

# EXECUTIVE SUMMARY

## The ASC

1. The ASC began operations on 1 January 1991 and is responsible for the administration of the Corporations Law throughout the Commonwealth, States and Territories. The ASC is required by its mandate to be both a business facilitator and an investor protector in carrying out its functions. The ASC also has a dual regulatory role: corporate regulation and market regulation. The Inquiry's Terms of Reference exclude the regulation of the general operation of companies through the Corporations Law (Chapter 1 and Appendices 1 to 6 for details).

## Forces for change

2. In the mid 1990s the ASC considers there is a transition occurring: a transition to a world where more individual Australians will be actively involved in managing the risks of personal long term market investments. These investments will be made in an emerging international market with fewer institutional, product and geographic boundaries.
3. Accordingly, investors will face a shift from a world where they had limited involvement in or choice between financial products, and experienced little competition as to price or other product attributes. Investors will face a world where all Australians will be increasingly involved in providing for their own retirement income, where they will need to become more sophisticated about understanding and managing risk; and where they will be faced with a greater array of products and services marketed more actively by financial intermediaries. Regulatory arrangements for this new marketplace must actively support both investor participation and product innovation in a cost-effective way (Chapter 2).

## Regulatory objectives and principles

4. The ASC recommends that the Inquiry should set as a key objective for financial market regulation the promotion of confidence in the integrity of our financial markets, market participants and their systems (Chapter 3).

5. The ASC is of the view that the current regulatory system is basically sound. However, current market trends provide both opportunities and challenges for current regulatory arrangements in a number of areas. The ASC considers that regulatory expertise and issues of style and culture of regulation are more important than changes in administrative structures in delivering effective regulatory outcomes. Accordingly, the ASC recommends the Inquiry adopt some general principles to guide regulation of the financial markets (Chapter 4). These principles are discussed in the submission and cover the following matters.
- ♦ focusing on identifying regulatory risks and performance outcomes;
  - ♦ emphasising the international nature of financial market activity;
  - ♦ ensuring flexibility in the setting and delivery of regulation;
  - ♦ promoting a higher level of commercial and market expertise, skill and experience within regulators;
  - ♦ promoting independent and accountable administration;
  - ♦ promoting open and transparent policy and administrative processes;
  - ♦ promoting effective and timely remedial and enforcement capacities; and
  - ♦ promoting cost-effective and service-orientated delivery of regulation.

## Structure of regulation

6. The ASC is of the view that there is no one best way in which administrative arrangements can be structured and that all alternatives bring their own advantages and disadvantages. The ASC favours an incremental approach that builds on existing legislation and regulatory bodies and recognises there will continue to be a mix of institutional and functional regulation.
7. This includes using the existing national scheme for corporate and securities regulation to the maximum extent possible. The national scheme laws have overcome the practical limitations on the Commonwealth's constitutional power to implement changes in the area of corporations and securities regulation.
8. In this regard, the advantages of an integrated companies and market regulator should be recognised. Many overseas jurisdictions have separate bodies performing the functions of corporate regulation and financial market regulation, or have split market regulation into a range of agencies. This leads to considerable difficulties, particularly in the area of enforcement.

## **Doubts about benefits of a single regulator for both market and prudential regulation**

9. Clearly there is potential for some savings made through a "merger" of all regulators into a single regulator, as well as some coordination benefits. However, as with all mergers, there is no guarantee that those savings will be realised, and often considerable management time must be committed to merger issues - resulting in a medium term increase in inefficiencies. At this time, we have no details on what the potential savings might be, or, more importantly, what the costs of change might be, and further substantial study should be undertaken before this option could be realistically considered.

## **Structure of prudential regulation**

10. Prudential regulation is concerned with supervising the solvency of institutions and with the stability of the financial system as a whole, including the payments system. The ASC can understand that there would seem to be some arguments for combining all current prudential activities of the RBA, AFIC and ISC into a single prudential regulator. The ASC is not well placed to assess whether the benefits, including economies of scale and scope, of a single prudential regulator would outweigh the advantages of specialist expertise of the current individual prudential regulators in this area.

