufacturer and advice parts of the business operate under separate licences and business names. Better informing clients about the nature of vertically integrated business models and their implications for financial decision making will go some way to increasing consumers' understanding of these issues. This could be done through:

(a) requiring advisers to provide a prominent, simple statement about the relationship of the adviser to the issuer and the limited range of products that the adviser is able to recommend, before the advice is provided; or

(b) requiring an advice business that is tied to an issuer to call itself a 'restricted advice' business or similar terminology.

156 Furthermore, an enhanced public register for advisers could also include disclosure of ownership of the licensed business for which the adviser works: see paragraphs 175–178 for further details on this proposal.

157 This is also an issue in the broader banking market for deposits and transactional services. Consumers who choose a particular brand to deal with may not realise that the brand is owned by and operates under the banking licence of a larger banking institution. It would be appropriate to consider reforms to allow consumers to make an informed decision about who they are dealing with.

Improving the accessibility of financial advice and information

158 Consumers benefit from access to financial information and advice through a range of different channels. Comprehensive or holistic advice is useful to consumers in some circumstances, but not all. Sometimes consumers simply desire advice or information on a discrete financial topic, and being able to access this can significantly improve the accessibility of advice. For many

investors and financial consumers, general advice and factual information may be sufficient to meet their current advice needs.

159 However, the provision of general advice or factual information is less extensive than it could and should be. Our research has found that many Australian consumers would like more information and advice about investment issues. Report 224 *Access to financial advice in Australia* (REP 224), released in December 2010, found that a third of Australians 'are now expressing a preference for piece-by-piece advice rather than holistic or comprehensive advice'.[26]

160 Technology can play a role in delivering financial advice and information in new ways. The Corporations Act is neutral about technology, meaning factual information and advice can generally be delivered by any means without regulatory impediment (e.g. by telephone, email, internet, video conferencing or face-to-face, or in any combination of these or other ways. However, it is also important to note that different modes of communication may give rise to different challenges about whether a client understands the advice they are being given, and what the limitations of the advice are.

161 Our experience is that a number of financial services businesses are exploring using technology to deliver new forms of advice in particular, ranging from using Skype to communicate with individual clients to using algorithms to prepare advice on discrete topic areas. We expect that these developments are likely to continue.

162 Government can also play a greater role in delivering financial information. This can help overcome gaps in the accessibility of advice, and provide an alternative, independent source of financial information.

163 ASIC's MoneySmart website, and supporting print publications, already provide practical, action-oriented information and guidance, as well as interactive tools that are tailored to various life stages and circumstances. We are always looking for opportunities for ASIC's MoneySmart to play a role in further enhancing consumer access to guidance, including in partnership with other relevant agencies and organisations.

164 Guidance and information currently provided includes information on investing basics, superannuation and retirement, financial advice, and various types of investments including complex products. In particular, MoneySmart has information on identifying financial advice needs, choosing an adviser, costs of advice, what to look for in advice, and working with an adviser. The interactive tools and calculators on MoneySmart (such as the money health check and retirement planner) also enable people to work

[26] REP 222, paragraphs 53 and 62. The original data was taken from Advice and limited advice report, Investment Trends, Sydney, December 2009.

through various scenarios that illustrate financial concepts and arm them with basic information to then, if necessary, discuss with a professional adviser. Critically, the information and guidance provided by MoneySmart is free and impartial, providing an important counterbalance to sales and marketing information for financial products and services.

165 The guidance on ASIC's MoneySmart website is freely available to all. The number of people using the website has doubled over the past two years. MoneySmart has had over 7.5 million visitors since launch, and now helps over 400,000 Australians a month. However, ASIC does not provide individualised online general advice, or operate a telephone or face-to-face service for people seeking guidance from MoneySmart.

166 We are always looking for opportunities, within our current operational settings, to enhance consumer access to guidance and general advice available from ASIC's MoneySmart website, including in partnership with other relevant organisations, and under the umbrella of the recently launched National Financial Literacy Strategy: see www.financialliteracy.gov.au.

167 An example of how ASIC's MoneySmart program could be significantly expanded to provide general advice to Australian consumers and investors may be found in the United Kingdom. In 2007, the UK Government commissioned the Thoresen Review to determine models for achieving greater access to generic financial advice, known as 'Money Guidance', on a national scale. In March 2008, the Thoresen Review published its final report containing recommendations for delivering a national service to the UK population. The Thoresen Review found that the establishment of a national Money Guidance service would achieve significant quantifiable benefits for individuals, the financial services industry, the UK Government and society as a whole.[27]

168 The Money Advice Service, launched in 2011, is the body established in the United Kingdom as a result of the Money Guidance Thoresen Review. It offers generic money advice online, via web chat, via telephone and face-to-face through a network of advisers. Since 2012, it is also responsible for the coordination of debt advice.

169 In terms of governance, the board of the Money Advice Service is appointed by the FCA, with the Chair and Chief Executive's appointment requiring approval of the UK Treasury. In terms of funding, the Money Advice Service is funded by a levy raised and collected by the FCA and paid by FCA-regulated financial services firms. For the year ended March 2013, the Money Advice Service net costs were over £77 million.[28] By contrast,

[27] O Thoresen, *Thoresen Review of generic financial advice: Final report*, report, UK Treasury, March 2008, http://webarchive.nationalarchives.gov.uk/+/http:/www.hm-treasury.gov.uk/media/8/3/thoresenreview_final.pdf

[28] Money Advice Services, *Annual Review, Directors' Report and Financial Statements for the year ended 31 March 2013* (Registered Number 7172704), June 2013.

funding for ASIC's MoneySmart program is approximately A$8 million per year (which includes funds from new policy proposals).

170 The provision of generic financial advice in the United Kingdom will be further enhanced under changes to the way that UK consumers access their retirement savings, which were recently announced following the UK Budget in March 2014. Under these changes, from April 2015, more UK consumers will have greater flexibility in how they can access their retirement savings from defined contribution pension schemes (i.e. instead of being effectively required to purchase an annuity).[29]

171 To support this increased flexibility, the UK Government announced a new 'Guidance Guarantee', where every individual with defined contribution pension savings will have a right to free and impartial guidance, available in a range of ways (including the option of face-to-face), to help them make confident and informed decisions on how they use their pension savings in retirement. The guidance service will be delivered by independent organisations that have no actual or potential conflict of interest, including the Money Advice Service and the Pensions Advisory Service.[30]

172 As part of the package of reforms, the FCA will be responsible for setting standards for the guidance and monitoring compliance with those standards. UK pension providers will also be required to make people aware of their right to impartial guidance and signpost them to the guidance service as they approach retirement.[31]

173 The UK Government has allocated £20 million to establish the Guidance Guarantee initiative. The ongoing costs of the guidance service will be funded by a levy on relevant FCA-regulated firms.[32]

174 The FCA is currently consulting on proposals for the standards that should apply to the delivery of the guidance service, and the levy arrangements for funding the service, as well as the requirements on pension providers to direct their customers to the guidance service as they approach retirement.[33]

Enhanced public register of financial advisers (including employee representatives)

175 ASIC is a longstanding supporter of a public register of financial advisers.

[29] *Freedom and choice in pensions: Government response to the consultation* (Cm8901), consultation paper, UK Treasury, July 2014.
[30] *Freedom and choice in pensions: Government response to the consultation* (Cm8901), consultation paper, UK Treasury, July 2014.
[31] *Freedom and choice in pensions: Government response to the consultation* (Cm8901), consultation paper, UK Treasury, July 2014.
[32] *Freedom and choice in pensions: Government response to the consultation* (Cm8901), consultation paper, UK Treasury, July 2014.
[33] FCA, *Retirement reforms and the Guidance Guarantee* (CP14/11), consultation paper, July 2014.

176 It is important that consumers have sufficient information to help them choose an adviser. An adviser register should lead to improvements in the quality of advice through market pressure, as consumers will be able to use the information in the register to decide whether or not to engage a particular adviser, based on their qualifications, work history and disciplinary history.

177 An adviser register will also improve the quality of advice by providing valuable information on the adviser population for ASIC and industry, a key piece missing from the regulatory framework up to now. ASIC should be able to use information in the register to identify 'bad apples' more readily and take appropriate action, and industry should be able to use the register to cross-check work history and qualifications.

178 The Australian Government has convened a working group to implement a register, and ASIC is participating in this process.

Enhancing ASIC's power to include banning individuals from managing a financial services business

179 ASIC's view is that an AFS licence should be a privilege, not a right. In circumstances where responsible managers are responsible for managing the day-to-day provision of financial services, ASIC should have the power to ban them. Such a banning power would be exercised for failing to take reasonable steps as a responsible manager to ensure the licensee and its advisers comply with the law (rather than being held responsible for the specific wrongdoing of any one adviser in the firm).

180 ASIC does have the power under s920A to make a banning order against a person in circumstances where the person has been 'involved in' the contravention of a financial services law by another person or ASIC has reason to believe the person is likely to become involved in a contravention of a financial services laws. However, the order made under s920A only prevents the banned person from providing financial services; it does not prevent them from being involved in the management of a financial services business.

181 ASIC's experience is that this limitation facilitates phoenixing of problem financial services business. ASIC can cancel a licence of a poor financial services business only to see the key people of that businesses establish a new financial services business or move to an existing financial services business. In engaging in such phoenixing activity, the managers may leave a significant number of consumers with uncompensated losses from poor advice.

182 The ability to ban those involved in managing a financial services business will enable ASIC to effectively target those who set the compliance culture

within a financial services business and provide a strong incentive for these individuals to create good compliance cultures.

Compelling an independent licensee review

In the United Kingdom, the FCA has the power to compel an independent review of a regulated entity by an external expert, the costs of which are payable by the regulated entity. Such a review allows the FCA to obtain an independent view of aspects of a firm's activities where compliance with the law is in question or that are otherwise providing cause for concern.

ASIC does not have a similar power. Nevertheless, having the power to compel such a review would provide useful information about a licensee's compliance culture.

Consumer loss and compensation

The Inquiry seeks further information on the following area:

Given the limitations of professional indemnity insurance, what options, if any, exist for addressing the issue of consumer loss?

183 Consumer confidence and trust in financial services relies on an effective dispute resolution and compensation framework.

184 ASIC does not have the direct power to award or compel the payment of compensation where the conduct of an AFS licensee has clearly caused direct financial loss to consumers.

185 A collective solution is required to respond to the growing number of unpaid consumer compensation claims against financial adviser licensees. We support the introduction of a limited last resort statutory compensation scheme to supplement PI insurance and the formal determination of claims by EDR schemes.

Dispute resolution and compensation

186 Having efficient and effective dispute resolution and compensation mechanisms is integral to ASIC's strategic priority of promoting consumer trust and confidence in the Australian financial services system. Mandating membership of an ASIC-approved EDR scheme has been one of the most successful of the reforms introduced following the Wallis Inquiry, providing very large numbers of consumers and financial investors with access to justice and the provision of compensation and redress. The Australian system is widely regarded as one of the best in the world.

187 ASIC has played a key role in establishing and shaping the dispute resolution system in financial services industry. Over the period since the

Wallis Inquiry, having set standards through regulatory guidance for both internal dispute resolution (IDR) processes and EDR schemes, ASIC approved a total of eight schemes. ASIC does not consider that competition between different schemes enhances consumer outcomes. ASIC has worked with industry to reduce the number of schemes, with resulting improvements in economies of scale and efficiency, the removal of uncertainty for consumers and financial investors, and the reduction in jurisdictional boundary issues. Following the merger of five EDR schemes into the Financial Ombudsman Service (FOS) in 2008 and 2009, there are now two ASIC-approved EDR schemes in Australia.

Compensation arrangements under the AFS licensing regime

188 In Australia, all AFS licensees, credit licensees and trustee companies must have:

(a) a dispute resolution system, which includes an IDR procedure and membership of an ASIC-approved EDR scheme; and

(b) arrangements for compensating retail clients and consumers for loss or damage due to breaches of the financial services or credit laws. The law requires that unless the licensee is exempt (i.e. because they are prudentially regulated) they must generally hold adequate PI insurance cover.

189 A licensee's PI insurance cover must be adequate for the licensee's business. ASIC's guidance also requires that a licensee's PI insurance must cover EDR scheme awards.

190 PI insurance is designed to protect licensees against business risk, and not to provide compensation directly to investors and financial consumers. It is a means of reducing the risk that a licensee cannot pay claims because of insufficient financial resources, but has some significant limitations, including where there are insolvency issues or multiple claims against a single licensee.

Uncompensated loss

191 Uncompensated loss in the regulated financial services sector can happen for a number of reasons including where the consumer has suffered loss but cannot access an EDR scheme because their loss exceeds current monetary limits and they cannot afford to take legal action.

192 Within the EDR scheme jurisdiction, PI insurance can also fail to adequately compensate consumers and investors when it is needed most—that is, when a licensee's misconduct is so serious or systemic that it affects a medium to

large number of clients at the same time, which causes the licensee to become insolvent.

193 FOS has recently contributed to the publicly available information about uncompensated loss. FOS reports that, between 1 January 2010 and 30 June 2014, 22 financial services providers have been unable to comply with 105 determinations exceeding $10.2 million. [34]

194 These unpaid consumer compensation claims have arisen almost exclusively in the financial advice sector, and in most of these cases the licensee has become insolvent and/or ceased business. PI insurance did not compensate consumers because of policy exclusions or because multiple clients suffered monetary loss at the same time, thereby exhausting the limit or maximum aggregate limit of the licensee’s PI insurance policy and any capital reserves it may have had.

195 Growing levels of uncompensated loss arising out of unpaid EDR determinations threaten to erode trust and confidence in the financial services sector and the effectiveness of the dispute resolution system. The concentration of these unpaid determinations in the small- and medium-sized advisory services sector potentially also places these licensees at a competitive disadvantage to larger AFS licensees, which are more likely to be able to ensure compensation (through self-insurance) for their clients.

196 Measures to address the issue of uncompensated loss, such as tightening capital adequacy requirements or introducing additional requirements that expand mandatory PI coverage, may impose additional cost and regulatory burden while failing to adequately address the problem. This is because PI insurance and capital adequacy requirements are focused at the individual licensee level and are not intended nor designed to be comprehensive compensation mechanisms for retail consumers and investors of financial products.

197 One option to address this issue is the introduction of a last resort compensation scheme (i.e. the scheme would only provide compensation where all other options have truly been exhausted). We support consideration of the introduction of a limited last resort statutory compensation scheme as part of a suite of measures to improve standards in the financial advice industry, as summarised in Table 2:

(a) improve competency and standards among financial advisers;

(b) address conflicts of interest; and

(c) increase access to safe and appropriate financial advice.

[34] FOS, ‘Unpaid determinations: Update’, *The Financial Ombudsman Service Circular*, issue 18, 2014, www.fos.org.au/the-circular-18-home/fos-forum/unpaid-determinations-update.jsp.

198 There are different possible models for such a scheme, but we envisage that a last resort compensation scheme would be narrow in scope and would only respond to retail claims regarding financial adviser licensees where the licensee's PI insurance policy does not pay a valid claim.

Retirement and superannuation

The Inquiry would value views on a spectrum of options to achieve the objectives of the retirement income system andposition australia to manage the challenges of having an ageing population:

- Provide policy incentives to encourage retirees to purchase retirement income products that help manage longevity and other risks.
- Introduce a default option for how individuals take their retirement benefits.
- Mandate the use of particular retirement income products (in full or in part, or for later stages of retirement).

199 ASIC's role in regulating retirement income products primarily relates to the adequacy of product disclosure documentation, marketing and promotional material, and through the regulation of financial advice.

200 ASIC also has an increasingly important role, through promoting financial literacy, to ensure consumers are confident and informed in making decisions about their retirement savings. Such decisions, with long-lasting consequences, are often complex and include estimating retirement consumption, longevity risk and investment returns.

201 Consumer research indicates that there is a relatively low level of awareness and understanding of retirement-phase superannuation products and the benefits of early retirement planning.[35] Often retirement is forced or unplanned. Where advice is sought, consumers may further face additional difficulties in evaluating the quality of any advice they receive.

Default retirement products

202 Retirement phase decisions require a heightened level of consumer engagement. The transition from accumulation phase to the de-accumulation phase necessitates a transition from a compulsory saving environment with higher levels of protections (e.g. default arrangements like MySuper or default investment options) to a phase that is essentially without default settings and requires significant consumer engagement. While financial

[35] Susan Bell Research, *How Australian plan for and make decisions about their retirement*: *research report prepared for ASIC*, May 2010 (unpublished).

advice has an important role to play here, the majority of people do not seek financial advice at this stage.

203 Consumer research indicates that there is a relatively low level of awareness and understanding of retirement-phase superannuation products and the benefits of early retirement planning.[36] Often retirement may also be forced or unplanned. ASIC's work in the area of retirement decision making has found that many retirees struggle to know what information to trust, and to decide whether they had sought out sufficient information and advice to make a sound decision about their superannuation savings. Many people feel it is difficult to determine whether the decisions they make are right or not. If consumers cannot access the information or advice they need, do not understand the information or advice they receive, alternatively do not seek information or advice, or simply fail to make a decision then it is difficult for them to make the best choices about their retirement finances.

204 The challenges and issues associated with retirement decision making mean that people can be placed in a vulnerable situation that can potentially lead to poor choices or even being sold inappropriate 'retirement-styled' products. There are clear arguments for continuing a form of default arrangement into the retirement phase, and ASIC would support consideration of this approach. For example, people in a MySuper accumulation product could be transitioned into a MySuper de-accumulation product.

205 In observing the need for a default de-accumulation product, we make no comment on which type of retirement income product is most appropriate. There are, however, currently a limited range of retirement income products available in the market to adequately meet the needs of members during retirement. People who wish to convert their superannuation assets into an income stream within the tax-advantaged superannuation environment largely have the choice of three products:

(a) Account-based pensions account for the majority of pension assets allowing retirees to choose their investment strategy and how much to draw down (subject to prescribed minimums). Members may make a lump sum withdrawal at any time.

(b) Annuities provide a guaranteed regular income stream for an upfront lump sum payment or a series of smaller payments. Retirees receive income over a specified time horizon (fixed-term annuities) or for the remainder of their life (lifetime annuities). 'Indexed annuities' protect this income from the effects of inflation.

(c) SMSF structures providing members greater flexibility and control to tailor investments to suit their retirement needs. The SMSF sector has

[36] Susan Bell Research, *How Australian plan for and make decisions about their retirement*: *research report prepared for ASIC*, May 2010 (unpublished).

rapidly expanded with assets of $506 billion at 30 June 2013 (an increase of nearly 550% since June 2001). Approximately 40% of all SMSFs are in pension phase, controlling 57% of assets.[37]

206 Account-based pensions are the main retirement-phase products. However, these products generally do not address longevity risk for retirees. Annuities protect retirees against longevity risk, but are relatively unattractive to investors due to their opacity, complexity and conservative investment profile. The annuity market has contracted considerably in recent years.

