

Australian Shareholders' Association Limited

ACN 000 625 669

Submission to:

FINANCIAL SYSTEM INQUIRY

September 1996

1. Introduction

The Australian Shareholders' Association (ASA) makes this submission as the representative of individual investors in Australia. About 2.6 million investors or approximately 21% of all adults own shares and other securities either directly or by way of interests in collective investments. The ASA seeks to protect and advance the interests of these investors. Further information about the role, structure and activities of the ASA is contained in the Appendix.

As the declared objective of the Inquiry is to make recommendations on the nature of future regulatory arrangements that will *underpin stronger economic performance*, individual investors have a vital interest in the outcomes of the Inquiry.

2. Purpose

The ASA is primarily concerned that Australia has an effective (ie. legislatively empowered, well-resourced, skilful, credible) and efficient (ie. effective at an affordable cost) system for the prudential supervision of financial intermediaries and regulation of users of publicly-raised capital. This system should be fair to all participants and should be seen to be fair. It should ensure that a level playing field is provided for all investors.

The ASA is aware of the debate over the desirability or otherwise of a mega-regulator and the conjecture about mergers of major banks. While these matters are of great interest to many investors and may be significant issues for the Inquiry, the ASA believes it is more important that there be substantive improvements in the regulation and prudential supervision of all organisations using the capital of investors.

3. Problems with the Existing Financial System

The following problems are identified from the perspective of the individual investor:

- The failure of many companies and other organisations because of inadequate systems of prudential supervision and regulation, rather than inherent performance problems.
- The apparent ineffectiveness of the Australian Securities Commission (ASC) in policing the corporate sector. In addition to the many well-publicised failures of the ASC to bring high profile corporate crooks to justice it often appears that the ASC is constrained by a lack of resolve and a lack of personnel with the appropriate commercial experience. It is of serious concern that the ASC's resources have been cut recently and that there is apparently pressure to cut them further.

- In many cases the apparent ineffectiveness of auditors to draw investor attention to asset valuation and performance problems with organisations.
- The failure of the ASC to suspend or revoke the licences of fund managers and advisers or to enforce any of the other powers of the ASC in cases where major losses have been suffered by many investors. These losses arose because fund managers failed to convey material information to investors about the risks involved.
- The inordinate amount of time it takes for the ASC/DPP and other regulatory bodies such as the National Crime Authority to mount actions in the courts. It has been said that corporate criminals in the US are indicted, tried and have served their sentences, before Australian regulatory bodies have completed their investigations. Justice must be done with reasonable expedition and it must be seen to be done.
- Major company floats and de-mutualisations have and will continue to create problems for new investors entering the sharemarket. The ‘average’ person struggles with the complexities of relevant legislation and regulation.
- Individual investors are at a distinct disadvantage to both the institutional investors and the users of capital. Notwithstanding the continuous disclosure provisions, they generally lack timely access to price-sensitive information. Individual investors have neither the capability nor the capacity for research and analysis as do the institutional investors.
- The failure, at least until recently, of other authorities such as the Insurance and Superannuation Commission to upgrade both accountability and reporting requirements to investors of the institutions under their control.
- The lack of investor representation on regulatory bodies. While a goal of the Howard government is to “make business once again the business of the Australian people” the ASA noted that the ‘people’ are not represented on the Financial System Inquiry. Members of the Inquiry include a director, a solicitor and two professors and the Inquiry is chaired by a businessman. All are distinguished in their field but there is no representative of participants in the financial sector. This is consistent with a general failure to provide investors with more say in how their money is regulated and supervised.

4. Issues for Consideration by the Inquiry

As stated earlier, the ASA is more concerned about the quality and effectiveness of regulation and prudential supervision than with the issue of whether there should be a mega-regulator or not. In the light of this objective the following suggestions are submitted for consideration by the Inquiry:

1. Prudential supervision should be particularly effective in relation to banks and other deposit-taking intermediaries because they are typically the entry-level vehicles for new and inexperienced investors. With the move away from defined benefit plans to accumulation plans there also needs to be more effective prudential supervision of superannuation funds. In both

cases this will give 'ordinary' Australians confidence in financial institutions and increase the rate of domestic savings.

2. According to the Section 1 (2) of the ASC Act 1989 the Australian Securities Commission must strive, inter alia, to maintain the confidence of investors in the securities markets and futures markets by ensuring adequate protection of such investors. It is important that this objective be given priority and pursued strongly by ensuring that the regulator(s) has adequate resources, adequate powers and adequate determination. The regulator(s) must be able to quickly gain credibility among the participants in the financial system.
3. The financial and taxation system should have the effect of encouraging Australians to use a more diverse range of investment assets, including those that will bring higher rates of return over the longer term. At present, the proportion of Australians investing in shares is still below the levels of many other countries. Significantly, these are the assets which offer the greatest assistance to productive enterprises. It is also particularly important in this context to provide a regulatory environment that will attract international investors and capital to Australia.
4. Legislation affecting all investors should be easily understood, unequivocal, readily enforceable and up-to-date. It should protect investors from corporate cowboys and pirates and provide at least some assurance that investors' rights are not going to be restricted, endangered or ignored. While the simplification of the Corporations Law is an excellent start to making legislation more understandable, the legislation itself still does not provide effective remedies for the investor. Obtaining the benefit of statutory rights often means litigation, but if investors cannot fund their litigation, any rights under the law are next to worthless.
5. Consideration should be given by the ASC and the DPP to making greater use of civil actions where appropriate rather than criminal proceedings.
6. The system of regulation and supervision should take account of developments such as home banking over the internet and be flexible enough to adapt to technological changes not presently apparent.
7. In view of the global nature of capital markets, the legislation and its ensuing processes must be compatible with those in comparable jurisdictions. The regulator(s) must be authorised to cooperate with like bodies in those places and be enabled to investigate and prevent the use of tax havens, numbered bank accounts and other dubious devices.
8. Investors should be encouraged by the financial system to take a greater interest in monitoring and managing their investments. They should be more involved in the decisions that affect their savings or investments and have a greater role on the regulatory bodies. There is for instance a provision under section 9 (1) and 9 (3) of the ASC Act for the appointment of part-time members to the Australian Securities Commission. The ASA understands that no part-time members have ever been appointed and the ASC is, in effect, run by public servants. An investor representative on the Commission might galvanise the ASC into action.