## **Support the coordination role of the Council of Financial Supervisors (COFS)**

11. Financial conglomerates are of increasing importance both domestically and internationally. In Australia financial conglomerates account for 75 per cent of domestic financial assets.
12. The ASC supports the current arrangements for the oversight of conglomerates on a solo plus basis (that is, prudential regulation of the parent supported by appropriate regulation of the various subsidiaries) and for COFS to continue to monitor international developments in this area (Chapter 3).
13. The role of COFS in coordinating system wide issues relating to supervising financial conglomerates, risks to system stability and other matters of regulatory consistency should be supported by the Inquiry.

## **Consistent product disclosure obligation**

### **All investment products to have clear and comprehensible disclosure**

14. The ASC recommends that a consistent, mandatory disclosure obligation should apply to all investment products offered to retail investors (Chapter 7). At present the regulation of the initial point-of-sale disclosure document differs significantly according to the nature of the investment product.
15. It is vital that retail investors be supplied with clear, comprehensible disclosure in a form which enables retail investors to assess and compare different investments. This is particularly important in an era likely to:
  - ♦ herald an increase in direct marketing of investment products;
  - ♦ lead to more product blurring; and
  - ♦ lead to greater involvement by retail investors in investment markets.

### **Regulation of disclosure based on outcomes not content**

16. A disclosure regime should be considered which focuses on the desired outcomes of disclosure and on the effectiveness of disclosure documents in communicating the desired information, not merely on prescribing the technical matters to be contained in product selling documents.
17. Before implementing this proposal, however, further investigation of several issues would be required. This includes investigating whether it is feasible to formulate a general disclosure test to cover all investment products and whether there are better ways of achieving comprehensible and comparable product disclosure.

## **No separate consumer financial services regulator**

18. The ASC does not support the establishment of a new and separate consumer protection regulator for financial services.
19. The key reason is that financial market regulation must balance the needs of consumers and business. There is a clear need for regulatory arrangements which take into account, and reconcile in a balanced manner, the competing needs and interests of consumers and business.
20. The ASC opposes the introduction of a separate consumer regulator for other reasons as well:

- ♦ it would add to the number of regulators and therefore runs the risk of creating further gap and overlap issues as the structure of the industry changes;
- ♦ it is unclear what functions a consumer regulator would be responsible for, and how the scope of its regulatory responsibilities would be determined; and
- ♦ it would result in a split in wholesale and retail market regulation. The consequences are dual regulation for entities involved in both areas, difficulties in clearly defining the boundaries and possible fragmentation of enforcement activity.

## **Single regulator for financial advisory services**

21. The ASC recommends that there should be a single regime administered by a single regulator for all financial advisory services (Chapter 8). This should be based on the Corporations Law and the recommendations contained in the ASC's Good Advice Report. While these proposals are currently being pursued as far as practicable through cooperative arrangements between the ASC and ISC, a single regime would allow the proposals to be implemented in a more efficient and cost-effective manner.
22. The regulation of advisory services should extend to any advice provided to consumers about a financial transaction involving securities, futures, superannuation, life insurance and deposits or deposit like bank/financial institution product. There should also be provision for extending regulation to similar advisory services (eg negative gearing advice) by regulation rather than legislative amendment.
23. The ASC supports the continuation of an active role for industry and professional bodies in the delivery of regulatory outcomes in the financial services industry. The ASC also supports the recognition in the law of the regulator's ability to delegate, under supervision, to such bodies. However, the ASC has reservations about making any further formal delegation of regulatory powers in this area at this stage.

## **An efficient complaints resolution system is essential**

24. The ASC recommends that there should be consistent coverage of consumer complaints relating to financial advisory services. The ASC considers that the regulator of financial advisory services should work closely with the current schemes to promote consistent coverage across all financial advisory services and to encourage the development of a complaints clearing house service.