207 The lack of genuine innovation occurring with retirement products may be in part due to restrictions and legislative barriers developed primarily with the accumulation phase in mind. However, as more Australians move into retirement, superannuation funds and financial advisers will adapt their business models and products to the retirement phase. This process of adaptation has progressed slowly.

208 We note that some industry participants have made attempts to design features for their annuities products to make them more appealing to a wider audience. These include allowing consumers to take lump sums from their annuities in certain time periods.

209 Other potential retirement products could include a reverse mortgage or home equity release built into a superannuation product as a top-up on an account-based pension, however, this is currently prevented by restrictions in the *Superannuation Industry (Supervision) Act 1993* (SIS Act).

Efficiencies

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements and review the effectiveness of the MySuper regime in due course.
- Consider additional mechanisms to MySuper to achieve better results for members, including actions for default fund status.

210 We note that there has been a continued lack of fee-based competitive tension within the superannuation sector, with the interim report noting that this is potentially leading to higher fees compared to other overseas jurisdictions.

211 In our experience, barriers to fee-reduction within the sector may include the following:

(a) *Lack of member engagement*—The long-tail nature of superannuation has meant that many members are not engaged with the operation of

[37] The n-size is 2,163. Investment Trends, *SMSF investor report*, vol 1 of 3, April 2014, p. 32.

their superannuation fund and are therefore less sensitive to the amount charged in fees.

(b) *Complexity and lack of transparent fees structures*—Even where members are engaged with their superannuation, they are often faced with the difficulties of non-uniform and non-transparent fee structures (see paragraph 212). The inability to compare and lack of price discovery impedes rational and informed decision making in the choice of superannuation funds.

(c) *Increased product inclusions*—Superannuation funds have sought to distinguish and compete on product and service propositions rather than directly on fees. Higher fees and cost basis may therefore reflect greater product inclusions or services provided to members.

212 We have recently released our findings in Report 398 *Fee and cost disclosure: Superannuation and managed investment products* (REP 398) on fee disclosure practices of superannuation and managed investment product issuers. REP 398 documents the following inconsistent fee practices and reporting that have the effect hindering accurate fee and cost disclosure for investors:

(a) *Reporting of fees in underlying investments*—Inconsistent treatment of management costs associated with investing funds through external investment structures (e.g. where funds are invested into a fund-of-fund structure that has its own fees and costs mechanism). Funds may be materially understating the fee structure of the product making any comparison of funds ineffective.

(b) *Data quality*—Data by investment managers feeds into the reporting and disclosure framework for trustees of superannuation funds and responsible entities of registered managed investment schemes varies significantly. This affects disclosure of fees and costs and the ability of investors to compare superannuation and managed investment products.

(c) *Treating management costs as transaction costs*—Under-reporting of management costs is a significant issue in the industry that has developed over time as industry innovation and product complexity have increased.

(d) *Performance fee reporting*—There are different practices used in the industry to disclose performance fees, which makes it difficult for investors to effectively compare products.

(e) *Tax treatment of fees and costs*—There is inconsistency in the tax treatment of costs, causing fees to be understated for some superannuation products.

(f) *Insurance disclosures*—Disclosure practices for superannuation funds offering insurance vary significantly. This makes it difficult for investors to make informed assessments of, and comparisons between, funds where insurance is a key factor in their consideration of superannuation products.

213 ASIC has recently released Information Sheet 197 *Fee and cost disclosure requirements for superannuation trustees* (INFO 197). We intend to revise Regulatory Guide 97 *Disclosing fees and costs in PDSs and periodic statements* (RG 97) after further industry consultation.

Stronger Super reforms

214 The Government's Stronger Super reforms relating to fee and cost disclosure, which came into effect on 1 July 2014, have had a substantial impact on how fees and costs are disclosed by superannuation funds.

215 ASIC is aware that fees and costs may be high at the moment because of initial implementation costs associated with these reforms, so the full benefits of the reforms may take a little time to eventuate. Anecdotally, however, we have observed that the introduction of lower cost MySuper products has increased fee competition within the superannuation sector.

Reverse mortgages

The Inquiry seeks further information on the following area:

What, if any, regulations impede the development of products to help retirees access the equity in their homes?

216 ASIC's view is that the disclosure and responsible lending requirements in the *National Consumer Credit Act 2009* (National Credit Act) on providers of reverse mortgages do not impede product development, and this is more likely to be due to other factors (e.g. low growth rate and long-term investment returns).

217 We are aware that some models for accessing equity are being developed that are functionally similar to reverse mortgages but do not meet the definition of credit for the purposes of being regulated by the National Credit Act. Such products may be inherently more risky and, if sold alongside or as alternatives to traditional and better-regulated products, may have a competitive advantage on cost.

218 Subject to restrictions on gearing, other alternate retirement products may include incorporating a reverse mortgage into the de-accumulation phrase of a superannuation fund.

Direct leverage by superannuation funds

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

Restore the general prohibition on direct leverage in superannuation on a prospective basis.

219 ASIC has concerns where leverage is promoted without adequate explanation of the risk and without sufficient regard to the needs, objectives and risk appetite of the investors.

220 What ASIC has seen in its work on SMSFs is an increasing use of leverage, with or without property, often where the situation suggests that it may not be an appropriate strategy.

221 ASIC's role in relation to SMSFs is to regulate the gatekeepers—the advice providers, SMSF auditors, and providers of products and services to SMSFs. One of the key factors behind ASIC's establishment of a dedicated SMSF taskforce September 2012 was the increase in geared investment strategies. In late 2012, the SMSF taskforce conducted a review of files of entities involved in providing financial services relating to SMSFs. This review found that 35% of SMSFs made a geared real property investment.

222 Financial advisers have to set out the benefits and risks associated with leveraging an investor's superannuation savings and need to make sure that the strategy is appropriate for the investor's circumstances.

223 ASIC is keeping a close eye on ensuring that the services provided in relation to SMSFs do not subject investors to risks for which they are not prepared.

Self-managed superannuation funds

The Inquiry seeks further information on the following areas:

- To what extent should the Inquiry be concerned about the high operating expenses of many SMSFs?
- Should there be any limitations on the establishment of SMSFs?

224 In our main submission to this inquiry, we questioned the appropriateness of SMSFs for some superannuation fund members with less investment experience, fewer investable funds, and less time to manage their superannuation. Inexperienced investors may not fully understand their trustee duties and obligations, including reporting obligations to the Australian Taxation Office (ATO), with significant adverse consequence should a breach occur.

225 The interim report also notes that perceived or actual lower fees is a driver of the growth in SMSFs, and that evidence of the effectiveness of this strategy is mixed.

226 In 2011–12, almost one quarter of SMSFs had a balance of $200,000 or less. After being established for three years, 50% of funds still hold a balance under $330,000. In late 2012, ASIC commissioned Rice Warner Actuaries to examine the fund balance at which an SMSF will be cost-effective compared with an APRA-regulated fund. Rice Warner found that the cost-effectiveness of an SMSF is very much affected by the amount of work the trustee is prepared to do themselves in administering the fund. As such, there will be a range of fund balances at which an SMSF will be cost-effective compared with an APRA-regulated fund.

227 In Report 337 *SMSFs: Improving the quality of advice given to investors* (REP 337), we found that there was often a reasonable explanation for the establishment of a lower balance SMSF, including:

(a) the investor's financial situation, needs and objectives in setting up the fund, including control over investment decisions;

(b) the investor's ability to transfer additional money into the fund;

(c) the investor's ability to contribute more to the fund;

(d) the investor's willingness to take on some of the administration of the fund;

(e) a low-cost investment strategy being implemented by the investor (i.e. cash and term deposit investments). We saw very few instances of platforms being recommended and used by lower balance SMSFs; and

(f) the relatively high costs of some investors' APRA-regulated funds.

228 Furthermore, with the increased commodification of the SMSF structure, we have observed that providers are increasingly offering differing service level propositions with varying associated costs (i.e. full administration services to self-service). This has meant that the minimum balance required to adequately cover the cost of operating an SMSF has been reduced from previous estimates.

229 For these reasons, ASIC is not supportive of minimum account balances on SMSFs.

230 This is not to say there should not be a focus on the appropriateness of the size of funds administered through an SMSF structure. There may well be a role for introduction of either a 'soft' minimum balance for SMSFs or guidance on an appropriate minimum balance. This may mean, for example, that a minimum balance applies unless certain requirements are satisfied. An alternative is to provide guidance on an appropriate minimum balance for SMSFs, which could be strengthened by applying an 'if not, why not'

disclosure requirement. That is, if the accountant or adviser recommends an SMSF for a client below, for example, $100,000, then the accountant or adviser would need to explain why it is appropriate to recommend an SMSF to a client with a low balance.

231 There may also be merit in considering what better information could be provided to potential SMSF members about the cost-effectiveness of SMSFs. For example, Statements of Advice in relation to SMSFs could be subject to a requirement to set out the operating costs of an SMSF compared to the cost of staying in the client's existing APRA-regulated fund.

Product rationalisation of legacy products

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options:

- No change to current arrangements.
- Government to renew consideration of 2009 proposals on product rationalisation of legacy products.

232 ASIC supports renewed consideration of the 2009 proposals on product rationalisation of legacy products by Government.

233 ASIC was actively involved in the development of the 2009 proposals. The proposals provide a means of facilitating product rationalisation in order to reduce operational risk and costs while safeguarding the rights of holders of legacy products. They focused on life insurance and managed investment products because there are already relatively effective mechanisms to rationalise superannuation products.

234 We support an approach developed from the 2009 proposals that provides a streamlined process for product rationalisation involving adequate disclosure and safeguards, without requirements of individual holder assent. Behavioural economics tells us that consumers may not respond to product rationalisation proposals rationally even if a proposal is in their interest. Consumers may react excessively cautiously or may not react at all when required to assent. A product rationalisation framework that merely relies on industry to obtain assent from the holders of legacy products may also result in inappropriate removal of holders' rights. Further, it would need to be supported by a strong financial literacy campaign, which may be impractical.

B Role of the regulator

Key points

The principles that have led to a specific regulatory regime for financial products and services, with ASIC as an integrated markets and financial services regulator, continue to have a solid policy basis and, in our regulatory experience, have been justified.

Nevertheless, it is timely to consider other changes to ASIC's mandate and role—that is:

- removing ASIC's registry responsibilities and combining ASIC's registers with other similar government businesses to achieve economies of scale;
- introducing a competition objective for ASIC;
- reviewing the penalties across ASIC-administered legislation, to ensure that ASIC has the regulatory tools to achieve its mandate;
- increasing accountability to our regulated population through a more autonomous 'user pays' budget and funding process; and
- increasing ASIC's flexibility and autonomy over staffing decisions by removing current legislative constraints.

Table 3: Summary of policy options responded to in Section B

Policy option	Summary of response	Reference
ASIC's mandate	ASIC is an integrated financial services and markets regulator that facilitates effective and efficient regulation through a holistic approach. ASIC's remit could be narrowed by removing our registry responsibilities, which have the least synergy with our regulatory functions.	Paragraphs 235–293
ASIC's accountability framework	ASIC already has a robust accountability framework, but we consider that a more autonomous budget and funding process would increase accountability to our regulated population. We also support independent reviews of regulators' performance at three-year to five-year intervals.	Paragraphs 294–311
Staffing	ASIC attracts highly qualified and experienced staff interested in engaging work in the public interest. However, we compete with the financial services industry to employ staff and would benefit from greater flexibility in our ability to recruit and reward.	Paragraphs 312–323
Costs and benefits of regulation	ASIC aims to ensure that the benefits of regulation outweigh the compliance costs by assessing costs and benefits before regulation, undertaking regulatory impact analyses and complying with best practice regulation requirements.	Paragraphs 324–337

Distinctive nature of financial services regulation

235 In examining the roles of ASIC and of other financial services regulators, it is important to highlight the principles that have led to a specific regulatory regime for financial products and services, with ASIC as an integrated markets and financial services regulator. These principles continue to have a solid policy basis and, in our regulatory experience, have been justified by developments in the financial services market.

236 The Productivity Commission, in its 2008 *Review of Australia's consumer policy framework*, defined the overarching objective of consumer policy as:

> … to improve consumer wellbeing by fostering effective competition and enabling the confident participation of consumers in markets in which both consumers and suppliers trade fairly and in good faith.[38]

237 The Productivity Commission's report goes on to outline where it may be appropriate for particular markets to have specific regulation that overlays a generic regime to provide more effective and certain consumer protection—specifically:

(a) where the risk of consumer detriment is relatively high and/or the detriment suffered if things go wrong is potentially significant or irremediable; and

(b) where products are 'credence goods'—that is, their suitability and quality is hard to gauge before or even after purchase.[39]

238 Markets for financial products and services exhibit both these characteristics. While market problems such as informational asymmetries are a feature of many different types of markets, there are specific features of financial products and services that make informational asymmetries particularly difficult to overcome. This means that there is a higher risk than in most markets for mis-selling (i.e. that an investor or financial consumer will acquire a product not aligned with their financial situation, risk profile, objectives and needs) due to the investor or financial consumer's own choices alone, or as a result of the exploitation of informational asymmetries by service providers due to conflicts of interest or outright misconduct.

239 These factors may make it more difficult for competition to effectively operate in markets for financial services and products. Competition requires consumers to be fully informed and freely able to exercise choice. However, as described, there are specific characteristics of markets for financial products and services that are likely to inhibit investors and financial consumers from exerting competition pressure. These include difficulties in:

[38] Productivity Commission, *Review of Australia's consumer policy framework* (Inquiry Report No. 45), 30 April 2008, p. 2, www.pc.gov.au/projects/inquiry/consumer/docs/finalreport.
[39] Productivity Commission, *Review of Australia's consumer policy framework* (Inquiry Report No. 45), 30 April 2008, p. 2, www.pc.gov.au/projects/inquiry/consumer/docs/finalreport.

(a) using disclosure to overcome informational asymmetries, due to low levels of financial literacy or behavioural biases (see paragraph 67–68);

(b) assessing financial products before purchase, because they are intangible and have complex features that are likely to be difficult for many to understand (e.g. leverage); and

(c) predicting how products will perform, as many financial products have a long lifespan and any detrimental aspects of a product may only become apparent long after the product is purchased.

240 Competitive pressure is less likely to be apparent in many financial markets, because of the demand-side problems. Many financial products are purchased infrequently or even only once, and their complexity means that consumers are less likely to be able to 'shop around'.

241 These factors increase the risk of the mis-selling of products to consumers. This is significant, as the potential effects on consumers of inappropriate products or advice are much higher for financial products and services than for many other types of products and services, which are typically regulated solely under generic consumer protection regimes (i.e. regimes without licensing regimes and specific conduct regulation).

242 Consumers many not have the ability to recover their position, especially for products involving longer term saving or insurance—in other words there is no 'learning' that can be applied to subsequent purchases. As a result, relying only on 'after the event' consumer protection provisions (e.g. misleading conduct prohibitions) may produce widespread and unrecoverable consumer detriment. This reality is reflected in the development of separate positive investor and financial consumer protection regimes (e.g. licensing and positive conduct and disclosure obligations) in most developed countries.

243 The difficulty in assessing products and services before delivery is a particularly strong rationale for the imposition of a licensing regime,[40] being a regulatory regime that provides minimum standards of conduct and education for providers of certain services in a manner that may be effectively enforced both before and after the point of sale. Licensing is a forward-looking regulatory tool: it imposes standards and rules before the point of sale, rather than simply reacting after the problem is discovered, unlike generic consumer product regulation. Importantly, in Australia licensing is also the mechanism for ensuring mandatory industry membership of dispute resolution schemes.

[40] Productivity Commission, *Review of Australia's consumer policy framework* (Inquiry Report No. 45), 30 April 2008, p. 2, www.pc.gov.au/projects/inquiry/consumer/docs/finalreport.

244 Additional advantages of an adaptive licensing regime as a regulatory tool to enhance generic consumer product regulation are that it can be targeted (i.e. enabling regulation to be applied proportionately to the risk of the activity involved), and modified quickly to address emerging risks.[41] Licensing also increases confidence in an industry, which has advantages for both consumers and industry participants alike.

245 These features of financial products and services are central to the case for industry-specific regulation of this market. A specific and more intensive regulatory regime does not come without a cost. Nevertheless, the demand-side weaknesses of this market produce sufficient risk of investor and financial consumer detriment to continue to justify such a regime.

246 The importance of regulating retail financial services via specialised regulation rather than generic consumer protection also means that providers of financial products and services are best regulated by a market regulator, which can apply forward-looking regulatory tools such as licensing rather than simply consumer protection standards that apply after any problem is discovered. This is outlined further at paragraphs 265–266.

ASIC’s mandate

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Strengthen competition considerations through mechanisms other than amending the regulators’ mandates.
- Refine the scope and breadth of ASIC’s mandate.
- Review the penalty regime in the Corporations Act.

The Inquiry seeks further information on the following areas:

- Are changes needed to strengthen and/or refocus ASIC?
- Is the current enforcement regime adequate? Does ASIC have adequate powers?
- Are there alternative mechanisms for promoting better consideration of competition within financial sector regulation?

247 ASIC regulates Australian companies, financial markets, financial services organisations and professionals who deal and advise in investments, superannuation, insurance, deposit taking and credit. Our mandate also encompasses investor and consumer protection in financial services, financial literacy, and includes business and company registration.

[41] This can be contrasted with the Australian markets licensing framework, which has not been sufficiently adaptive to keep pace with industry change.

248 The interim report noted the breadth of ASIC's mandate and questioned whether ASIC:

(a) has too many regulatory functions; and

(b) would become a more tightly focused regulator by narrowing its mandate.

249 While we consider that there is a strong rationale to narrow ASIC's remit by removing our registry responsibilities, we also consider that ASIC should remain an integrated financial services and markets regulator. Separating consumer protection and market integrity functions risks losing the many synergies and benefits resulting from ASIC's current integrated mandate, and could result in less effective regulation.

250 Nevertheless, it is timely to consider other changes to ASIC's mandate. For example:

(a) introducing a competition objective for ASIC; and

(b) reviewing the penalties across ASIC-administered legislation, to ensure that ASIC has the regulatory tools to achieve its mandate.

Separate business registry from ASIC

251 Efficient business and company registration is an important function in a modern market economy. This involves significant information technology and data management issues. ASIC's registry focus is to maintain the data on the 42 registers for which ASIC is responsible. In practical terms, the registry function is carried out by a dedicated team of staff skilled in operational registry management.

252 However, this is not a function that has a clear synergy with financial services and markets regulation. We now manage our regulatory and registry functions separately. Each operate independently of each other (except for the current sharing of technological infrastructure, corporate support and data held on our registers). This provides greater focus on the specialisation of the registry function. Nonetheless, the activities involved in business registration generate significant risks that require intensive oversight at the most senior levels of the organisation.