Investors should also be represented on the controlling boards of organisations such as banks, companies, building societies, credit unions, insurance companies, superannuation funds and property trusts.

9. There has been considerable confusion about the regulatory environment involving floats. Not only should all information be provided in a prospectus to enable an investor to make an informed decision, but it should be easily understood. The ASC policy with respect to the post-vetting of prospectuses should be transparent and should at least ensure that the major floats are examined.
10. The role of the Corporations and Securities Panel should be examined. At present the Panel has a limited function in determining whether unacceptable conduct has occurred in relation to an acquisition of shares. The constitution and powers of the panel should be reviewed to make it more effective.
11. There should be consistency between the regulatory requirements governing advisers who give wide-ranging investment advice and those giving advice say in the life insurance, stockbroking and real estate areas. Among other matters, advisers should know the client's circumstances and needs, ensure that recommendations are appropriate and that advice (and the reasoning behind it) is recorded for audit trail purposes.
12. There should be uniform investor and consumer protection laws and regulations across Australia. By having one national financial system, investors will benefit from having the same rights regardless of where they live.
13. The ASA supports in principle a number of recommendations made to the Inquiry by the Australian Securities Commission, in particular:
 - That in the event no changes are made to the present regulatory structures, the ASC be given the power to regulate disclosure and sales practices of all investment-linked managed funds, undertake fund manager approval and operational monitoring.
 - The implementation of a single regime for investment advice based on the Corporations Law and the ASC's Good Advice Report.
 - The adoption of a consistent framework for product disclosure for all investment products offered to retail investors.
 - To allow the regulator(s) to accept enforceable undertakings.

5. Conclusion

It is important to strike the right balance between business facilitation and investor protection. The ASA does not advocate regulation at any cost and does not want to see entrepreneurship, initiative or innovation stifled. Business growth and Australia's long-term economic performance depends on the effectiveness of the regulation and prudential supervision of intermediaries. Adequate investor protection will encourage savings and enhance the capacity of the market to continue creating wealth and prosperity for all Australians.

ABOUT THE AUSTRALIAN SHAREHOLDERS' ASSOCIATION

1. BACKGROUND

The Australian Shareholders' Association was established as a non-profit organisation in 1968, to represent the interests of all Australian investors, including shareholders, unit holders, note holders and investors in property and equity trusts and insurance and superannuation bonds.

The Association is incorporated as a company limited by guarantee. The Memorandum of Association provides that the income and property of the Association shall be applied solely towards the promotion of the objects of the Association and that no portion of that income or property shall be paid or transferred directly or indirectly by way of profit to the members of the Association.

The Association comprises a board of ten directors and a supporting network of branch councils in Sydney, Melbourne, Brisbane and Adelaide. All directors and councillors serve in an honorary capacity and draw no fees or other remuneration for services. The day-to-day running of the Association is handled by an Executive Officer based at the national office in Sydney.

The Board meets once a month in Sydney and Branch Councils meet on a monthly basis at the other locations. Monthly information meetings are also held at Australian Stock Exchange premises in Sydney, Melbourne, Brisbane and Adelaide to review and examine shareholder issues. These meetings are attended by members and the public. Investor Relations and Corporate Governance Committees involving some forty members meet on a monthly basis.

2. ACTIVITIES OF THE ASSOCIATION

The ASA seeks to protect and advance the interests of individual investors through a range of activities, in particular:

- Representing and acting on behalf of investors when their rights are modified, reduced or ignored.
- Bringing to the attention of the public and the media any breakdowns in corporate accountability and securities market regulation.
- Making formal submissions to government and regulators on investment matters and related legislation.

- Lobbying government, the Australian Securities Commission and the Australian Stock Exchange to effect reforms to the Corporations Law, listing rules or other matters affecting the interests of investors.
- Procuring and supplying company annual reports to overseas proxy analysis services and having access to their reports on the corporate governance of Australian listed companies.
- Enhancing Australia's reputation in financial markets. (eg. the Association presents annual Media Awards to recognise both journalistic excellence and integrity in the reporting of investor related matters and outstanding contribution to shareholder interests)
- Providing information and guidelines on important investment issues.

3. CO-OPERATION WITH OTHER ORGANISATIONS

The ASA liaises extensively with bodies representing other groups of participants in financial markets and the securities industry. In particular, the ASA enjoys cordial working relations with the Australian Institute of Company Directors, the Australian Employee Ownership Association, the Australian Investment Managers' Association, the Australian Stock Exchange, the Australian Securities Commission and the accounting bodies.