## More consistent and coherent regulatory regime for managed funds

25. The current regulation of investment-linked managed funds is not consistent and coherent. Rather, it is split according to whether the product is a public unit trust or investment company (in which case it is regulated by the ASC) or an investment-linked life insurance or superannuation product (in which case it is regulated by the ISC). Different regulatory standards are applied to these different products, although the operational risks are broadly the same in all cases.
26. The ASC understands that this causes problems for industry as it leads to unnecessary costs being imposed on product issuers who wish to offer various investment-linked managed fund products, particularly unit trusts and superannuation. This is because more than one regulatory compliance system must be set up and administered. These costs are passed on to consumers. The differing regulatory standards also impede competition, which affects the international competitiveness of the Australian managed fund industry.
27. The ASC recommends that the current regulatory arrangements should be reviewed with a view to providing a more coherent and cost-effective regulatory regime for investment-linked managed funds (Chapter 9).

### Options for future regulation

28. There are several options for the future regulation of unit trusts and superannuation. Each option has advantages and disadvantages. Practical considerations and industry views should be taken into account in determining the most cost-effective option. The ASC considers that the new regulatory regime for managed funds should build on existing structures as far as possible. In practical terms, this means utilising existing ASC and ISC administrative arrangements.
29. The ASC considers that, subject to industry views about transitional and implementation issues, the preferable option is to build on existing national scheme laws and ASC infrastructure, including its enforcement capabilities.

### Other market regulation issues

30. The ASC's submission discusses and makes recommendations in relation to the following areas of market regulation:
  - ♦ the removal of some of the regulatory overlaps between existing consumer and competition regulation and the Corporations Law (Chapter 10);
  - ♦ the continued market regulation of clearing houses (Chapter 3);

- ♦ the importance of avoiding a split between wholesale and retail market regulation (Chapter 3);
- ♦ the need to minimise disruption to current international arrangements (Chapter 2 and Appendix 10);
- ♦ support for enhancing the role of professional bodies while avoiding some of the difficulties of formal self-regulation (Chapter 3); and
- ♦ the importance of continued support for current initiatives in relation to the Corporations Law Simplification program, the CASAC review of derivatives regulation, ASC initiatives on electronic commerce and simpler managed fund prospectuses and the current ASC/ISC harmonisation of financial advice requirements (Chapter 2 and Appendices 8 and 9).

## **Adequate funding and emphasis on cost-effectiveness**

31. There needs to be a stronger emphasis on regular assessment of regulatory outcomes and cost-effectiveness of the regulatory system. All regulators should be required to have appropriate mechanisms in place for assessing compliance costs and for assessing performance (Chapter 6).
32. The regulatory system must be adequately funded to enable it to meet community expectations. The regulatory system needs to be adequately funded through a mechanism which insulates the regulator from funding variations unrelated to specific regulatory policy decisions.
33. At a time of increasing pressure on public resources, a genuine user-pays funding system should be introduced for market regulation to supplement the budget allocations on which the ASC and other regulators are at present dependent. Any new funding mechanism should recognise the need to recast the burden of regulatory cost for smaller entities and that revenue sources should be better aligned with activity.

## **Contact details**

All queries in relation to this submission may be directed to the Chairman of the ASC, Mr Alan Cameron or the Director of Regulatory Policy, Mr Shane Tregillis, telephone no: 03-9280-3305 or facsimile no: 03-9280-3339.

# LIST OF RECOMMENDATIONS

## Chapter Two: The Financial System - The Regulatory Challenge

- ♦ The ASC recommends that support for investor participation and product innovation in our financial markets can best be achieved by:
  - ♦ building on the strengths of the current corporate and markets regulatory regime;
  - ♦ encouraging a style of regulation that is responsive to market innovation;
  - ♦ adopting a consistent framework for product disclosure; a single regime for all financial advice to retail investors; a more coherent and cost-effective regime for managed funds; and better coordination of financial services and competition regulation;
  - ♦ supporting current initiatives for: simplifying the Corporations Law; implementing the CASAC review of derivatives regulation; and implementing ASC initiatives on electronic commerce, simpler managed funds prospectuses and ASC/ISC harmonisation of financial advice requirements;
  - ♦ ensuring adequate funding for the regulatory system so it can meet community expectations. This would include implementing user-pay options and introducing a mechanism which insulates regulators from funding variations which are unrelated to their policies; and
  - ♦ promoting a greater emphasis on cost-effectiveness in the setting and delivery of regulatory outcomes.