253 ASIC's combination of regulatory and registry responsibilities makes it unique among leading financial services regulators and corporate registries internationally. Regulatory and registry functions are performed by separate agencies in most other jurisdictions.

254 By removing business registration, ASIC would be able to direct its attention more fully to the strategic, operational and regulatory issues in financial services and markets regulation. This would allow a much clearer focus on the regulatory and enforcement challenges that ASIC faces. ASIC's

regulatory functions are more proactive in approach, with a strong external stakeholder focus.

255 Significant opportunities to introduce economies of scale at the whole-of-government level exist by combining other 'like' registers with ASIC's registry business and creating a simpler, more direct, process for Australia's business community. This model would also bring Australian corporate registry functions in line with corporate registries internationally.

256 In July 2014, following the May 2014 budget, the Government also released the terms of reference for a scoping study into the future ownership of ASIC's registry business. Our approach to managing our regulatory and registry functions separately is a logical interim step to facilitate future moves the Government may wish to take with registry businesses generally.

Retain an integrated financial services and market regulator

257 In relation to consumer and investor protection in financial markets, there is a clear rationale for retaining ASIC as an integrated regulator. For the reasons outlined in paragraphs 235–246, financial services generate different and more complex risks than other markets, and it is important to retain a positive, integrated regime to ensure the financial system meets the financial needs of Australians.

258 Separating consumer protection and market integrity functions would lose the synergies and benefits resulting from ASIC's current integrated mandate, and would result in less effective regulation.

Risks of separating consumer protection and market integrity functions

259 The interim report notes that some stakeholders have raised the option to split ASIC's consumer protection functions from conduct and market integrity functions. While the interim report briefly raises some possible options for such a move, it is far from clear as to how such a split would work in practice. Possible models mentioned include:

(a) transferring generic consumer regulation contained in the ASIC Act to the Australian Competition and Consumer Commission (ACCC); or

(b) moving industry-specific consumer regulation, including the relevant licensing regimes, either to a new, specialised consumer conduct regulator or to the ACCC (leaving ASIC responsible for corporate regulation and markets and wholesale activity).

The interim report also notes the option of giving responsibility for market supervisory activities (i.e. licensing and oversight of financial markets infrastructure and market participants) to a specialised market supervisor.

260 In relation to the policy option of transferring generic consumer regulation contained in the ASIC Act to the ACCC, the interim report notes that there would be problems in severing the consumer protection functions in the ASIC Act from the positive consumer protection requirements in the financial services laws. After all, most of the consumer and investor protection rules that ASIC administers are not found in the ASIC Act, but in the more detailed regulatory regimes governing financial services and credit. These positive regimes have been developed to address the more complex market failures that typically arise in the finance sector.

261 To provide just one example, there are not only prohibitions against misleading conduct in the ASIC Act, but also in the Corporations Act and in the National Credit Act. In relation to the latter two regimes, this prohibition is integrated into the positive requirements set out in those Acts. Removing the current ASIC Act prohibition from ASIC's jurisdiction would appear to serve little purpose in this context, and would clearly create the potential for ongoing confusion as to which regulator would be responsible for taking action in relation to these sorts of issues.

262 In relation to the option of creating a separate consumer protection regulator, during the Wallis Inquiry, the issue of whether Australia should have a combined securities and consumer protection regulator, or two separate agencies, was under significant debate. While that inquiry received submissions arguing for both models, it concluded that the regulation of financial market integrity and investor and consumer protection in the finance sector should be carried out together, due to the significant synergies between the two types of regulation. This remains the case.

263 A key challenge with this approach would be that it would not address the underlying issue that regulators are ultimately limited in their work by resources and/or powers and penalties. Simply rearranging structures without any consideration of resources or powers is unlikely to produce a different outcome, and runs the risk of generating greater problems in the short to medium term through the disruptive effects of structural change.

264 Separating consumer protection and market integrity functions raises a number of issues to be considered, including:

(a) the loss of the benefits of an integrated regime, which has access to a range of regulatory tools;

(b) communication between agencies and the potential for regulatory fragmentation;

(c) the risk of a lack of a holistic approach to regulation; and

(d) challenges involved in building the organisational capacity of any additional regulator.

Benefits of an integrated regime with access to a range of regulatory tools

265 Significant benefits flow from a positive, integrated regulatory regime covering financial services and markets. Market integrity and consumer protection are closely linked and ASIC considers both objectives in deciding which regulatory tool or tools to use in a particular matter. Separating market integrity and consumer protection responsibilities risks a narrower approach to responding to problems in the financial system.

266 A separate financial services consumer protection regulator is also less likely to have the regulatory means and resources to take meaningful action to remedy the consumer protection problems it identifies. Typically, effective action against a financial services provider needs to involve the option of revoking their authorisation to provide financial services, or the imposition of ongoing conditions on that authorisation. A consumer protection body that is not also responsible for licensing or authorising financial services providers is not able to effect this kind of regulatory remedy.

Example 3: Opes Prime

Opes Prime was a securities lending and equity financing business that collapsed in March 2008, leaving creditors $630 million out of pocket. ANZ and Merrill Lynch were major financiers of Opes Prime.

ASIC's investigation into the collapse of Opes Prime considered both consumer protection and market integrity objectives:

- *How to maximise the return available to Opes Prime creditors*—On 6 March 2009, we announced that we had entered into a settlement that resulted in $253 million being paid to Opes Prime creditors.
- *How to improve compliance processes across ANZ*—On 6 March 2009, ASIC entered into an enforceable undertaking with ANZ. The enforceable undertaking required ANZ to complete a program to remedy deficiencies in operational procedures across the ANZ Custodian Services business, including its securities lending operations.
- *Whether certain directors of Opes Prime had dishonestly breached their duties as directors*—On 11 January 2010, Julian Smith, Laurie Emini and Anthony Blumberg were charged with dishonestly breaching their duties as directors of Opes Prime. Mr Emini and Mr Blumberg each entered into early guilty pleas and, on 27 July 2011, were sentenced to 12 months and six months imprisonment respectively. The case against Mr Smith proceeded to trial and, on 6 September 2013, Mr Smith was found not guilty.
- *Wider market integrity issues*—We take into account capital adequacy requirements, substantial shareholder notices and breach reporting.
- *The business models of other securities lending and equity finance businesses*—ASIC conducted a surveillance of securities lending and equity finance businesses and concluded that they were based on a model traditionally used in the wholesale market, in which the participants were more sophisticated and had a clear understanding of

> their rights and obligations. Of concern to ASIC was that Opes Prime in particular took this model to the retail market, where some retail investors may not have been aware of their rights and obligations. We raised these issues in our submission to the 2009 Parliamentary Joint Committee Inquiry into financial products and services in Australia, which contributed to law reform in the area of retail securities and margin lending facilities.

Communication between agencies

267 As with all regulators, in all sectors, we acknowledge that there will be ‘boundary issues’ with other agencies (e.g. APRA, RBA, ACCC, the Australian Federal Police). Such boundary issues are inevitable, and there will always be limits to the jurisdiction of any regulator.

268 There is, on some occasions, some overlap in the current jurisdictions of ASIC and of the ACCC. For example, in a small number of matters there may be a financial services component to a broader non-financial services matter the ACCC is pursuing. However, the current memorandum of understanding between the two agencies already provides for each to refer the necessary powers to one another, either for individual matters or for a particular area of jurisdiction. This enables the two agencies to work effectively together on areas of mutual interest. ASIC has also recently developed an internal protocol for processing any such referrals in a set timeframe.

269 For example, in relation to debt collection, the source of the debt determines the jurisdiction—jurisdiction over the collection of a financial services debt (e.g. credit card bills) falls to ASIC, but jurisdiction over collection of a non-financial services debt (e.g. an unpaid utility bill) falls to the ACCC. To ensure seamless ability to address misconduct by a debt collector who collects both types of debt, the two agencies have cross-referred their powers in this area and have arrangements to inform each other of all matters taken on. This works effectively. The alternative approach, of providing the ACCC with full concurrent jurisdiction over financial services, would involve duplication of effort, confusion for consumers wishing to make complaints and potentially multiple regulatory intrusions on a matter about the same issue.

270 Restructuring regulatory responsibilities does not remove boundary issues and the need for interagency communication and cooperation. It simply shifts the particular set of circumstances around which such boundary issues arise. In some cases it may increase the possibility for jurisdictional confusion.

Regulatory fragmentation

271 Splitting market integrity and consumer protection responsibilities risks regulatory fragmentation. Gaps inevitably occur when regulatory authority over an institution or a particular market problem is unclear, or when regulatory accountability is shared. Increasing the number of regulators and regulations an entity operating in the financial services industry needs to answer to could also risk duplication of compliance for the entity.

272 For example, the distinction between 'retail' and 'wholesale' markets is not always sufficiently clear to separate responsibility between different regulators along these lines.

273 Fragmentation may also affect the ability of regulators to detect and respond quickly, cohesively and effectively to emerging risks. This may, in turn, jeopardise the level of resilience in the Australian financial system.

Lack of a holistic approach

274 Separate regulators would not have the mandate to review how their actions affect the market as a whole, and balance consumer protection with market efficiency. It could 'over-regulate' to pursue a consumer protection aim at the cost of market efficiency.

275 As an integrated financial services and markets regulation, we are able to balance consumer protection with market integrity, and review how our actions affect the market as a whole.

276 An integrated regulator can also focus on each stage of the product lifecycle—product development, product distribution (including disclosure and advertising), point-of-sale (including financial advice), and post-sale. This shows how a deeper understanding of financial products and their role in the market can provide a sound foundation for integrated regulation.

Example 4: Whole-of-lifecycle regulation of products

ASIC's recent work on complexity in financial products demonstrates the benefits of a holistic, integrated approach.

Report 384 *Regulating complex products* (REP 384) illustrates the range of tools ASIC uses to regulate business conduct to mitigate risks posed to consumers of complex financial products (e.g. hybrid securities). Our whole-of-lifecycle regulation of complex products enables us to introduce AFS licence obligations that influence the way products are issued, conduct surveillances to monitor compliance with disclosure obligations, and issue warnings about the risks of investing in hybrid securities and trading in margin foreign exchange contracts. We also are able to provide specific disclosure guidance for various complex products (e.g. Regulatory Guide 240 *Hedge funds: Improving disclosure* (RG 240)).

Challenges of creating any additional regulator

277 There will be challenges in building organisational capacity of any additional regulator. Furthermore, a combined regulator is more likely to be able to attract and retain high-quality staff with a broader range of experience, rather than the more specialised skills required of staff in a dedicated, single-focus regulator.

Integrated markets and financial services regulators globally

278 Internationally, many other regulators are integrated. Figure 2 illustrates the industry segments that selected international markets and financial services regulators are responsible for.

Figure 2: International regulation by industry segment

	Industry segment	AU	HK	MY	SG	NZ	UK	IE	FR	DE	CA	US
Investors and financial consumers	Consumer credit		CB	CB					CB		Govt	Govt
	Deposit takers		CB	CB					CB		Govt	Govt
	Margin lenders			CB					CB		Govt	SRO
	Non-cash payment facilities		CB	CB					Govt		Govt	Govt
	Insurers		Govt	CB					Govt		Govt	Govt
	Insurance brokers		Govt	CB					Govt		Govt	Govt
	Custodians/trustees		Govt	Govt.							Govt	Govt
	Super/scheme operators		Govt						Govt		Govt	Govt
	Fund managers											
	Hedge/PE funds											
	Financial advisors			SRO							SRO	SRO
	Scheme issuers											
	Retail derivatives			N/O								
	SMSF auditors		N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Markets	Investment banks											SRO
	FMI operators										SRO	
	FMI participants										SRO	SRO
	Credit rating agencies					N/A	ESMA	ESMA	ESMA	ESMA		
	Auditors		Assoc.		Govt.	Assoc.	SRO	Govt	Govt	Govt	Govt	Govt
	Insolvency practitioners		N/A	Govt	Govt.	N/A	SRO	N/A	Govt	Govt	Govt	Govt
	Market misconduct		Exch.	Exch.	Exch.	Exch.		Exch.	Exch.	Govt	SRO	SRO
	Company disclosures	Exch.	Exch.	Exch.	Exch.	Exch.	Exch.	Exch.	Exch.	Exch.	Exch.	
	Mergers and acquisitions	Panel	Panel			Panel	Panel	Panel				
	Securities issuers											

Key

- Directly regulated
- Co-regulated
- Regulated by another body

Assoc.	Industry association
CB	Central bank
ESMA	European Securities and Markets Authority
Exch.	Securities exchange
Govt.	Another government entity
Panel	
SRO	Self-regulatory organisation
N/A	Not applicable
N/O	Not occurring

279 Figure 2 shows that comparatively more overseas jurisdictions (e.g. Singapore, Denmark and Ireland and, more recently, the United Kingdom) have chosen integrated markets and financial services agencies. Nevertheless, internationally, there does not seem to be any one preferred regulatory model, nor any one natural point of division of regulatory responsibilities.

280 We note that some overseas jurisdictions have chosen to establish separate consumer protection agencies. The US Consumer Financial Protection Bureau is often cited as an example of this type of model. However, it is important to recognise that the Bureau's jurisdiction is very limited in its coverage of consumer financial products. For example, while it covers consumer credit, its jurisdiction does not include general insurance. Its ability to cover the range of issues facing financial consumers is inherently limited. Furthermore, there is also a significant overlap between the Bureau's jurisdiction and those of state regulators.

United Kingdom's new Financial Conduct Authority

Australia's integrated 'twin peaks' model of regulation has been seen as a contributing factor to Australia's resilience during the global financial crisis. Its strengths have been recognised in the United Kingdom, where the regulatory framework has been restructured to more closely align with the integrated Australian 'twin peaks' model. The Financial Services Authority was replaced with:

- the Prudential Regulation Authority, which regulates financial firms whose business activities require a significant degree of expert prudential supervision; and
- the FCA, which is responsible for ensuring that business across financial services and markets is conducted in a way that advances the interests of all users and participants.

There was widespread support from all stakeholders to make this change during the consultation process in the United Kingdom.

Competition objective

281 An express competition objective, which would require ASIC to consider the effect on competition when implementing policy, is not currently part of ASIC's statutory objectives under the ASIC Act.

282 ASIC is not seeking powers to regulate competition. This is the role of the ACCC, which has the mandate to carry out economy-wide competition regulation, including in the finance sector. Rather, as with the FCA, ASIC is seeking an explicit competition objective to ensure that our regulatory actions are explicitly informed by competition consideration, and that all stakeholders understand the importance of competition as a factor in regulatory decision making.

283 The addition of a statutory competition objective that requires ASIC to consider the impact of regulation on the long-term benefits for end users

would add valuable analysis to our decision making. The pursuit of this objective would not take precedence over ASIC's other objectives. Rather, it would enhance them by recognising the importance of competition in encouraging commercial certainty, efficiency, consumer confidence and trust, and the development of the economy. This is a vital step in the development of Australia as a centre of financial excellence and a regional financial hub.

284 As a practical matter, ASIC would need to continue to consider the impact of our own regulatory decisions on competition, as well as including a consideration of whether competition is working effectively when we conduct reviews of market sectors we regulate.

Note: The FCA says that it expects to use market studies as the main tool for examining competition issues in the markets it regulates. To date, the FCA has announced market studies into the cash savings market, the general insurance add-on market and the asset management market.

285 The competition objective would require and enable ASIC to select the most 'competition-friendly' option from a range of potential regulatory responses, provided that this option was also capable of achieving ASIC's other regulatory objectives.

286 The competition objective would also bring us in line with APRA, which is required by legislation to consider the impact of its actions on competition in the financial system, and would be similar to the approach required of the FCA. As a result, ASIC would be better placed to engage with other domestic and international regulators to address competition issues in global financial markets.

Penalties

287 We welcome this inquiry's interest in a review of the penalty regime in the Corporations Act.

288 We believe that the review should extend to all ASIC-administered legislation, and should specifically address the power to remove the financial benefit obtained from corporate wrongdoing.

Scope of penalties review

289 We support the approach in the interim report that indicated a proposed review of penalties should include all ASIC-administered legislation: see p. 3-127 of the interim report.

290 A review that focused solely on the Corporations Act (p. 3-128 of the interim report) would not identify how penalties vary for comparable types of wrongdoing. For example, where an individual provides financial services without an AFS licence, a maximum fine of $34,000 may be imposed under

the Corporations Act. In contrast, an individual who engages in credit activity without an Australian credit licence is subject to the same criminal penalty under the credit legislation, or alternatively a civil penalty up to ten times greater—that is, up to $340,000.

Ability to remove the financial benefit obtained from corporate wrongdoing

291 Since making our main submission to this inquiry, we have extended the comparison of the penalties available for corporate wrongdoing we set out in Report 387 *Penalties for corporate wrongdoing* (REP 387) to cover New Zealand and Singapore. Our comparison of penalties for corporate wrongdoing in these additional jurisdictions supports the key findings in REP 387: see Appendix 2 to this submission.

292 Specifically, in each of the international jurisdictions we have surveyed, regulators or courts have the ability to remove the financial benefit obtained from corporate wrongdoing in non-criminal settings. This is achieved by:

(a) having legislated maximum penalties that are a multiple of the financial benefit obtained from the wrongdoing (New Zealand, Singapore and the United States);

(b) taking into account the financial benefit obtained from the wrongdoing when determining the quantum of penalty that should be imposed (Hong Kong and the United Kingdom); or

(c) having a disgorgement power that is distinct from the ability to impose non-criminal penalties (Canada, Hong Kong, the United Kingdom and the United States).

293 In contrast, maximum non-criminal penalties for corporate wrongdoing in Australia are set at fixed amounts. As a result, it may not be possible for ASIC or courts to remove the financial benefit obtained from corporate wrongdoing in non-criminal settings even if the maximum penalty were imposed.

Independence and accountability of regulators

ASIC's accountability framework

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Move ASIC and APRA to a more autonomous budget and funding process.

- Conduct periodic, legislated independent reviews of the performance and capability of regulators.
- Clarify the metrics for assessing regulatory performance.
- Enhance the role of Statements of Expectations and Statements of Intent.
- Replace the efficiency dividend with tailored budget accountability mechanisms.
- Improve the oversight processes of regulators.

294 As noted in our main submission to this inquiry, ASIC is currently subject to a range of accountability measures covering governance, efficiency, financial management, legal and regulatory decision making, and enforcement of the law.

295 We are also accountable to our various stakeholders, including:

(a) the Australian Government and Parliament;

(b) industry and end users; and

(c) international bodies and our international peers.

296 In addition to the many formal channels by which we are held accountable, ASIC has put in place measures to be accountable to industry and the broader public. These measures focus on improving transparency and communication in the way we choose our strategic priorities and the day-to-day decisions we make. Some examples of these measures include:

(a) taking advice from our Consumer Advisory Panel and External Advisory Panel;

(b) our stakeholder survey, which regularly measures ASIC's stakeholders' perceptions of the environment in which ASIC operates, and ASIC's performance; and

(c) our Service Charter, which covers the most common interactions between ASIC and our stakeholders and sets performance targets for each type of interaction.