## Chapter Three: Confidence in the Integrity of Our Financial Markets

- ♦ The ASC recommends that the Inquiry should set as a key objective for market regulation the promotion of confidence in the integrity of our markets, market participants and their systems:
  - ♦ confidence that investors have available the information to make informed investment decisions and that intermediaries do not place their own interests above those of the investors for whom they act;
  - ♦ confidence that market prices are reliable and the markets are free from misconduct, are transparent and operate fairly; and
  - ♦ confidence that the legal, operational and system infrastructure of our markets is sound.

- ♦ The ASC recommends that securities and derivatives clearing houses continue to be subject to authorisation and regulation as part of the market regulatory regime because of the important role they play in the operation of these markets, but that the Council of Financial Supervisors (COFS) should play an active coordinating role in areas where there are possible prudential or system-wide issues involved.
- ♦ The ASC recommends that the current approach of COFS members in adopting a solo plus approach to supervising financial conglomerates in Australia should be supported by the Inquiry. The ASC recommends support because the COFS approach is consistent with international standards.
- ♦ The ASC recommends that disclosing prudential, insurance or guarantee arrangements for financial products should be part of the point-of-sale disclosure framework in Australia.
- ♦ The ASC recommends that the Corporations Law provides an appropriate regime for the regulating wholesale markets. There would be few advantages and many disadvantages in splitting wholesale and retail market regulation into separate agencies. The ASC supports the continuing emphasis on ensuring that requirements for retail transactions are not inappropriately applied to the wholesale markets. The focus of regulation for the wholesale markets should be on ensuring orderly markets and preventing misconduct. The regulator should be given sufficient powers to ensure that regulation is not applied inappropriately to the wholesale markets.
- ♦ The ASC supports the recognition in the law of the regulator's ability to delegate regulatory functions, under supervision, to industry and professional bodies. This delegation should be accompanied by authority to establish appropriate performance standards for those regulatory functions, ability to monitor performance and capacity to take effective action where those standards are not being met. However, the ASC has reservations about any further formal delegation of regulatory powers at this stage.

### Chapter Four: Responsive Financial Market Regulation

- ♦ The ASC recommends that the Inquiry adopt the following eight principles for market regulation.
  - ♦ A focus on identifying regulatory risks and on performance outcomes.
  - ♦ An emphasis on the international nature of financial market activity.
  - ♦ Flexibility in the setting and delivery of regulation.
  - ♦ A high level of commercial and market expertise, skill and experience within the regulator.
  - ♦ Independent and accountable administration.

- ♦ Open and transparent policy and administrative processes.
- ♦ Effective and timely remedial and enforcement capacities.
- ♦ Cost-effective and service orientated delivery of regulation.

### **Chapter Five: Effective Enforcement**

- ♦ The ASC recommends that the Inquiry adopt the principle that effective enforcement is a key focus of financial market regulation.
- ♦ The ASC recommends that the financial market regulator should have the ability to enter into effective cooperative relationships with other regulators, exchanges and industry bodies.
- ♦ The ASC recommends that the financial market regulator should possess adequate enforcement powers, including a full portfolio of enforcement responses.
- ♦ The ASC recommends amending the law to enhance its enforcement capabilities:
  - ♦ to expressly provide that written records of examinations conducted by the ASC are admissible in proceedings for alleged contravention of national scheme laws;
  - ♦ so that the laws of evidence are made uniform throughout Australia;
  - ♦ to be given express power to provide, subject to conditions imposed by the ASC, a copy of a record of examination to an examinee's lawyer, and a copy of a tape of the examination to the examinee and to their lawyer;
  - ♦ to allow for a compelled answer by an accused to be available for use when the person has contradicted it at his or her trial;
  - ♦ to allow the ASC to accept legally enforceable undertakings in relation to compliance with national scheme laws and matters over which the ASC has jurisdiction;
  - ♦ to allow for a management banning order to be sought once it has been established that a person has breached a civil penalty provision, whether or not subsequent criminal proceedings may be pursued; and
  - ♦ to protect from liability those people who provide investigative assistance or information to the ASC on a voluntary basis.

### **Chapter Six: Cost-Effective Regulation**

- ♦ The ASC recommends:

- ♦ that the regulatory system needs to be adequately funded;
  - ♦ that a funding mechanism which insulates the regulator from funding variations unrelated to specific regulatory policy be adopted; and
  - ♦ that any new funding mechanism recognise the need to recast the burden of regulatory cost for smaller entities and that revenue sources be better aligned with activity.
- ♦ The ASC recommends that the emphasis on cost-effective regulation should be a key principle underlying the regulatory system and that all regulators should have in place appropriate mechanisms for compliance cost and performance assessment.

### **Chapter Seven: Product Disclosure**

- ♦ The ASC recommends that a consistent, mandatory disclosure obligation should apply to all investment products offered to retail investors.
- ♦ A disclosure regime should be introduced which focuses on the desired outcomes of disclosure and on the effectiveness of disclosure documents in communicating the desired information, not merely on prescribing the technical matters to be contained in product selling documents.

### **Chapter Eight: Financial Advisory Services**

- ♦ The ASC recommends that there should be a single regime administered by a single regulator for all financial advisory services. The content of regulation should be based on the Corporations Law and the proposals in the ASC's Good Advice Report.
- ♦ The ASC recommends that there should be consistent coverage of consumer complaints against financial advisory services. The ASC recommends that the regulator should work closely with current schemes to identify opportunities for rationalisation, encourage consistent coverage across all financial advisory services and promote the development of a complaints clearing house service.
- ♦ The ASC recommends that the Law should recognise the capacity of the regulator to delegate functions to industry and professional bodies. This recognition should be combined with appropriate powers to establish performance standards for the delivery of these regulatory functions.
- ♦ The ASC recommends that the regulator should have the legal capacity to play an active role in developing, formulating, and monitoring compliance with codes of practice in a wide range of areas which are relevant to retail consumers of financial services.

## Chapter Nine: Managed Funds

- ♦ The current regulatory arrangements should be reviewed with a view to providing a more coherent and cost-effective regulatory regime for investment-linked managed funds.
- ♦ Market regulation is the appropriate form of regulation for investment-linked managed funds.
- ♦ There are several options for the future regulation of unit trusts and superannuation. Each option has advantages and disadvantages. Practical considerations and industry views should be taken into account in determining the most cost-effective option.
- ♦ The new regulatory regime for managed funds should build on existing structures as far as possible. In practical terms, this means utilising existing ASC and ISC administrative arrangements.
- ♦ The ASC considers that, subject to industry views about transitional and implementation issues, the preferable option is to build on existing national scheme laws and ASC infrastructure, including its enforcement capabilities.

## Chapter Ten: Consumer And Competition Regulation

- ♦ The ASC recommends that the overlap between s52 of the Trade Practices Act and ss995 and 996 of the Corporations Law be removed. At present, this regulatory overlap means that issuers preparing prospectuses or advertising an issue of securities must comply with two laws designed to achieve the one basic objective - to prevent misleading or deceptive conduct. In cases where the Corporations Law applies, s52 of the Trade Practices Act should not apply.
- ♦ There is a need for regulation in the financial markets which balances and reconciles the needs and interests of consumers and business. Accordingly, it would not be appropriate to rely on a generic consumer protection regime to regulate financial market activity.
- ♦ There is a need to for better coordination between the roles of the ACCC and the Treasurer on ASX and SFE rule amendments. One option for consideration would be for the ASC rather than the Treasurer to assume the role of approving rules and procedures of exchanges and clearing houses. The approval process would involve consulting with the ACCC.