297 We believe these measures will create a better relationship with our regulated population and increase voluntary compliance.

298 ASIC supports well-designed accountability measures as an important tool for improving our performance, and there is significant potential for further accountability and transparency in implementing a user-pays funding model for ASIC.

299 We note that that the recent Senate Economics References Committee inquiry into the performance of ASIC recommended that the current arrangements for funding ASIC be replaced with a user pays funding model. Under the new framework, different levies should be imposed on the various

regulated populations ASIC oversees, with the size of each levy related to the amount of ASIC's resources allocated to regulating each population. The levies should be reviewed on a periodic basis through a public consultation process (Recommendation 50).

300 The user-pays funding model proposed by ASIC is based on recovering costs from those who engage in regulated activities, and would therefore require ASIC to regularly consult on and publish our cost recovery methodology. This would result in greater cost transparency of ASIC's regulatory activities and services, and greater cost accountability for ASIC. It would also mean that industry would be consulted more regularly and directly on ASIC's regulatory focus and activities.

301 We have proposed the new funding model directly to the Government and in our main submission.

Performance reviews and audits

302 ASIC supports independent reviews of regulators' performance. We suggest that these reviews be conducted at three-year to five-year intervals.

303 We suggest that performance reviews should be conducted by an independent panel of experts with a corporate and financial services and consumer perspective, rather than Government audits by the Australian National Audit Office or the Productivity Commission.

304 Performance metrics should be specific and meaningful. Performance measurement should go beyond simply financial efficiency to also encompass measures of ASIC's effectiveness in achieving our objectives of confident and informed investors and financial consumers, fair and efficient markets, and efficient registration and licensing. Metrics should focus on ASIC's activities and objectives, rather than 'one size fits all' whole-of-government metrics.

305 Further work must be done to determine the appropriate performance metrics for ASIC. We note that a number of overseas financial services regulators have adopted performance measurements. For example, the US Securities and Exchange Commission reports its performance against a range of financial and non-financial measures in an annual Performance and Accountability Report.

306 ASIC supports strengthening the Statement of Expectations and Statement of Intent to include relevant performance metrics.

307 The Statement of Expectations outlines the Government's expectations about the role and responsibilities of ASIC, our relationship with the Government, issues of transparency and accountability, and operational matters. The Statement of Expectations recognises ASIC's obligation to act independently

and objectively in performing our functions and exercising our powers under the ASIC Act. Nevertheless, the Government expects that ASIC take into account the Government's broad policy framework, including its deregulation agenda, in performing our role and meeting our responsibilities.

308 ASIC's Statement of Intent outlines our response to the Government's Statement of Expectations. The Statement of Intent outlines some of the key forward-looking challenges facing ASIC. It also sets out our 'detect, understand and respond' approach to identifying and dealing with those who break the law.

Budget and funding process

309 ASIC supports adopting a more autonomous budget and funding process. This will improve transparency over funding and accountability to our regulated population for the services we deliver. As outlined in our main submission, ASIC proposes a user pays funding model for ASIC.

310 As noted in paragraph 299–300, accountability to our stakeholders would be enhanced under a more autonomous budget and funding process. This is because a user pays funding model requires regular consultation with stakeholders to establish the funding level.

311 In setting our annual budget, ASIC would comply with all relevant whole-of-government policies—in particular, the *Australian Government cost recovery guidelines*. ASIC notes that the proposed user pays funding model would incorporate the following key elements of a cost-recovery framework under the guidelines:

(a) efficiency and effectiveness;

(b) transparency and accountability; and

(c) stakeholder engagement.

Staffing

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Review mechanisms to attract and retain staff, including terms and conditions.

Legislative framework

312 Section 120(1) of the ASIC Act provides that ASIC staff must be persons engaged under the Public Service Act. Section 120(3) grants the Chairman of ASIC the power to employ any additional staff considered necessary for the performance of ASIC's functions. By contrast, our partner financial

services regulators, APRA and the RBA, are not required to employ staff under the Public Service Act.

Constraints of the Public Service Act

313 The requirement to employ staff under the Public Service Act presents a number of challenges:

(a) *Leadership*—Approximately half of ASIC's Senior Executive Service are employed under s120(3) of the ASIC Act, not under the Public Service Act. As a consequence, these senior executives do not have staffing delegations to lead and manage ASIC's staff, all of whom are public servants. While we have developed strategies to manage this situation, it is neither desirable nor sustainable.

(b) *Competing for talent*—ASIC competes for talent from the legal, business and financial services sectors in Sydney and Melbourne. ASIC's enterprise agreement sets the remuneration structure for ASIC staff and caps the remuneration of ASIC's Executive Level 2 staff at $156,488 (for example). This salary is well below the 25% percentile for the financial services sector ($200,000) and consequently limits ASIC's ability to attract and retain experienced staff from the private sector. This issue may become critical if remuneration levels increase at a greater rate in the financial services sector than under ASIC's enterprise agreement.

    ASIC also competes for talent with the RBA and APRA, organisations that are not constrained by the Public Service Act. Although ASIC's remuneration is at the median of the Australian public service, ASIC does not generally compete with the broader public sector pool for talent.

(c) *Decision making*—Engaging staff under the Public Service Act directly and indirectly influences decisions that ASIC can make about, among other things:

    (i) the number of senior executives employed by ASIC and how they are remunerated—for example, the Australian Public Service Commission has capped the number of permanent senior executives ASIC can employ at 25. The remuneration of senior executives is capped at 65% of the total of the lowest reward amount;

    (ii) the classification and grading of all staff—for example, our organisational structure must be in accordance with the Australian Public Service Commission's organisation classification system, which limits our ability to be flexible and to reflect the market for some positions;

    (iii) the length of employment of temporary staff—for example, the employment of non-ongoing staff is restricted to two blocks of 18 months. This makes it difficult to attract temporary staff for large enforcement matters and other significant projects.

Option for reform

314 To overcome these constraints, ASIC recommends that s120(1) of the ASIC Act be replaced with the following:

> (1) The Chairperson may, on ASIC's behalf, appoint such permanent, temporary or casual staff as he or she considers necessary for the performance or exercise of any of ASIC's functions and powers.
>
> (2) The terms and conditions of appointment (including as to remuneration) are to be determined by the Chairperson.

315 This legislative amendment will allow ASIC to shape a workforce and culture for those staff who are essential to the effective performance of our regulatory functions—that is, high-performing and experienced staff with backgrounds in law, business, economics, auditing and forensic investigation (among others).

ASIC's staff

316 Notwithstanding the constraints identified above and the competition we face from the private sector, ASIC currently attracts many highly qualified graduates and experienced staff who are keen to perform engaging work in the public interest. We seek to retain staff by investing in learning and development and actively managing talented individuals. However, the issues mentioned in paragraph 313 may arise if salaries increase at a greater rate in the financial services sector than under ASIC's enterprise agreement.

Graduates

317 ASIC attracts high-calibre graduates, with around 1700 applications annually. Of the successful applicants, 70% have an average grade of Distinction or High Distinction. Internal research completed in 2010 identified that the quality of work and working in the public interest are the key reasons graduates want to work at ASIC. Turnover of graduates is 15% at year three and 37% at year five, which is as good or better than the financial services industry. We do, however, experience more significant turnover after year five once graduates have moved into executive level roles.

Qualifications and background

318 ASIC's staff are highly qualified and experienced. In ASIC's stakeholder, enforcement and legal functions, our statistics show that 96.3% of our staff hold a tertiary qualification and 69% hold one or more post-graduate qualifications. The qualifications are predominantly in the fields of law, business and commerce.

319 At the executive level, and within ASIC's stakeholder, enforcement and legal functions, staff come to ASIC with significant industry experience: 28.4% have worked in financial services, 35.9% have worked in law firms, 24.4% have worked in other government departments and 7.1% have backgrounds in government enforcement agencies. There is also significant international experience in ASIC; 15.7% of our staff have worked abroad, including working for overseas regulatory bodies.

Turnover

320 The average turnover for the last three years is 7.4%. This is slightly higher than the APS (6.3%), but lower than financial services (between 10% and 14%). People rated at the lower end of the performance scale leave in greater numbers than our high performers. The turnover of people identified as being high performers is lower than the rest of the organisation.

Staff engagement and job satisfaction

321 The 2014 staff survey indicates staff continue to have high levels of engagement, loyalty and commitment to ASIC.

Training

322 The capabilities we acquire from the market and develop internally include a mix of specific technical skills, regulatory craft and commercial acumen. We have a comprehensive training curriculum, including formal training, professional networks, a study assistance scheme and just-in-time learning through communities of practice, lessons learned and other knowledge management initiatives.

Talent management

323 ASIC has a number of measures in place to develop and retain high-performing individuals, including:

(a) the ASIC Talent Council, which meets twice per year to review the development of high-potential individuals;

(b) the ASIC Talent Framework, which focuses on identifying and developing high-potential staff at each level of the organisation; and

(c) talent development activities such as formal programs and experience-based learning.

Costs and benefits of regulation

The Inquiry seeks further information on the following areas:

- Is there evidence to support conclusions that the regulatory burden is relatively high in Australia when considered against comparable jurisdictions?
- Are there examples where it can be demonstrated that the costs of regulation affecting the financial system are outweighing the benefits?

324 ASIC aims to ensure that the regulatory compliance costs arising from ASIC regulation are outweighed by their regulatory benefits. We do so by:

(a) assessing the costs and benefits of regulation before implementing any new regulation that is not minor and technical; and

(b) consulting with stakeholders to ensure we understand the impact of proposed new regulation.

325 Comparing the costs and benefits of regulation can be challenging, particularly as the benefit of regulation may not be readily measurable.

326 Much of our work also involves reducing the compliance burden of individuals and businesses. We deliver this through our day-to-day work as well as through additional project work to support the Government's red-tape reduction target.

Assessing the impact of regulation

327 ASIC undertakes a rigorous regulatory impact analysis before implementing any new regulation that is not minor and technical. We do so by examining the likely regulatory and financial impacts of a proposed regulation and a range of alternative options that could meet the desired policy objectives. We regularly consult with stakeholders as part of our regulatory impact analysis. Depending on the nature of the regulation, we may consult with a wide range of individuals, businesses, professional bodies, industry groups, community organisations and Government agencies before determining the impact of a proposed regulation.

328 Like other Government departments and agencies, ASIC must comply with the best practice regulation requirements set out by the Office of Best Practice Regulation (OBPR). Under these requirements, we must prepare a regulation impact statement for all new regulation that is not minor and technical, which must quantify the cost to individuals and business arising from the new regulation using an appropriate costing methodology. Where a proposed new regulation increases compliance costs for individuals and businesses, we must also identify other reductions in regulatory costs to offset the cost of the proposal.

329 Before we can make the final decision to proceed with a proposed regulation, OBPR must assess that the regulation impact statement complies with all requirements, that the depth of analysis is in keeping with the size of the problem and potential regulatory impact, and that the quantification of regulatory benefits, costs and offsets is accurate.

330 To promote transparency in ASIC's policy development processes, our regulatory impact statements are usually published on ASIC's website together with the document setting out the new regulation.

Delivering compliance cost savings for individuals and businesses

331 Much of ASIC's work involves delivering compliance cost savings for individuals and businesses.

332 Our mandate under the ASIC Act requires us to strive to reduce business costs and administer the law effectively with a minimum of procedural requirements.

333 Examples of our work that have delivered compliance cost savings include:

(a) providing waivers or relief from the law where any regulatory detriment is minimal and is outweighed by the commercial benefit;

(b) promoting recognition of Australian laws and substituted compliance through our international work;

(c) engaging with our regulated population to improve our guidance and communication, including the launch of a new online hub for small business;

(d) updating the application process for an AFS licence; and

(e) simplifying business names registration.

334 We are continuing to work towards reducing the compliance burden of individuals and businesses to support the Government's $1 billion red-tape reduction target. Measures we have implemented between September 2013 and February 2014 have resulted in annual compliance cost savings of over $14 million per year.

Challenges in assessing the costs and benefits of regulation

335 There are inherent challenges in assessing the costs and benefits of regulation.

336 While it is possible to estimate the costs incurred by individuals and businesses in complying with regulatory requirements and processes, the benefit of regulation is often intangible. For example, the Future of Financial Advice (FOFA) reforms seek to improve the ability of consumers to make informed choices that better suit their needs through the provision of better

quality financial advice, while a benefit of ASIC's financial resource requirements is reducing risk to the market and investors of the disorderly failure of a licensee by ensuring that AFS licensees have sufficient financial resources to conduct their financial services business in compliance with the Corporations Act, and do so with a high level of care and diligence. These benefits are, by nature, difficult to measure.

337 In the context of financial regulation, the benefits of regulation can also extend beyond the immediate sector to which the regulation relates and have broader implications for the financial system (e.g. by increasing the confidence of investors and financial consumers). This poses further challenges to measuring the benefits of regulation.

C Systemic issues

Key points

Since the global financial crisis, international regulatory developments have emphasised the importance of identifying and addressing issues of systemic risk to protect financial stability. Financial regulators need to be able to promptly identify and monitor systemic risk. The Council of Financial Regulators (CFR) is well placed to provide a flexible and timely response to new systemic risks.

Many payment systems are systemically important but there are gaps in the current regulatory framework. A scaled model of prudential and conduct regulation would better address these.

As long as important pre-conditions are met, self- or co-regulatory systems can bring many benefits for industry and consumers. ASIC encourages the development of self- or co-regulatory arrangements wherever possible.

Table 4: Summary of policy options responded to in Section C

Policy option	Summary of response	Reference
Systemic risk	Financial regulators need to be able to promptly identify and monitor systemic risk. The CFR is well placed to provide a flexible and timely response to new systemic risks	Paragraphs 338–365
Payment systems regulation	A scaled model of prudential and conduct regulation may better ensure that consumer funds are adequately protected. It would also provide business with greater certainty about regulatory requirements.	Paragraphs 366–378
Co-regulation	Where appropriate for the industry in question, a well-designed co-regulatory system could improve outcomes for consumers by providing greater flexibility, responsiveness and oversight. Co-regulation can also help drive regulatory costs down by ensuring resources are allocated efficiently and pricing is competitive.	Paragraphs 380–390

Systemic risk

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Establish a mechanism, such as designation by the relevant Minister on advice from the RBA or the Council of Financial Regulators, to adjust the prudential perimeter to apply heightened regulatory and supervisory intensity to institutions or activities that pose systemic risks.

- Introduce specific macroprudential policy tools.
- Australian regulators make greater use of stress testing with appropriate resourcing.

The Inquiry seeks further information on the following areas:

- Is new legislation the most appropriate mechanism to adjust the prudential perimeter to respond to systemic risks, or could a more timely mechanism be of benefit? What alternative mechanisms could be used?
- What accountability processes would be necessary to accompany any new mechanism?
- What criteria could determine when an institution or activity was subject to heightened regulatory and supervisory intensity?
- Are there specific macroprudential tools that Australia should adopt to manage systemic risk?
- What agency or agencies should have these macroprudential tools?

338 Systemic risk is broadly defined as 'the risk of disruption to the flow of financial services that is caused by an impairment of all or parts of the financial system and has the potential to have serious negative consequences for the real economy'.[42]

339 Since the global financial crisis, international regulatory developments have emphasised the importance of identifying and addressing issues of systemic risk to protect financial stability.

Mechanism to adjust prudential boundaries

340 Financial regulators need the capacity to monitor the emergence of systemic risk in entities or sectors outside the current boundary of prudential regulation and to adjust the prudential perimeter to address systemic risk, if necessary.

341 The sources of systemic risk may arise from outside the areas that are currently within the focus of any individual CFR agencies.

342 The CFR's current role of identifying important trends that may affect overall financial stability would, importantly, include advising the Minister about areas where the prudential perimeter requires adjustment to address systemic risk.

343 The CFR provides a flexible and responsive mechanism to deal with systemic risk arising from different institutions, products or sectors. It also

[42] FSB, IMF, and Bank of International Settlements, *Guidance to assess the systemic importance of financial institutions, markets and instruments: Initial considerations: Report to the G-20 finance ministers and central bank governors*, October 2009.

enables the development in the future of proportionate and targeted responses to systemic risk outside the current prudentially regulated sector.

344 As a corollary, it would be appropriate to establish a mechanism (such as a regulation-making power) to enable the Minister to respond quickly to the advice of the CFR to extend the prudential boundaries or establish new macroprudential tools. The objective in suggesting the inclusion of a power to make regulations is to provide the Australian Government with the capacity to quickly respond to issues which may develop that need intervention.

Flexible application of prudential regulation

345 ASIC considers that the regulatory perimeter for prudential regulation should not be static and should be adjusted to allow appropriate responses to systemic risk.

346 This flexibility is consistent with international developments on addressing systemic risk, including the work of the Financial Stability Board (FSB), which expects that regulatory responses to systemic risk—such as through ‘shadow banks’—are proportionate to the risks posed, and forward-looking and adaptable to emerging risks, with a capacity to review and assess regulatory measures over time.

347 We recognise that there is a trade-off between innovation and growth—including the development and use of new or complex financial products, and the resilience and integrity of the financial system. However, having a flexible mechanism to proportionately target any systemic risk that may arise from sources that cannot be identified today may increase confidence and trust in the financial system.

348 This is consistent with the approach to prudential regulation in the Wallis Inquiry’s report. That report considered that prudential regulation should be proportionate, and that it is necessary to enable a targeted approach to risk and externalities (principle of proportionality). This approach is intended to ensure that innovation in the financial markets and economic growth are not unduly stifled by regulation.

349 As the CFR provides a forum to identify important trends in the financial system, including those that impinge on overall financial stability, this forum provides an important means by which Government can be advised about the need to adjust the prudential perimeter or apply heightened regulatory and supervisory intensity to institutions or activities that pose systemic risks.

350 It would be expected that when the CFR provides advice to the Minister that a product, entity, sector or activity poses a systemic risk and warrants

prudential regulation, the Minister would receive and consider advice on the costs and benefits of an action to extend the regulatory perimeter.

Example 5: Shadow banking

'Shadow banks' and systemically important financial institutions (such as securitisation vehicles, money market funds, and investment banks) play an important role in the global financial markets, particularly in market-based financing. Further, as additional regulatory obligations are placed on banks, there will be greater incentive to seek alternative sources of funding. However, their role makes them susceptible to being a source of, and conduit for, systemic risk.

Public confidence in market-based financing, such as securitisation vehicles and money market funds, could be bolstered by providing a regulatory environment intended to support growth and greater resilience.

While additional and proportionate regulatory oversight (if exercised) can increase costs of funding, undermining its benefit as an alternative source of funding, a level of resilience and certainty in the financial system is required to promote public confidence and growth in those markets.

351 In practice, such a mechanism may never be exercised if the financial system remains stable and the risks are appropriately regulated; however, the monitoring of the regulatory perimeter by the CFR to respond to changes in systemic risk can promote increased confidence and trust in the financial system.

352 The current memorandum of understanding on financial distress management between the members of the Council of Financial Regulators identifies that each agency has different responsibilities for detecting emerging distress in the financial system. The memorandum also envisages that once a CFR agency identifies an emerging vulnerability or distress situation it will advise the other members of the Council as a matter of urgency.

353 Under the memorandum, each agency has specific responsibility for detecting emerging distress in the financial system:

(a) RBA has lead responsibility for monitoring financial markets and payment and settlement systems;

(b) APRA has lead responsibility for monitoring and prudentially supervising financial institutions;

(c) ASIC has lead responsibility for monitoring financial service providers and for advising on emerging vulnerabilities in this area.

354 The memorandum anticipates that timely advice will be provided to the Treasurer and Treasury on developments, including potential threats to financial stability and the economy.

Macroprudential tools

355 The CFR also has the ability to provide advice to the Minister on the use of existing, or the need for additional, macroprudential policy tools to ensure financial stability. Similar to any extension of the prudential perimeter, the Minister should have access to the advice of the CFR on those tools. This is consistent with a flexible and proportionate framework. Any macroprudential tools are best exercised by APRA or the RBA within their existing mandates.

356 To support both the extension of the regulatory perimeter and the application of macroprudential tools, consideration could be given to the ability to obtain and share data to determine systemic risk in a particular entity or sector.

Tension between market disclosure and crisis management arrangements

357 One of the issues about the scope of the prudential perimeter and the effect of prudential regulation is the tension between disclosure to achieve market transparency objectives and systemic stability. To address this policy tension we support greater clarity and transparency on how continuous disclosure requirements for a listed company would apply to a distressed prudential regulated entity, including ADIs.

358 In September 2012, Treasury consulted on strengthening APRA’s crisis management powers. It proposed that APRA be given powers to suspend market disclosure requirements (continuous disclosure of price-sensitive information) for a regulated entity in financial distress for a limited period, if certain circumstances apply, to enable APRA to work with the entity to implement a resolution to address its financial difficulty.

359 We recognise that there is the need to balance the interests of financial stability and market disclosure of price-sensitive information. It would be appropriate to clarify when APRA should be permitted to suspend market disclosure requirements for a temporary period to ensure that an orderly resolution can be reached, including to limit ‘bank runs’ and other risks to stability.

Structurally important financial market infrastructure

360 It is important for the regulatory regime to have measures for resolution and recovery that apply to the providers of financial market infrastructure—such as licensed financial market operators, licensed clearing and settlement operators, and securities and investment firms—where those providers are systemically important.

361 The FSB has outlined a range of resolution and recovery arrangements that should be available to regulators to address the failure of these providers.

362 In 2012, the Council of Financial Regulators recommended to the then Treasurer that there should be streamlining of powers to give directions to Australian market licensees and clearing and settlement facility licensees. The Council has also recommended that there be step-in powers over systemically important financial system infrastructure providers (i.e. enabling the regulators to appoint a statutory manager for that provider, in consultation with the Minister).

363 We suggest that these measures are relevant and appropriate for ensuring that there are adequate powers to address the situation of distressed providers of systemically important financial market infrastructure.

364 The FSB is developing measures to reduce the need for taxpayer support in the event of failure and at the same time avoid disruption to the financial system and real economy. These measures include developing credible resolution plans, including cross-border cooperation agreements to reduce the difficulties of resolving important financial institutions that operate in multiple jurisdictions.

365 The development of credible resolution plans for systemically important institutions, including financial market infrastructure providers, is an important measure to lessen the effect of the failure of any such organisation and so we support measures that require such institutions to have appropriate pre-planning and pre-positioning.

Payment systems regulation

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Consider a graduated framework for retail payment system regulation with clear and transparent thresholds.

The Inquiry seeks further information on the following areas:

- Is there firm evidence to support opportunities for simplifying the regulatory framework for retail payment systems and participants?
- What are practical and appropriate options to simplify the current regulatory framework for retail payment systems and participants?

366 In the past, stored value payment products, such as ‘prepaid debit cards’, were typically limited and closed loop facilities (such as gift cards). However, increasingly these payment products are being offered as reloadable, open loop facilities for making general purpose payments. These

products generally access the MasterCard and Visa debit systems, and may be used at any merchant accepting payments through those systems. Depending on the terms of a particular facility, loaded value may also be redeemable as cash through an automatic teller machine (ATM).

367 The providers of these payment products are often ADIs. Although many have 'deposit-like' features (e.g. being redeemable for Australian currency), it is unclear whether these products are offered or treated as part of the ADI's banking business under the *Banking Act 1959* (Banking Act).

368 Some products of this kind are issued by non-ADIs. Currently it appears that such providers operate on a smaller scale (remaining under the $10m cap set in declarations made by the RBA to exclude smaller scale facilities from the definition of purchased payment facilities under the *Payment Systems (Regulation) Act 1998*) and/or have arrangement in place for an ADI to act as the holder of stored value.

369 A graduated framework for regulation of this retail payment system already exists.

Facilities that are not regulated by ASIC under financial services law

370 Some payments facilities are exempted from the Corporations Act. For example, facilities where there is only one person to whom payments can be made are not financial products under Ch 7 (s763D(2)(a)(i)), along with most remittance services (reg 7.1.07G).

371 Additionally, ASIC has declared that some payments schemes (such as loyalty schemes) are not financial products for the purposes of Ch 7.

372 ASIC has also exempted some payments schemes from the licensing, conduct and disclosure provisions of Ch 7. These include stored value cards marketed as gift cards (where those gift cards may be redeemed with purchases from more than one person or entity), low-value payment facilities (where there is a $1000 limit per person and $10 million total limit for facilities of the same kind), road toll devices and pre-paid mobile facilities.

Facilities that are regulated by ASIC (and not by APRA or the RBA)

373 Facilities that are regulated by ASIC (and not by APRA or the RBA) include retail payment systems and providers where the stored value held by the operator of the facility is under $10 million (not including any stored value held in facilities that are exempted from the financial services laws by ASIC or by statute). These entities are subject to the AFS licensing requirements and consumer protection provisions in the ASIC Act.

Facilities that are regulated by ASIC and APRA

374 Larger retail payment systems and providers (i.e. with stored value of $10 million or more) are also regulated by APRA (if APRA determines the payment product constitutes 'banking business') and/or the RBA. As noted by the RBA in its submissions to the Financial System Inquiry, the definitions of 'purchased payment facility' and 'holder of stored value' in the *Payment Systems (Regulation) Act 1998* are technical and affected by the nature of the entity that is under an obligation to make payments through the facility, which may be different to the entity that operates the facility and has direct obligations to the consumer.

375 To date, PayPal is the only system that APRA has determined to constitute banking business, and it is authorised as an ADI by providing a 'purchased payment facility'. We are not aware of any other larger scale payment systems that would require authorisation by APRA or the RBA (though several may operate on a larger scale by ensuring that an ADI is involved as the holder of stored value to complete payments through the facility).

376 Most retail payment systems are either operated by ADIs, or an ADI is involved as the holder of stored value. However, in the absence of a determination by APRA that such facilities constitute 'banking business' for the purposes of the Banking Act, it appears that provisions of that Act (e.g. the unclaimed money and the financial claims scheme provisions) may not apply to value held in those facilities.

Alternatives to the current regulatory framework

377 The current framework may not be ideal from a business or consumer perspective, as it may encourage providers to engage in complex white labelling arrangements (e.g. non-ADIs distributing ADI-issued products) in an effort to sustain existing business models and to potentially avoid exceeding the low-value threshold and therefore attracting RBA and APRA regulation. Consumers may also be uncertain about which regulatory protections apply to monetary value that is stored in these products.

378 We note comments in the interim report that the regulatory framework should take account of the costs of regulation and potential effects on innovation and competition. We consider that if the current graduated framework of regulation, or a similar framework under which ASIC is the primary regulator, is to be retained:

(a) the client money handling provisions in Pt 7.8 of the Corporations Act should be significantly strengthened to ensure that client funds held in these products are appropriately 'ring-fenced' and protected in the event of insolvency of the product provider. The application of these provisions to money stored in this kind of product is uncertain; and

(b) the regulatory status of retail payment products offered by ADIs should be clarified, to provide consumers with greater certainty about whether these products form part of the ADI's banking business and should be regarded as having protections comparable to deposit products.

379 Consumer expectations are likely to be that value held in these products is 'their' money and is treated like a deposit with an ADI. However, we understand that providers of these products, including ADIs, do not hold the money on trust for the consumer. We also note that, in general, ADIs take the view that money paid to these products is not a deposit, and that provisions in the Banking Act dealing with unclaimed money and the financial claims scheme do not apply.

Co-regulation

The Inquiry seeks further information on the following areas:

In addition to the current regulatory framework, what role can industry self-regulation play in improving consumer outcomes generally?

380 The interim report refers to self-regulation and states that '[m]arket discipline, through competition or self-regulation, is generally preferred to Government intervention.' It also notes that, 'in some cases, industry may be able to play a greater role in improving consumer outcomes. Greater supervision, more effective enforcement and/or industry self-regulation may be appropriate alternatives to further regulation, which may reduce innovation and competition or result in leav[ing] some consumer needs partially or wholly unmet.'

381 Self- or co-regulatory models are an alternative to regulation imposed wholly by government; industry develops and enforces its own regulatory rules, with a minimum of, or with specifically designated, government involvement.

382 ASIC's view is that, in some situations, self- or co-regulation has distinct advantages over government regulation, particularly where:

(a) there is no strong public interest concern and, in particular, no major public health and safety concern in relation to the subject matter of the regulation;

(b) the problem the regulation is seeking to address is a low-risk event, or is of low impact or significance; and

(c) the problem can be fixed by the market itself (e.g. there is an incentive for individuals and groups to develop and comply with self-regulatory arrangements to ensure the industry survives or to gain a market advantage).

383 However, in other situations it is less effective. There are several factors that determine whether self- or co-regulatory models are likely to be appropriate for or effective in a particular industry. These factors relate to the nature of the relevant industry, the type of regulatory problem to be addressed by self- or co-regulation and the level of risk to consumers if the regulation fails.

384 The potential advantages of self- or co-regulation include:

(a) expertise—compared with government and government regulators, industry is considered to have greater understanding and knowledge of the conduct of industry participants and the markets in which they operate. This should mean that industry is best placed to both craft regulatory solutions and take appropriate monitoring and enforcement action;

(b) flexibility and timeliness—compared to government and regulators, industry is typically able to respond to emerging regulatory problems in a more flexible and timely manner; and

(c) cost efficiency—self- and co-regulatory models ensure that the cost of regulation falls more efficiently on the industry that generates the need for regulation.

385 The limitations include that self- or co-regulation could:

(a) lack credibility and public confidence;

(b) lack effective enforceability;

(c) prove to be anti-competitive in nature by creating inefficient barriers to entry;

(d) be subject to 'regulatory capture', where the regulation and self-regulatory body comes to serve only the interests of the self-regulated industry;

(e) break down under stress, such as when market conditions change, meaningful reforms are proposed, or conflicts of interest arise between the aims of industry members and self-regulatory objectives; and

(f) be subject to 'free riders' to reduce the model's overall effectiveness (e.g. where industry members choose not to join the self-regulatory scheme, or join but do not properly adhere to the agreed rules).

386 The financial services industry is not an area of low risk to consumers. Many sectors of the industry are diverse, and in some areas there have been entrenched problems with the quality of products or services being provided. This means that the pre-conditions for effective self- or co-regulation may not be fully present in certain parts of the financial services industry.

387 Care needs to be taken to ensure that further moves to self- or co-regulatory models are only made where consumer protection or industry standards will not be compromised. The absence of appropriate industry settings in a

particular sector of the financial system suggests that increased reliance on self- or co-regulation in that sector may not be effective.

388 However, we acknowledge that together with government regulation, self-regulation can play an important role in the financial services sector. A well-designed system of co-regulation could improve outcomes for consumers through greater flexibility, responsiveness and oversight.

389 Co-regulation can also help ensure resources are allocated efficiently and pricing is competitive by creating an alternative regulatory services provider to government, driving regulatory costs down. As outlined in our main submission to this inquiry, ASIC proposes a user pays funding model for ASIC. Such a model could facilitate a co-regulatory model through the following methods:

(a) *Price signalling*—Transparent costs would act as a signal to the market about the true cost of regulation, acting as an incentive to industry to self-regulate (either through greater investment in internal compliance or through participation in industry bodies) in order to drive down the cost of achieving the Government's policy outcomes that they would otherwise be required to pay for.

(b) *Fostering greater industry motivation and accountability*—Financial markets that operate fairly and efficiently with minimal regulatory intervention would result in a reduction in ASIC's fees and levies. This would motivate business to voluntarily comply with Government policy objectives regarding financial markets to benefit from this potential cost saving.

(c) *Promoting greater use of relational contracts and coordination and information sharing*—The contract that a self-regulatory organisation has with its individual and entity members can potentially be more effective than legal remedies available to regulators, and cover more than one jurisdiction.

390 We also note that IOSCO recognises that significant benefits can flow to systems that make use of self-regulatory organisations where there is an appropriate system of oversight and accepted standards of conduct.

D Funding

Key points

We see market forces and tax barriers as the most significant deterrents to the development of a liquid retail corporate bond market, rather than existing regulatory settings.

In light of this, relaxing the disclosure requirements for corporate bond issues is unlikely to significantly stimulate Australia's retail bond market. In particular, allowing listed issuers to issue 'vanilla' bonds directly to retail investors without a prospectus will disproportionately increase the risks to investors without providing significant benefit to bond issuers.

Nevertheless, the ageing of the population, together with the continued growth of funds under management (due to compulsory contributions), may be expected to increase demand for corporate bonds within fixed income portfolios of superannuation funds.

Table 5: Summary of policy options responded to in Section D

Policy option	Summary of response	Reference
Equity market financing	The existing prospectus regime enables companies to adapt their disclosure to reflect commercial circumstances and take advantage of exemptions. ASIC does not think a change to the regime would significantly stimulate equity investment in smaller companies.	Paragraphs 391–400
Debt market financing	Market forces and tax barriers are the primary impediments to the development of a liquid retail corporate bond market. These impediments are not likely to be remedied through changes to the regulatory framework. ASIC believes that the Simple Corporate Bonds Bill may achieve the right balance between shorter disclosure and ensuring investors are well informed. The existing prospectus regime enables companies to adapt their disclosure to reflect commercial circumstances and take advantage of exemptions. ASIC does not think a change to the regime would significantly stimulate equity investment in smaller companies. ASIC believes that financing infrastructure projects through debt capital markets is desirable. However, the impediments of market forces and tax barriers need to be addressed in order for this to occur.	Paragraphs 401–412
Superannuation	Domestic equities receive the greatest allocation of funds from superannuation funds' portfolios. Australia's ageing demographic and the continued growth of investable assets within superannuation will likely increase demand for fixed income products over time.	Paragraphs 413–419

Equity market financing

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Review the size and scale of offerings that can be made without a prospectus where the offering is limited to 20 people in 12 months up to a value of $2 million, or for offers of up to $10 million with an offer information statement.
- Introduce additional protections for investors in relation to use of private placements and non-renounceable rights issues.

The Inquiry seeks further information on the following areas:

- Should other capital-raising requirements be modified to reduce dilution effects? Would this affect the capacity of corporates to raise funds, particularly under conditions of market stress?

Fairness in capital raising

391 The interim report questions whether specific requirements on the structure of capital raisings should be imposed. While specific requirements may assist in ensuring a greater level of fairness in some cases, such requirements may mean less flexibility for boards to tailor the structure of fundraisings to meet their companies' specific needs and respond at times of both crisis and opportunity.

392 ASIC considers that the choice of capital raising mechanism, such as private placements or pro rata rights issues, and the terms on which offers are made are most appropriately commercial decisions for directors, given the particular circumstances of the issuer, within the limits set by the company's constitution and the exchange's listing rules.

> Note: Under a placement, a company makes offers to subscribe for new shares to persons of its choosing (often substantial or sophisticated shareholders such as institutions). Placements can be a faster way of raising funds but often mean that not all existing shareholders are given the opportunity to participate.
>
> Under a pro rata rights issue, offers are made to existing shareholders to subscribe for additional shares in proportion to their existing holding. These offers can be renounceable (allowing the shareholder to sell or transfer their allotted entitlement to another person) or non-renounceable (in which case the entitlement expires if it is not taken up by the existing shareholder).

393 Within this framework, ASIC encourages the use of pro rata renounceable rights issues where possible. It is a well-recognised method for allowing fair and equal participation by existing shareholders in the benefits and opportunities associated with a capital raising—such as the ability to purchase shares at a discount.

394 Equity financing innovations, such as accelerated rights issues, have also improved the ability of boards to address issues of fairness and equality. Accelerated rights issue models combine the speed of institutional placements with the fairness of pro rata participation.

395 ASIC considers that boards should actively and transparently communicate with shareholders about their choices of capital raising mechanism. This includes providing shareholders with meaningful explanations of their reasoning for electing to use a particular form of raising that may exclude participation by particular holders. For example, small- and medium-sized enterprises listed on the ASX may raise capital by issuing an additional 10% of issued capital by way of placements over a 12-month period. In such cases, the board must get ordinary security holder approval by a special resolution at the annual general meeting. Directors must disclose to shareholders the intended use of the funds, the allocation policy used, the risk of economic and voting dilution to existing ordinary security holders, and whether any securities are being offered for non-cash consideration.

Small- and medium-sized enterprises

Access and funding costs for public small- and medium-sized enterprises

396 The interim report suggests that the requirement to prepare a prospectus may discourage some small- and medium-sized enterprises from seeking equity financing. ASIC considers that lowering the standard of disclosure required for capital raisings would be unlikely to significantly stimulate equity investment in smaller companies, for a number of reasons:

(a) *Prospectuses have multiple purposes*—Issuers will often consider it necessary to provide a level of up-to-date information that is generally similar to that required under the short-form prospectus to:

  (i) ensure investors have confidence that they have been given all material information relating to the investment decision, in order to encourage participation in the offering and enhance and protect their corporate reputation; and

  (ii) take advantage of relevant due diligence defences available under the prospectus regime.

(b) *Flexibility of the current prospectus regime*—The existing prospectus regime already allows ASX-listed small- and medium-sized enterprises to adapt their disclosure documents to reflect the commercial circumstances of the offering. For example, a prospectus is not required where securities are sold to sophisticated investors.

(c) *Preference for prospectuses*—ASIC's internal figures indicate that, in the 2013–14 financial year, 62% of all disclosure documents lodged with ASIC were aimed at raising less than $10 million (this number falls to 49% when compliance prospectuses are excluded). Offer information statements made up less than 10% of these disclosure documents. This suggests that the requirement to prepare a prospectus is not disadvantaging companies wishing to undertake small-amount equity raisings.

Table 6: Prospectuses lodged in 2013–14

	Prospectus	Offer information statement
Number relating to offers to raise <$10m	292	30
Number relating to offers to raise >$10m	532	N/A

Note: This table excludes disclosure documents lodged with ASIC that do not seek to raise funds under the documents (e.g. compliance prospectuses).

397 ASIC considers that that the risks of further lowering the standard of disclosure required for capital raisings (principally, a lower level of protection for investors) are disproportionate to the benefits associated with such a change (marginally decreasing the costs associated with conducting a successful fundraising).

Note: Standards of disclosure required for capital raisings could be lowered by increasing the thresholds for using an offer information statement or changing the content of an offer information statement (e.g. by excluding the requirement for financial reports).

398 Further, extending the 20/12 exemption may have unintended consequences; in particular, it may undermine the objective of the s708AA prospectus exemption.

Note: Under the 20/12 exemption, a prospectus is not required where the offering is limited to 20 people in 12 months up to a value of $2 million, or for offers of up to $10 million with an offer information statement: s708(1).

399 The s708AA exemption allows an entity to forgo preparing a prospectus for rights offerings in circumstances where a cleansing notice has been given to the relevant market operator. A cleansing notice contains information regarding the potential effect of the rights issue on the control of the issuer and the consequences of that effect. It also contains all information previously withheld from disclosure to investors on the basis of exceptions to the continuous disclosure obligations contained in ASX Listing Rule 3.1A.

400 The objective of the s708AA prospectus exemption is to encourage the use of pro rata offerings by allowing offers to existing shareholders under a cleansing notice. This objective may be undermined if the 20/12 exemption is extended—that is, if (on the basis of limited or no disclosure) more money

can be sourced from more persons, who are not necessarily existing shareholders.

Debt market financing

The corporate bond market

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Allow listed issuers (already subject to continuous disclosure requirements) to issue 'vanilla' bonds directly to retail investors without the need for a prospectus.
- Review the size and scale of corporate 'vanilla' bond offerings that can be made without a prospectus where the offering is limited to 20 people in 12 months up to a value of $2 million, or for offers of up to $10 million with an offer.

Development of the corporate bond market

401 The domestic listed corporate bond market remains underdeveloped when compared to those internationally. The primary impediments to the development of a liquid retail corporate bond market are taxation and market based.

402 A key impediment is the willingness of companies to issue bonds in the domestic bond market. This is driven by the cost and availability of bank loans, which compares favourably to the cost of issuing bonds. Banks may have better knowledge of a company's financial profile and may, therefore, be better able to assess the risk involved; investors, without that knowledge, may require a higher rate of return.[43] In addition, in an environment where there is reduced demand for external funding, bank loans with low interest rates may be considered more attractive to companies than issuing bonds.[44] International debt markets also continue to be an attractive and competitive source of debt funding for domestic companies that may otherwise rely on issuing bonds in the domestic market.

403 These impediments are unlikely to be resolved through changes to the regulatory framework; accordingly, ASIC does not believe that eliminating

[43] K Davis and M Jenkinson, Australian Centre for Finance Studies, *Australian debt securities and corporate bonds: Trends and prospects*, report commissioned by National Australia Bank, February 2014, www.australiancentre.com.au/sites/default/files/NewsDocs/australian-debt-securities-and-corporate-bonds-february-2014.pdf.
[44] RBA, *Submission to the Financial System Inquiry*, submission, March 2014, p. 122, www.rba.gov.au/publications/submissions/fin-sys-inquiry-201403/pdf/fin-sys-inquiry-201403.pdf.

the requirement for disclosure will stimulate the corporate bond market in any significant manner.

404 ASIC has, nonetheless, made efforts to reduce the regulatory burden on prospective retail bond issuers where appropriate. ASIC has given class order relief in Class Order [CO 10/321] *Offers of vanilla bonds* for reduced disclosure for issuers of vanilla corporate bonds. This reduced disclosure regime has been largely carried through to the provisions of the Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2014 (Simple Corporate Bonds Bill).

Simple Corporate Bonds Bill

In May 2014, the Australian Government released the Simple Corporate Bonds Bill, which is aimed at developing the retail corporate bond market in Australia. The key measures of the Bill include introducing a streamlined disclosure regime for simple corporate bonds and removing the presumptive civil liability for directors of issuers of simple corporate bonds under a defective prospectus.

Streamlined disclosure

Offers of simple corporate bonds to retail investors will be subject to a new two-part prospectus regime (consisting of a base prospectus and an offer-specific prospectus) instead of a full prospectus.

According to the draft explanatory memorandum:

- the base prospectus will contain general company information. It will be valid for three years and must be available on the issuer's website for the whole of that time. It will not be required to be updated; and
- the offer-specific prospectus will be issued for each new offer of bonds. It must outline the key details of the offer and may modify or supplement the base prospectus. It will have an expiry date, which must be no later than 13 months after the date the document is lodged with ASIC, and must be available on the issuer's website during the offer period.

Simple corporate bonds

To be considered 'simple' the debt securities must satisfy certain criteria, including that:

- the securities are quoted on a prescribed financial market (e.g. ASX);
- the fixed term of the securities does not exceed 15 years; and
- the securities meet certain conditions about repayment, interest rates and payment of interest.

405 In formulating the Simple Corporate Bonds Bill, Parliament considered the costs and benefits of a reduced disclosure and liability regime for simple corporate bonds.[45] The view from industry, which Parliament considered in formulating the Bill, is that it is expected that retail investors will become more familiar with bonds over time and readily invest in them.[46] This will provide an alternate source of funding to companies, which are likely to

[45] Regulatory Impact Statement of the Simple Corporate Bonds Bill.
[46] Regulatory Impact Statement of the Simple Corporate Bonds Bill, paragraph 2.83.

issue more bonds due to the greater ease of issuing bonds and the increase in investor demand.[47]

406 ASIC considers that the approach proposed in the Simple Corporate Bonds Bill balances the convenience of shorter disclosure with the need to ensure that investors are fully informed about the investment products.[48] It is ASIC's view that the appropriate avenue would be to allow for the regime proposed under the Simple Corporate Bonds Bill to come into effect to determine whether it will have a positive impact on Australia's corporate bond market.

Offering vanilla bonds without a prospectus

407 This inquiry has asked for views on the policy option of allowing listed issuers to issue 'vanilla' bonds directly to retail investors without the need for a prospectus. This is akin to the s708AA prospectus exemption, the capacity of listed issuers to offer new securities to its existing shareholders to raise capital without a disclosure document: see paragraph 399.

408 While listed issuers generally keep the market well informed through continuous disclosure, ASIC notes some relevant distinctions between the current provisions for rights offerings and the policy option of extending such a regime to corporate bonds.

409 These differences heighten risks associated with offering retail bonds without a prospectus. These differences are as follows:

(a) Rights offerings are to existing shareholders, whereas bond offerings would be to new retail investors. Existing shareholders have a history with, and a level of knowledge about, the issuer and the particular security, because they already hold that security. New retail investors would have no prior knowledge of the security or the issuer.

(b) Rights offerings are of a class of equity securities that are already in the market and already have a market price. An offering of bonds to retail investors would be a new offering and there would not be a market price for that product. Disclosure documents are useful because they bring together all relevant information about a security for market participants to assess in determining what price they are willing to pay for that security.

(c) The continuous disclosure regime is, in practice, focused on announcements relevant to the value of equities. While an issuer's obligations under the continuous disclosure regime apply not only to listed equity securities, but also to listed and unlisted debt securities,

[47] Regulatory Impact Statement of the Simple Corporate Bonds Bill, paragraph 2.77.
[48] Regulatory Impact Statement of the Simple Corporate Bonds Bill, paragraph 2.85.

continuous disclosure announcements are typically framed to highlight the potential impact on the market price of the issuer's ordinary shares.

Most information that could affect the price of an issuer's ordinary shares will also affect the price of its debt securities. However, the assessment of materiality for each purpose is different. It cannot be assumed that all material information disclosed under ASX Listing Rule 3.1 will necessarily include all information that is material to the price of debt securities.

Note: ASX Listing Rule 3.1 provides that once an entity is or becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities, the entity must immediately tell ASX that information.

410 ASIC considers that reducing or eliminating the disclosure requirements for vanilla corporate bonds will disproportionally increase the risks to investors with marginal benefits to issuers. Retail investors would struggle to assess the issuer and the security without a disclosure document; information available through continuous disclosure (and presumably supplemented by a cleansing notice) is diffuse and much more difficult to assess.

Infrastructure financing from debt capital markets

The Inquiry seeks further information on the following area:

What are the impediments to the development of liquid, tradeable claims on infrastructure projects?

411 Historically, investors have been able to gain access to infrastructure projects through ASX-listed equity (e.g. stapled securities) and wholesale debt. However, ASIC considers that there is merit in including corporate bonds in the options currently available to fund infrastructure projects because:

(a) the stable, long-term revenue profile of infrastructure projects is a natural match for the regular payment flows and longer terms of corporate bonds;

(b) corporate bonds may provide pricing competitive to that offered on comparable loans, but be available for longer terms and without restrictive loan covenants; and

(c) raising funds directly from debt capital markets diversifies an issuer's sources of funding, providing a potential advantage in terms of pricing and availability should disruption occur in other markets.

412 While financing infrastructure projects through debt capital markets is desirable, there are market- and taxation-based impediments to doing so, as set out in paragraphs 401–404.

Superannuation: Role in funding

The Inquiry seeks further information on the following area:

What effects will the trends in the size and composition of superannuation have on the broader flow of funds in the economy over the next few decades, including on international flows to and from Australia?

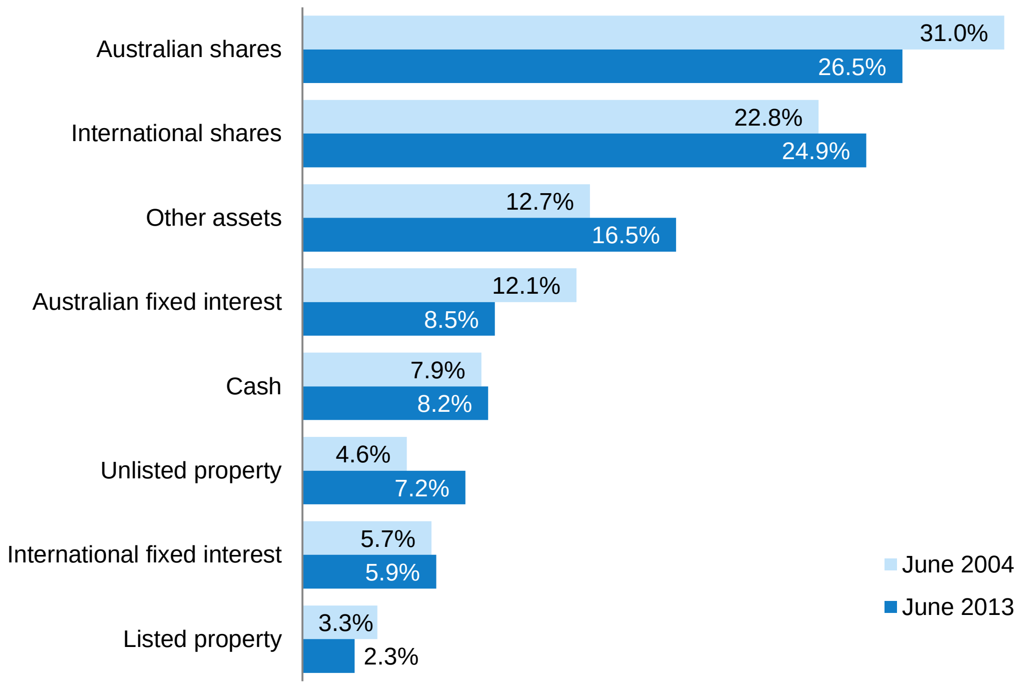
413 Since 2004, there has been little change in the asset allocation of APRA-regulated superannuation funds: see Figure 3. Domestic shares continue to receive the greatest allocation of funds from superannuation funds' portfolios, which reflects, in part:

(a) finance theory (the equity risk premium) and the relatively strong performance of Australian shares over the medium and longer term; and

Note: The equity risk premium is the difference between the expected rate of return on shares (collectively across the market) and the risk-free rate of return.

(b) the preference by superannuation funds for assets (such as shares) that are more suited to unit pricing.

Figure 3: Asset allocation of APRA-regulated funds



Note: Asset allocation figures only includes those in the default strategy of the funds

Sources: 2004 data from APRA, *Insight: Celebrating 10 years of superannuation data collection—1996–2006*, issue 2, 2007, Table 14; 2013 data from APRA, *Annual superannuation bulletin*, June 2013 (revised 5 February 2014), Table 18.

Future trends: Fixed income products

414 The demand for fixed income products will likely increase as Australia's population ages.

415 The proportion of Australians aged over 60 has increased from 15.9% of the total population in 1997 to 19.8% in 2013. This change is also reflected in superannuation membership. In June 2005, 6.5% of superannuation fund members were aged over 60; this had risen to 11% in June 2013. The ABS forecasts that the proportion of Australians over 60 will reach 25% by 2040.

416 As increasing numbers of people transition to the de-accumulation phase of superannuation, ASIC expects a greater percentage of total assets to be allocated towards defensive assets, including fixed income products. Fixed income products, such as corporate bonds, typically provide income at regular intervals at reasonably predictable levels.

417 The ageing of the population, together with the continued growth of funds under management (due to compulsory contributions), may be expected to increase demand for corporate bonds within fixed income portfolios of superannuation funds. This is dependent on the development of the corporate bonds market, the impediments to which are set out in paragraph 401–404.

418 Australia's infrastructure development is suffering from a shortfall in capital, which could be met by greater levels of investment by superannuation funds.

419 ASIC is involved in IOSCO initiatives that identify ways to increase investment in infrastructure to promote economic growth. IOSCO is seeking to:

(a) demonstrate how capital markets can be a useful funding tool for infrastructure; and

(b) encourage the use of market-based financing by infrastructure developers and investors, including superannuation funds.

E International integration

Key points

International financial integration is a critical feature that shapes and grows the Australian economy.

Australia's regulatory system needs to be appropriately calibrated to ensure the benefits of integration can be accessed.

A particular initiative that warrants consideration is extending passporting arrangements for securities offerings, such as bond and equity investments, on a wider scale to other regions (e.g. the United States).

Table 7: Summary of policy options responded to in Section E

Policy option	Summary of response	Reference
Impediments to financial integration	ASIC supports increasing financial integration while maintaining appropriate standards for financial stability and conduct in Australia. Passporting arrangements may facilitate further regional, and international, financial integration. A particular initiative that warrants consideration is extending passporting arrangements for securities offerings, such as bond and equity investments, on a wider scale to other regions (e.g. the United States).	Paragraphs 420–429
Cross-border regulatory settings	The international regulatory landscape is becoming more globalised and ASIC is focused on ensuring that domestic regulation is consistent with international standards where possible and appropriate.	Paragraphs 430–437
Coordination of financial integration	Successful international integration is key to Australia's future and ASIC believes that there is a role for a body to coordinate Australia's international integration objectives and strategies for implementation.	Paragraphs 438–442

Impediments to financial integration

The Inquiry seeks further information on the following areas:

- What are the potential impediments to integration, particularly their relative importance, and the benefits to the broader Australian economy that can be demonstrated if they were removed?
- Where is future Government engagement needed to facilitate integration with Asia?

420 The interim report lays out the case for Australia's international financial integration. This integration is a critical feature shaping and growing the Australian economy. Australia's regulatory system needs to be appropriately calibrated to ensure the benefits of integration can be accessed.

421 We support this inquiry's view that efforts to drive financial integration with the rest of the world should not be at the cost of appropriate standards for financial stability and conduct in Australia.

422 Integration facilitates increased cross-border flows and transactions, which inevitably results in the need for market participants to consider two or more different regulatory regimes. This may result in overlaps and inconsistencies in regulations, potentially adding unnecessarily to operating costs.

423 ASIC has existing policy setting out how it approaches cross-border regulation, including considerations applied for equivalence assessments and mutual recognition proposals where regimes are 'sufficiently equivalent': see paragraph 100 of our main submission. We believe Australia is well placed, with tools available for the recognition or licensing for overseas infrastructure providers and financial service providers, and that ASIC's current policy settings appropriately balance the need for mutual recognition and equivalence assessments with the need to maintain appropriate regulatory standards in Australia.

424 Our main submission also recognised the benefits of the Asia Region Funds Passport, and continued Government support is critical to the success of this initiative.

425 We also noted areas of future development in our main submission. In addition to passporting for managed investment schemes we suggested considering further passporting arrangements for securities offerings such as bond and equity investments. Such initiatives may be considered on a wider scale to other regions, such as the United States.

426 A particular initiative that warrants further exploration and analysis is allowing US or Australian issuers wanting to access retail investor markets in either country to use home jurisdiction offer documents in the other jurisdiction. This would reduce some of the costs of cross-border offerings. The initiative could explore developing mutual recognition or passporting arrangements predicated on reliance on the home jurisdiction's regulatory framework.

427 This initiative could benefit the Australian economy in a number of ways, in particular by:

(a) diversifying funding sources for Australian issuers by reducing the cost of access to the substantial US retail debt market;

(b) providing Australian retail investors with a more diverse range of investment options; and

(c) encouraging and supporting the development of the Australian retail corporate bond market. Introducing new US issuers to the Australian market, which may potentially be seeking new funding sources, may result in greater interest in this market.

428 We acknowledge there are considerable challenges in achieving these goals. However, the longer term benefits outlined above justify consideration of the issues.

429 To ensure the success of such initiatives it is important to have appropriate bilateral government commitment. Regulators need the necessary tools, support and direction to develop solutions to these cross border impediments in co-operation with their overseas counterparts, and with industry. Government engagement in these areas is important to making progress.

Cross-border regulatory settings

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Improve domestic regulatory process to better consider international standards and foreign regulation – including processes for transparency and consultation about international standard implementation, and mutual recognition and equivalence assessment processes.

The Inquiry seeks further information on the following areas:

- What changes can be made to make implementing international standards more transparent and otherwise improved?
- What improvements could be made to domestic regulatory process to have regard to foreign regulatory developments impacting Australia?
- Are there priority jurisdictions and activities that might benefit from further mutual recognition or other arrangements? What are the identified costs and benefits that might accrue from such an arrangement?

430 The interim report rightly recognises international standards and foreign regulation as two sources of increasing international influence affecting the activities of Australian market participants and the Australian financial system.

431 ASIC noted in our main submission that since the global financial crisis there has been a significant increase in the volume of international standards being developed. This has been reinforced by regular assessments of each

jurisdiction's compliance with these standards, including by IOSCO, the FSB and the International Monetary Fund (IMF).

432 ASIC also noted that there have been significant regulatory developments in key financial markets, such as the United States and the European Union, which have had extra-territorial effect. Given the importance of these markets, these regulatory developments have been taken into account when developing our own rules to facilitate substituted compliance decision making and equivalence assessments. This is seen as the most efficient way to facilitate continued participation in these global markets by our institutions.

433 ASIC is well aware of the need to ensure domestic regulation is consistent with international standards to maintain level playing fields, reduce the opportunities for regulatory arbitrage, and preserve Australia's reputation as a nation with good rule of law and a world-class regulatory system.

434 These are important factors in preserving trust and confidence in our markets and have been taken into account in the development of local rules, most recently in implementing over-the-counter (OTC) derivatives markets reforms.

435 In implementing international standards locally and being cognisant of foreign regulation, as noted in our main submission, our freedom to implement regulation of our own choosing becomes more limited. This is a cost of retaining efficient access to global markets.

436 Regardless of these limitations, ASIC continues to apply principles of good regulation in how it develops domestic regulatory policy. Public consultation is a key aspect of the development process, as is significant cost–benefit analysis of any proposals. Both of these are cornerstones of ASIC's policy development process. This provides ample opportunity to engage in a meaningful way with industry and other relevant key stakeholders and to consider all viewpoints.

437 ASIC is therefore transparent in its approach to implementing international standards and in how it takes account of foreign regulation.

Coordination of financial integration

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Amend the role of an existing coordination body to promote accountability and provide economy-wide advice to government about Australia's financial integration.

The Inquiry seeks further information on the following areas:

- Have appropriate elements been put forward for an effective coordination body?
- What role should industry play in any new coordination body, including its funding?

438 Successful international integration is critical to Australia's future, particularly integration with Asia. This will create challenges and opportunities. Australia would benefit from a coordinated approach to take advantage of the opportunities and determine how to deal with the challenges. This involves both a proactive effort and a reactive element.

439 Before determining the format and make up of a coordination body, the objectives of Australian financial integration and strategies to implement those objectives should be clear. Objectives are essentially a matter of government policy and strategies are likely to cut across different government departments and agencies.

440 Once objectives and strategies are clearly articulated, then the purpose and make up of a coordination body could be clearly defined. Roles for such a body could include:

(a) co-ordinating communication between agencies;

(b) seeking input from senior industry leaders;

(c) updating government on overall progress of strategy; and

(d) providing economy-wide advice to government on financial integration.

441 The body would need to be more than an advisory council for real progress toward achieving the articulated objectives to be made. If it is to promote accountability on progress towards financial integration objectives, a government body that has a regular consultation mechanism with industry may be more workable.

442 Industry consultation is critical to understanding strategic drivers operating in the economy and for feedback on implementation challenges. This consultation mechanism may be an additional source of industry input that complements the main forms of public consultation already in place in relation to standard setting processes and the development of regulatory policy. Whether industry should be a part of such a body, rather than just consult to it, would depend on the detail of the roles and purpose agreed for it.

F Other issues

Key points

This section raises other issues that require consideration for regulatory change. These relate to:

- the conduct regulation of fund administrators, technology service providers and securities dealers;
- the regulation of financial reporting and audit of superannuation entities; and
- the perceived complexity of and costs associated with external administration in Australia.

Table 8: Summary of policy options responded to in Section F

Policy option	Summary of response	Reference
Conduct regulation: Fund administrators, technology service providers and securities dealers	Certain areas of Australia's financial system should be subject to greater regulatory scrutiny. There should be a regulatory model to oversee technology service providers of sufficient scale, including AFS licence requirements. AFS licence requirements should also be imposed on providers of fund administration services of sufficient scale, and market integrity rules should be applied to securities dealers.	Paragraphs 443–463
Financial reporting and auditing of superannuation entities	Significant investor money is held in superannuation in Australia; however, a regulatory gap exists in that the financial reporting and audit of superannuation entities is not regulated. ASIC considers this should be addressed.	Paragraphs 464–467
External administration	The perceived complexity in Australia's insolvency regime and the costs associated with external administration are issues that need to be addressed.	Paragraphs 468–481

Conduct regulation: Fund administrators, technology service providers and securities dealers

The Inquiry seeks views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Impose AFSL requirements for providers of fund administration and technology service of sufficient scale.
- Apply market integrity rules for licensed securities dealers that provide investor services substantially similar to market participants of a licensed financial market.

- Introduce a mechanism to allow a heightened level of regulatory intensity to be applied where risk arises outside the conduct perimeter.

Impose AFS licence requirements for technology service providers of sufficient scale

443 Technology underpins all key operations in Australia's financial markets. Market participants and market operators rely heavily on key technology service providers to perform core business operations in the financial markets.[49] As noted in paragraph 616 of our main submission, the core functions performed by key technology service providers or 'vendors' include the following:

(a) *Data vendors* provide data inputs into buy- and sell-side algorithms, portfolio pricing systems, transaction cost analysis, and benchmarking, among other things. The data is typically exchange generated pricing data and/or related to an index.

(b) *Front and middle office vendors* provide front and middle office functionality, such as order processing, risk monitoring, algorithmic trading and portfolio management services. These functions have the capacity to affect market integrity, given the nature of front office functions such as order management systems and execution management systems.

(c) *Back office vendors* perform 'back office' tasks such as booking and settlement of trades and position keeping. The outsourcing of 'back office' functions to vendors has typically been driven by a desire for lower cost operating models and, as such, this outsourcing often includes a degree of 'off-shoring' by the market participants and/or vendors.

(d) *Exchange and clearing vendors* help market operators and their participants conduct their day-to-day operations.

444 This reliance means that outages or system malfunctions at a technology service provider that provides a large proportion of the industry with services (e.g. technology service providers of sufficient scale) have the capacity to affect the fair and orderly functioning of Australia's financial markets. There is, however limited regulatory visibility and oversight of technology service providers of sufficient scale in Australia. The law places the onus on the licensees to ensure that the technology is appropriate for its operations. There are also very few regulatory requirements that cover business continuity requirements for market participants.

[49] Clearing and settlement facilities may also rely on technology service providers to perform key functions. Outsourcing by clearing and settlement facilities is currently regulated by the RBA under the Financial Stability Standards.

445 We expect market participants to consider the risks posed by a technology service provider's activities (including system malfunctions and failures) to their operations. However, market participants may not always consider the broader risks of disruption to the fair and orderly operation of Australia's financial markets posed by the technology service provider's activities. For example, a major system failure or malfunction by a technology service provider of sufficient scale could have widespread ramifications for the ability of multiple market participants to settle trades for that period.

Note: Market participants may not necessarily be in a position to adequately mitigate the broader risks of disruption to the fair and orderly operation of Australia's financial markets either.

446 It is also unclear to what extent market participants and market operators can adequately mitigate and manage their operational risks when they rely on vendors to perform significant business operations (both through outsourcing and off-shoring).

447 A regulatory model to oversee technology service providers of sufficient scale would assist in addressing or mitigating the risks posed by these entities to the fair and orderly operation of Australia's financial markets.

448 Imposing AFS licence requirements for technology service providers of sufficient scale would impose a range of obligations on these key entities, including an obligation to have adequate risk management systems under s912A(h) of the Corporations Act. ASIC may also tailor obligations in the AFS licence to suit the unique services provided by technology service providers. Such conditions could include mandatory business continuity and minimum IT infrastructure requirements.

449 A regulatory model to oversee technology service providers of sufficient scale could also:

(a) specify indicators for ASIC (or another agency with appropriate expertise in relation to technology service providers) to identify technology service providers of sufficient scale with the capacity to affect the fair and orderly operation of Australia's financial markets. Indicators that would be relevant include the size of the technology service provider's Australian market share, how many market operators and participants use them, their interconnectedness in the market, the critical nature of the function or service provided, and their substitutability; and

(b) require market participants and market operators that outsource material business activities to technology service providers of sufficient scale to ensure appropriate due diligence, approval, and ongoing monitoring and risk management.

Impose AFS licence requirements for providers of fund administration services of sufficient scale

450 We support the policy option of requiring investment administrators and fund administrators to hold an AFS licence.

451 It is common practice in superannuation and funds management to outsource certain functions, such as investment administration and fund administration services, to specialist firms.

452 Investment administration involves:

(a) income and distribution processing;

(b) implementation of corporate actions and proxy voting;

(c) trade settlement;

(d) making calculation for unit pricing;

(e) providing information for client reporting about investments (e.g. fund accounts);

(f) compliance monitoring and reporting in relation to investments; and

(g) investment performance measurement and reporting.

453 Fund administration involves:

(a) setting up client accounts;

(b) processing contributions and investment switches;

(c) general account maintenance;

(d) processing/facilitating redemptions; and

(e) preparing and posting members statements (periodic statements) and otherwise maintaining a client register

454 The functions provided by such administrators are systemically important for the funds management industry. The safety of managed fund and superannuation fund assets is critical given the significant volume of assets in the industry and the concentration of services with a few major entities. Our view is that more direct regulatory oversight over investment administrators and fund administrators would be beneficial for these administrators' clients (including superannuation fund trustees and responsible entities) and ultimately provide greater confidence and protection to consumers and investors.

455 Even if an entity outsources any of the functions set out in paragraphs 453–454 to an administrator, the superannuation trustee or responsible entity remains responsible for the proper delivery of the services to consumers and investors. We consider that if the investment administrators and fund administrators were required to hold an AFS licence to carry out some or all of these functions, the following benefits would eventuate:

(a) Under s912D, licensees are required to lodge a breach report for any significant breaches by the licensee. Breach reports related to fund administration or investment administration—for example, problems with member data on insurance or unit pricing—would be able to be handled centrally and efficiently rather than more unsystematically through the responsible entity or registrable superannuation entity (RSE) licensee. The ability to directly require information and assistance from the licensee, rather than seeking it from another person, would allow more direct regulatory oversight of changes to systems and compliance frameworks. If the administration system is defective, for example, the licensee is directly responsible to the regulators to fix it.

(b) There would be more visibility and transparency associated with potential systemic issues that may emerge from outdated administration systems or technology.

(c) Administrators and technology providers would be required to have appropriate risk management systems under their AFS licence. There are many requirements that must be met before an entity obtains an AFS licence, some of which are explained in:

- (i) Regulatory Guide 104 *Licensing: Meeting the general obligations* (RG 104);
- (ii) Regulatory Guide 105 *Licensing: Organisational competence* (RG 105); and
- (iii) Regulatory Guide 166 *Licensing: Financial requirements* (RG 166).

(d) There would be a regulatory level playing field between entities with an in-house administrator and entities with an outsourced administrator.

Apply market integrity rules for licensed securities dealers that provide investor services substantially similar to market participants of a licensed financial market

456 The regulatory framework that applies to market participants is substantially different to that which applies to securities dealers, even though market participants and securities dealers play similar roles within our financial markets. In particular, ASIC does not have the power to make market integrity rules that bind securities dealers.[50]

457 Market integrity rules impose a range of specific obligations to protect the integrity and efficiency of licensed markets. In many cases, the risks that are addressed by ASIC's market integrity rules may arise from the operations of both market participants and securities dealers.

[50] This issue is discussed in more detail in paragraphs 630–633 of our main submission.

458 From a retail client's perspective, a securities dealer's services may be indistinguishable from those of a market participant. Clients place trades with securities dealers in a very similar manner to market participants and securities dealers may also offer other services such as managed discretionary accounts.

459 Because the market integrity rules cannot apply to securities dealers, ASIC has no power to take administrative action against securities dealers through the Markets Disciplinary Panel. Decisions of the Markets Disciplinary Panel have a high level of recognition and impact in the markets. Although remedies under the Corporations Act may be available against securities dealers, the inability to refer securities dealers to the Markets Disciplinary Panel deprives ASIC of an important and effective regulatory mechanism.

460 We note that this issue has also been raised in other submissions to the Financial System Inquiry.

461 We propose that ASIC be provided with the power to make market integrity rules for securities dealers, and Treasury prescribe securities dealers as entities that must comply with the market integrity rules in the Corporations Regulations 2001 for the purpose of s798H.

462 This would:

(a) enable ASIC to consult on, and make relevant market integrity rules that bind securities dealers. We do not anticipate that all the market integrity rules that apply to participants will be extended to apply to securities dealers. In some cases, that will not be appropriate. For example, securities dealers cannot run an automated order processing system because they are not connected to the market. As such, it would be inappropriate for Rule 5.6.3 of the ASIC Market Integrity Rules (ASX Market) 2010, which sets out requirements for automated order processing systems such as requiring automated filters, to apply; and

(b) enable ASIC to address misconduct by securities dealers and market participants in an equivalent manner via the Markets Disciplinary Panel.

463 This proposal is also consistent with feedback received in response to ASIC Consultation Paper 145 *Australian Equity Market Structure: Proposals* released in November 2010. Through CP 145, we sought views on the extension of the application of the market integrity rules, in particular to fund managers and securities dealers. The response was generally supportive of an extension, with six of the seven market participants who responded being in favour of an extension to securities dealers.

Financial reporting and auditing of superannuation entities

464 Although significant investor money is held in superannuation in Australia, neither ASIC or APRA regulates the financial reporting and audit of the large regulated superannuation funds, approved deposit funds and pooled superannuation trusts (superannuation entities). There are no proactive surveillances of financial reports or inspections of the work of auditors. This significant gap in the regulation of super entities places investors in superannuation at greater risk of not being properly informed about the financial position and results of a superannuation entity.

465 In contrast, the audits of self-managed superannuation funds are subject to regulation and compliance reviews by the ATO.

466 ASIC would be willing to undertake the regulation of superannuation entity financial reporting and audit, provided we are given:

(a) responsibility for the regulation of the provisions of the SIS Act concerning financial reporting and audit for superannuation entities;

(b) the necessary powers to regulate superannuation entities (e.g. powers to obtain information from super entities and their auditors under notice, and take enforcement action);

(c) access to superannuation entity financial reports; and

(d) appropriate resources to undertake the role.

467 In our view, this inquiry should include a recommendation in its final report that regulation of superannuation entity financial reporting and audit be introduced. This will support investor confidence in the quality of independently audited superannuation entity financial reports, and ensure that investors are properly informed.

External administration

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Implement the 2012 proposals to reduce the complexity and cost of external administration for SMEs.

The Inquiry seeks further information on the following area:

Is there evidence that Australia's external administration regime causes otherwise viable businesses to fail and, if so, what could be done to address this?

ASIC's view on current policy options

468 ASIC welcomes the anticipated benefits of the Australian Government's 2012 insolvency law reform proposals, which largely aim to harmonise and align the systems of corporate and personal insolvency by introducing:

(a) a streamlined model for winding up or restructuring small- and medium-sized enterprises; and

(b) a review of current external administration options for restructuring large and complex, financially distressed companies to consider whether Australia could adopt attributes of external administration processes in other jurisdictions to achieve better outcomes.

469 However, we note that these proposals do not fully address the issue of perceived complexity in Australia's insolvency regime, or the issue of the costs of the regime. The law reform proposals arose out of the 2010 Senate inquiry into the conduct of insolvency practitioners and ASIC's involvement. The 2010 Senate Inquiry's terms of reference reflected concerns about registered liquidator conduct and ASIC's supervision of registered liquidators, rather than more fundamental policy issues.

470 The vast majority of external administrations occur in the small- and medium-sized enterprise market. For these companies, the opportunity exists to consider how the winding up and restructuring processes might be further streamlined to reduce complexity and costs. Initiatives to reduce costs while appropriately remunerating registered liquidators for their work, increasing competition and ensuring consistency in external administration processes would also help maximise the potential return to creditors and help build confidence in the insolvency regime.

471 ASIC suggests that in considering how the external administration process can be streamlined for small- and medium-sized enterprises, consideration should be given to:

(a) alternative funding models, as discussed in ASIC's main submission to this inquiry and which are the subject of recommendations made by the Senate inquiry into the performance of the Australian Securities and Investments Commission. The funding model affects, among other things, the supervision of registered liquidators and, potentially, their remuneration; and

(b) professional standards and regulation, including those relating to investigation and reporting to creditors and to ASIC.

Australia's external administration regime and business failure

472 ASIC is not aware of empirical evidence supporting the view that Australia's external administration regime causes otherwise viable businesses to fail. If

empirical evidence supporting the contention that viable companies unnecessarily enter external administration does exist, ASIC believes the Australian Government could consider legislative change that would address this, and that would achieve better outcomes for creditors.

473 We are aware, however, of concerns in the market that unnecessary external administrations, which destroy entity value and result in significant cost, are the result of:

(a) a lack of a 'safe harbour' from what are said to be stringent insolvent trading laws (which can make a director personally liable for a company's debts); and

(b) the positive obligation/duty on directors to appoint an external administrator if their company is insolvent, or might become insolvent.

474 We acknowledge the possibility that the formal appointment of an external administrator can also reduce the value of a company's business, and note that there is anecdotal evidence to support this view.

475 ASIC's statistics on voluntary administration and deeds of company arrangement suggest that, for small companies, there is often not a viable business worth saving as many companies that enter voluntary administration end up in liquidation. This is supported by a recent review of 72 sample deeds of company arrangement (85% of which related to what might be described as small company insolvencies). The review found that 72% of these deeds were compromises akin to liquidation and involved no, or very limited, trading on of the business under the deed (although the dividend return paid to creditors was greater than that estimated if an immediate winding up of the company had occurred). In other words, the statistics show that companies often use the restructuring option of voluntary administration as a 'quasi liquidation'.

476 The current insolvency legislation provides for the continuation of a viable business. Where there is a viable business of a company in liquidation, the liquidator has the ability to sell that business. Alternatively, the liquidator can appoint a voluntary administrator to facilitate the company's restructuring with a view to its continued operation.

477 We note that four main reasons are often cited as inhibiting corporate restructuring in Australia:

(a) the perceived stringency of our insolvent trading laws;

(b) destruction of value by *ipso facto* clauses in contracts, which enable creditors to pursue enforcement action or enforce their contractual rights. This issue impacts on the extent of any moratorium on creditor claims during the period of a company's restructuring;

(c) a lack of formal 'pre-pack sale' regulation, which allows a sale of the business, or some company assets, to be negotiated prior to the appointment of an external administrator; and

(d) the inability to bind third parties.

478 In principle, we consider these matters worthy of further discussion and consultation noting they have proved contentious in the past.

479 In terms of any legislative change, ASIC does not advocate a wholesale adoption of a US Chapter 11 style regime or other processes. However, we note that the US Chapter 11 regime, along with the administration regimes in the United Kingdom and Canada, might be worth examining to identify elements that could address the issues claimed to inhibit effective corporate restructuring in Australia.

480 We consider that a 'one size fits all' approach to the external administration or reorganisation of failed and distressed entities may not be appropriate. The framework for external administration needs to take account of the fact that issues affecting large proprietary and public companies differ from those affecting small- and medium-sized enterprises.

481 Legislative changes to facilitate corporate rehabilitation might therefore consider the different characteristics of large and small companies, and policy settings may need to be specifically tailored for these sectors, in order to promote deregulation, facilitate efficient reallocation of resources and improve competition.

Appendix 1: Enhancing prospectus disclosure

The prospectus regime

482 Prospectuses have three primary, and often competing, purposes. They are:

(a) a sales document for the company's securities;

(b) a disclosure document that provides information to allow investors to make an informed decision; and

(c) a compliance document that places liability for disclosure on the company while providing a means to mitigate that liability through compliance with the law (and in the case of listed entities, the listing rules).

483 To effectively achieve these purposes within the existing regulatory settings, prospectuses generally strive to strike an appropriate balance between the objectives of:

(a) addressing the information asymmetry between issuers and current and prospective investors in the issuer's securities; and

(b) delivering effective disclosure that is focused on the information that investors need to make informed investment decisions and is no more burdensome on the issuer than necessary.

484 Companies issuing some prospectuses are under statutory obligations to ascertain and provide all material information that an investor or their advisers would reasonably require and expect to find. This can lead to disclosure documents that are long, complex and may be difficult to understand for retail investors. For example, prospectuses may contain large amounts of 'boilerplate' risk disclosure that, while meeting the statutory requirement, may be of limited practical use and serve as a disincentive to read the document for retail investors. Further, the inclusion of such boilerplate text can distract investors from more important risk disclosures contained in the document.

485 Similarly, prospectuses for complex products can be difficult for retail investors to understand, and this can be a disincentive to read the prospectus for investors, even in circumstances where they intend to invest in the product.[51]

486 To ameliorate this problem, the prospectus disclosure regime under Ch 6D provides for a level of graduated disclosure depending on the circumstances of the capital raising. This allows entities to prepare shorter documents with more focused information when the scope or risk of information asymmetry

[51] Report 230 *Financial literacy and behavioural change* (REP 230).

between the company and its potential investors is lessened (principally where the issuer is listed and has provided information to the market in compliance with its continuous disclosure obligations).

487 The most lengthy prospectus documents are usually those used for an initial public offering to list on an approved market. The length of the document reflects an investment that is being made in an unknown and untested entity with no observable market pricing mechanism. Initial public offering documents for companies with complex business models or large private companies with established businesses that wish to float on a securities exchange are necessarily lengthy, as they provide detailed information, such as the entity's financial position and business model (which is at that time only available from the entity) and the risk of the investment (which has not yet been priced on the market). However, it is possible for smaller or less complex businesses to prepare substantially shorter and simpler documents. The costs associated with preparing such prospectuses vary, but our experience indicates that some simple initial public offering documents have been prepared for less than $10,000.

Enhancing prospectus disclosure

488 ASIC considers that, as with the PDS regime, there is potential to enhance prospectus disclosure to make it more effective for consumers.

489 As previously discussed, the prospectus requirements apply to a different range of financial products than those of the PDS regime. Because of the difference in the type of financial products being offered under the two regimes, enhancements might need to take different forms.

490 By way of example, disclosure of a PDS offering for insurance may well be enhanced by a comparison website that allows retail clients to compare similar products offered by different issuers. Shares offered under a prospectus, however, are a direct reflection of the underlying individual business. As each business is unique, it would be incorrect to compare the performance of different businesses, of different sizes and in different industries, merely by their share price. In this instance, the use of a comparison website would not provide an effective means of comparison.

Appendix 2: Penalties for corporate wrongdoing in New Zealand and Singapore

491 ASIC has conducted research on penalties for corporate misconduct in Australia, and how penalties for corporate wrongdoing in ASIC-administered legislation line up with other domestic and international practices: see Report 387 *Penalties for corporate wrongdoing* (REP 387). REP 387 looked at the penalties available to ASIC compared with those in Canada (Ontario), Hong Kong, the United Kingdom and the United States. We also made some domestic comparisons between the maximum penalties available to other comparable Australian Government regulators, as well as the penalties available in the different pieces of legislation we administer.

492 Since making our first submission to this inquiry, we have extended our comparison of the penalties available for corporate wrongdoing set out in REP 387 to cover New Zealand and Singapore. Our comparison of penalties in these additional jurisdictions supports the key findings in REP 387.

493 Penalties for corporate wrongdoing in New Zealand are provided in the *Financial Markets Conduct Act 2013*, the *Financial Advisers Act 2008* and the New Zealand *Crimes Act 1961*. Penalties for corporate wrongdoing in Singapore are provided in the *Securities and Futures Act 2001*, the *Financial Advisers Act 2001* and the *Singapore Penal Code 1871*.

Legislated maximum criminal penalties

494 Table 9 shows that maximum prison terms in New Zealand and Singapore are broadly consistent with those in Australia and other jurisdictions surveyed in REP 387. This supports the key finding in REP 387 that maximum prison terms in Australia are generally comparable with those in other jurisdictions, with the exception of the United States.

Table 9: Comparison of prison terms (years)

Country	Insider trading	Market manipulation	Disclosure	False statements	Unlicensed conduct	Fraud
Australia	10	10	5	10	2	10
Canada*	10	10	5	5	5	14
Hong Kong	10	10	—	10	7	10

Country	Insider trading	Market manipulation	Disclosure	False statements	Unlicensed conduct	Fraud
New Zealand	5	5	—	5	—	7
Singapore	7	7	7	7	3	Life[52]
United Kingdom	7	7	—	7	2	10
United States	20	20	20	20	20	20[53]

* References to 'Canada' in this section are to 'Canada (Ontario)'.

495 Table 10 demonstrates that the maximum fines in New Zealand and Singapore are generally less than those available in other jurisdictions considered in REP 387 (including Australia).

496 Even so, it remains the case that maximum fines in Australia are generally comparable with those available in the other jurisdictions surveyed. A breach of continuous disclosure obligations, as highlighted in REP 387, remains an exception to this general rule.

Table 10: Comparison of fines for individuals ($AUD)[54]

Country	Insider trading	Market manipulation	Disclosure	False statements	Unlicensed conduct	Fraud
Australia	Greater of $765,000, or 3 times the benefit gained	Greater of $765,000, or 3 times the benefit gained	$34,000	Greater of $765,000, or 3 times the benefit gained	$34,000	Greater of $765,000, or 3 times the benefit gained[55]
Canada	Greater of $5.25 million, or 3 times the benefit gained	$5.25 million	$5.25 million	$5.25 million	$5.25 million	—
Hong Kong	$1.44 million	$1.44 million	—	$1.44 million	$720,000	—
New Zealand	$459,601	$459,601	—	$459,601	$9,192	—

[52] Under s409 of the Singapore Penal Code, criminal breach of trust by a public servant, or by a banker, merchant or agent, attracts imprisonment for life, or imprisonment for up to 20 years. Like the fraud provisions in a number of other jurisdictions, this offence is not specific to the provision of financial services.

[53] Fraud offences that amount to 'securities and commodities fraud' attract a maximum prison term of 25 years under the *Sarbanes-Oxley Act 2002*: see 18 U.S.C. § 1348.

[54] All monetary conversions in this appendix are based on the daily exchange rate published by the RBA as at 31 December 2013.

[55] This is the maximum fine for dishonest conduct under s1041G of the Corporations Act. While this section is not specifically directed towards fraud, conduct that constitutes fraud also frequently raises issues of dishonest conduct.

Country	Insider trading	Market manipulation	Disclosure	False statements	Unlicensed conduct	Fraud
Singapore	$220,790	$220,790	$220,790	$220,790	$132,474	Fine (unlimited)
United Kingdom	Fine (unlimited)	Fine (unlimited)	—	Fine (unlimited)	Fine (unlimited)	Fine (unlimited)
United States	$5.6 million	$5.6 million	$5.6 million	$5.6 million	$5.6 million	$5.6 million

Non-criminal penalties

497 Like Australia, there is limited power to impose administrative penalties in New Zealand, although the New Zealand Financial Markets Authority is able to issue infringement notices for certain offences. In contrast, the Monetary Authority of Singapore has the power to impose administrative fines for certain types of wrongdoing, such as unlicensed conduct.

498 Table 11 provides further support for the key finding in REP 387 that the maximum non-criminal penalties in other jurisdictions, including New Zealand and Singapore, are higher than the maximum non-criminal penalties available in Australia.

499 Both New Zealand and Singapore have maximum civil penalties of three times the amount of the profit gained or loss avoided by the wrongdoer. Depending on the financial benefit obtained as a result of the misconduct, these penalties have the potential to be much higher than the maximum civil penalties in Australia—that is, $AUD200,000 for an individual and $AUD1 million for a corporation.

Table 11: Comparison of civil and administrative penalties for individuals ($AUD)[56]

Country	Insider trading	Market manipulation	Disclosure	False statements	Unlicensed conduct	Inappropriate advice
Australia	Civil: $200,000	Civil: $200,000	Civil: $200,000	—	—	Civil: $200,000
Canada	Administrative: $1.05 million	Administrative: $1.05 million	Administrative: $1.05 million	Administrative: $1.05 million	Administrative: $1.05 million	Administrative: $1.05 million

[56] This table does not address the availability of disgorgement, which is addressed in Table 4 of REP 387. Some contraventions that do not attract a civil or administrative penalty may nonetheless be subject to disgorgement orders. For example, in Hong Kong, market manipulation does not attract a civil or administrative penalty, although disgorgement is available.

Country	Insider trading	Market manipulation	Disclosure	False statements	Unlicensed conduct	Inappropriate advice
Hong Kong	Administrative: unlimited	—	Civil: $1.12 million	—	—	Administrative: greater of $1.4 million, or 3 times the benefit gained
New Zealand	Civil: greater of $919,202, or 3 times the benefit gained	Civil: greater of $919,202, or 3 times the benefit gained	Civil: greater of $919,202, or 3 times the benefit gained	Civil: greater of $919,202, or 3 times the benefit gained	Civil (in certain cases): greater of $919,202, or 3 times the benefit gained	—
Singapore	Civil: $1.77 million, or 3 times the benefit gained	Civil: $1.77 million, or 3 times the benefit gained	Civil: $1.77 million, or 3 times the benefit gained	Civil: $1.77 million, or 3 times the benefit gained[57]	Administrative: $66,237	—
United Kingdom	Civil and administrative: unlimited	Civil and administrative: unlimited	Administrative: unlimited	Civil and administrative: unlimited	—	Administrative: unlimited
United States	Civil: 3 times the benefit gained[58]	Civil: greater of $111,000, or the benefit gained	Civil: greater of $111,000, or the benefit gained	Civil: greater of $111,000, or the benefit gained	Civil: greater of $111,000, or the benefit gained	Administrative: $83,850

Availability of disgorgement

500 Disgorgement is not available in New Zealand and Singapore: see Table 12. However, both jurisdictions have civil penalty provisions that prescribe a maximum non-criminal penalty of three times the amount of the profit gained or loss avoided. This means that the courts have the discretion to impose a penalty that is more than the financial benefit gained from the wrongdoing.

[57] Administrative penalties are also available for false or misleading statements or omissions made in the context of an offer of securities, which are contained in a prospectus, profile statement or application form for securities and that are materially adverse to investors. Under Singapore's Securities and Futures Act, the maximum administrative penalty is half the maximum fine prescribed for that offence.

[58] For control persons, the maximum non-criminal penalty is the greater of $AUD1.1 million, or three times the benefit gained.

Table 12: Availability of disgorgement in non-criminal proceedings

Country	Insider trading	Market manipulation	Disclosure	False statements	Unlicensed conduct	Inappropriate advice
Australia	×	×	×	×	×	×
Canada	✓	✓	×	✓	✓	✓
Hong Kong	✓	✓	×	✓	×	×
New Zealand	×	×	×	×	×	×
Singapore	×	×	×	×	×	×
United Kingdom	✓	✓	✓	✓	×	✓
United States	✓	✓	✓	✓	✓	✓

Key terms

Term	Meaning in this document
20/12 exemption	An exemption contained in s708(1) of the Corporations Act that provides that a prospectus is not required where an offering is limited to 20 people in 12 months up to a value of $2 million, or for offers of up to $10 million with an offer information statement.
ACCC	Australian Competition and Consumer Commission
ADI	Authorised deposit-taking institution—has the meaning given in s5 of the Banking Act
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services Note: This is a definition contained in s761A.
AFS licensee	A person who holds an AFS licence under s913B of the Corporations Act Note: This is a definition contained in s761A.
ANZ	Australia and New Zealand Banking Group Limited
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ASIC Act	*Australian Securities and Investments Commission Act 2001*
ASIC stakeholder survey	The regular independent survey of ASIC's stakeholders commissioned by ASIC. To date, ASIC has commissioned surveys to be undertaken in 2008, 2010 and 2013
ASIC's Service Charter	ASIC's policy on our service delivery targets for our most common interactions between ASIC and our stakeholders
automated order processing	The process by which orders are registered in a market participant's system, which connects it to a market. Client or principal orders are submitted to an order book without being manually keyed in by an individual (referred to in the rules as a DTR). It is through automated order processing systems that algorithmic programs access our markets
ASX	ASX Limited or the exchange market operated by ASX Limited
ATO	Australian Taxation Office
Banking Act	*Banking Act 1959*

Term	Meaning in this document
best interests duty	The duty to act in the best interests of the client when giving personal advice to a client as set out in s961B(1) of the Corporations Act
Business Names Register	The register of business names established and maintained under s22 of the *Business Names Registration Act 2011*
CFR	Council of Financial Regulators
CFR agency	Agencies currently participating in the Council of Financial Regulators: RBA, which chairs the Council, APRA, ASIC and Treasury
Ch 7 (for example)	A chapter of the Corporations Act (in this example numbered 7)
clearing and settlement facility licence	An Australian CS facility licence under s842B of the Corporations Act that authorises a person to operate a clearing and settlement facility in Australia.
[CO 07/428] (for example)	An ASIC class order (in this example numbered 07/428)
competition objective	A proposed statutory objective under the ASIC Act that would require ASIC to consider the effect on competition when implementing policy
Corporations Act	*Corporations Act 2001*, including regulations made for the purposes of that Act
CP 209 (for example)	An ASIC consultation paper (in this example numbered 209)
credit licence	An Australian credit licence under s35 of the National Credit Act that authorises a licensee to engage in particular credit activities
credit licensee	A person who holds a credit licence under s35 of the National Credit Act
EDR	External dispute resolution
EIOPA	European Insurance and Occupational Pensions Authority
equity market	A market on or through which offers to acquire or dispose of equity market products are made or accepted, the operator of which is an equity market operator
FCA	Financial Conduct Authority (UK)
FOFA	Future of Financial Advice

Term	Meaning in this document
FOS	Financial Ombudsman Service
FSB	Financial Stability Board
IDR	Internal dispute resolution
IMF	International Monetary Fund
INFO 153 (for example)	An ASIC information sheet (in this example numbered 153)
Insurance Contracts Act	*Insurance Contracts Act 1984*
interim report	*Financial System Inquiry: Interim report*, released by the Inquiry on 15 July 2014
IOSCO	International Organization of Securities Commissions
main submission	ASIC's first submission to this inquiry
market participant	A participant of a licensed market
Markets Disciplinary Panel	ASIC's Markets Disciplinary Panel, through which ASIC exercises its power to issue infringement notices and to accept enforceable undertakings in relation to breaches of the market integrity rules
MoneySmart	ASIC's website for consumers and investors (www.moneysmart.gov.au)
MySuper	A simple and cost-effective superannuation account type introduced by the Stronger Super reforms, which will eventually replace existing default superannuation accounts
National Credit Act	*National Consumer Credit Protection Act 2009*
National Financial Literacy Strategy	A strategy published by ASIC in 2014, replacing the first strategy published in 2011, aiming to promote a national approach to improving the financial wellbeing and literacy of all Australians
OBPR	Office of Best Practice Regulation
OECD	Organisation for Economic Co-operation and Development
OTC	Over the counter
PI insurance	Professional indemnity insurance
policy option	Policy option set out by this inquiry in its interim report

Term	Meaning in this document
Product Disclosure Statement (PDS)	A document that must be given to a retail client in relation to the offer or issue of a financial product in accordance with Div 2 of Pt 7.9 of the Corporations Act Note: See s761A for the exact definition.
Pt 9.4AAA (for example)	A part of the Corporations Act (in this example numbered 9.4AAA), unless otherwise specified
Public Service Act	*Public Service Act 1999*
RBA	Reserve Bank of Australia
reg 7.6.02 (for example)	A regulation of the Corporations Regulations (in this example numbered 7.6.02), unless otherwise specified
REP 240 (for example)	An ASIC report (in this example numbered 240)
RG 97 (for example)	An ASIC regulatory guide (in this example numbered 97)
RSE licence	Registrable superannuation entity licence (granted by APRA)
s961B (for example)	A section of the Corporations Act (in this example numbered 961B), unless otherwise specified
securities dealer	An entity that is an AFS licensee but is not in itself a market participant and that accesses the market on behalf of its clients through a market participant
Senate inquiry	Senate Economics References Committee inquiry into the performance of the Australian Securities and Investments Commission (ASIC)
shadow banking	Activities that are banking business or have a similar function to banking business, principally involving credit intermediation, by entities that are not regulated in a way that is substantially similar to banks
shorter PDS	A PDS that is required to comply with the shorter PDS regime
shorter PDS regime	The requirements set out in Div 3A of Pt 7.9 of the Corporations Act as modified by Subdivs 4.2 to 4.2C and Schs 10B, 10C, 10D and 10E of the Corporations Regulations, which prescribe the content and length of the PDS for first home saver accounts, margin loans, superannuation products and simple managed investment schemes
Simple Corporate Bonds Bill	Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2014
SIS Act	*Superannuation Industry (Supervision) Act 1993*

Term	Meaning in this document
SMSF	Self-managed superannuation fund
SMSF auditor	The auditor of an SMSF responsible for the financial and compliance audit of the fund's operation
Stronger Super reforms	Reforms implemented in response to the Super System Review and contained in the following Acts (and associated regulations): • *Superannuation Auditor Registration Imposition Act 2012* • *Superannuation Laws Amendment (Capital Gains Tax Relief and Other Efficiency Measures) Act 2012* • *Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Act 2012* • *Superannuation Legislation Amendment (MySuper Core Provisions) Act 2012* • *Superannuation Legislation Amendment (Service Providers and Other Governance Measures) Act 2013* • *Superannuation Legislation Amendment (Stronger Super) Act 2012* • *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012* • *Superannuation Supervisory Levy Imposition Amendment Act 2012*
superannuation entities	Large regulated superannuation funds, approved deposit funds and pooled superannuation trusts
this inquiry	Financial System Inquiry
Wallis Inquiry	Financial System Inquiry (1997)