

## **S P E E C H E S**

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### **Rationalisation of the Australian Regulatory System by Alan Cameron AM Chairman Australian Securities and Investments Commission**

The signing today of the Memorandum of Understanding between the Malaysian Securities Commission and the Australian Securities and Investments Commission is a landmark event in the regulation and facilitation of financial markets in the south east Asia region. Regulators, central banks and market participants in the region are faced with difficult and complex challenges in the coming months. It is therefore very appropriate that we have chosen now as the time to enhance the co-operative and regulatory links between Malaysia and Australia.

The system of financial regulation in Australia, financial market participants and the regulators themselves have been subject to intense scrutiny over the past two years. Today I intend to give you an overview of the changes which have taken place in the Australian regulatory system and some of the reasons for those changes.

#### **REGULATION OF THE FINANCIAL SYSTEM IN AUSTRALIA Financial System Inquiry**

As many of you may be aware, the Australian Government is now in the last stage of implementing the result of a significant and all-encompassing review of the Australian financial system; the first major review since the early 1980's, the period which saw the float of the Australian dollar and a substantial deregulation of the financial market.

In November 1995, the then Deputy Opposition Leader and shadow treasurer, now the Federal Treasurer, Mr Peter Costello announced that there was to be an inquiry into the Australian financial system. He suggested that there was room for rationalising regulation by function, rather than institutions. He referred to the separate and distinct regulatory functions of prudential supervision and consumer protection.

This, as far as I could see, was the first suggestion that there should be introduced to Australia regulation based on a functional distinction between products, as opposed to institutional supervision. Regulation based on products, such as bank deposits, or insurance policies; rather than according to institutions' predominant characteristics. According to the Treasurer, the existing need for rationalisation and harmonisation of the overlapping regulatory bodies had to be addressed - the objective not being to create more regulatory bodies, but to create a system of consistent and focussed prudential control and regulation.

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### Background - Regulation prior to 1995

Table 1: Regulation of the Financial System prior to the Inquiry

<u>Regulator</u>	<u>Financial Institutions</u>	<u>Financial Service &amp; Markets</u>
Reserve Bank of Australia	banks (consolidated)	currency issues foreign exchange dealers settlement
Australian Financial Institutions Commission	building societies credit unions special services providers	
Insurance and Superannuation Commission	life companies general insurers superannuation (pension) funds	insurance agents and brokers approved trustees (public offer superannuation)
Australian Competition and Consumer Commission		access to essential facilities restrictive trade practices/exemptions consumer protection prices surveillance
Australian Securities Commission	units trusts merchant banks finance companies pastoral finance companies	fundraising by corporations and trusts securities, futures and options exchanges exempt securities and futures markets (bonds, OTC derivatives) securities dealers and investment advisers futures brokers and advisers

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		auditors and liquidators accounting standards
State authorities	friendly societies trustee companies public trustees co-operative housing societies state government owned insurance offices	consumer protection consumer credit authorised trustee investment status insurance

Source: Financial System Inquiry Discussion Paper, November 1996

To give you a background to the impetus for the inquiry, prior to the beginning of 1995, there were 5 main financial regulators in Australia (as shown in Table 1); the Reserve Bank of Australia - the "central bank", the Australian Financial Institutions Commission, the Insurance and Superannuation Commission, the Australian Competition and Consumer Commission and the Australian Securities Commission, together with a number of State authorities who performed similar functions on a State level. As you can perhaps gather from the names of these agencies, the regulatory regime was geared towards the particular financial institutions and corporations operating in the market, rather than towards the types of products and services offered by those institutions.

### "Wallis"

The Financial System Inquiry, also known as the "Wallis Inquiry" after its Chairman, a prominent business leader, Mr Stan Wallis, was commissioned by the Australian government in 1995 with three major terms of reference:

1. to review the results of financial deregulation of the Australian financial system;
2. to analyse the forces driving change in the financial system, in particular, technological development; and
3. to recommend regulatory arrangements that will best ensure an efficient, responsive, competitive and flexible financial system to underpin stronger economic performance, consistent with financial stability, prudence, integrity and fairness.

It was apparent from these terms of reference that it was not the government's intention to avert some perceived impending economic boilover; rather, the need was to

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produce a more focussed regulatory framework, not so much "rationalised", but more efficiently and effectively structured, from the point of view of market participants, the public at large and the regulatory agencies themselves. In short, the Inquiry was not the result of a crisis, like the collapse of a bank, or a widespread perception of misconduct in the finance sector.

### **Recommendations of the Inquiry**

The Financial System Inquiry Final Report, released in March 1997, proposed a regulatory system based around three regulatory agencies:

- the "central bank", but without the role of bank supervision;
- a new prudential regulator; and
- a new corporations and financial services commission (the ASC re-named and re-named again to Australian Securities and Investments Commission or ASIC !!)

Broadly speaking, under the Wallis recommendations, each regulatory agency takes on responsibilities based on functionality and products rather than the type of institution and market sector.

The **central bank** is responsible for maintaining systemic stability. It continues to have powers as a lender of last resort to financial corporations who operate exchange settlement accounts with the Reserve Bank, but it ceases to have explicit responsibility for the protection of bank depositors. The central bank should act in the "national interest" and depositor protection functions should be transferred to the prudential regulator.

The central bank remains as the regulatory authority responsible for the integrity of the payments system. A separate subsidiary board to the Reserve Bank of Australia board is to be established to oversee this specific function.

The **prudential regulator** has responsibilities in four major areas:

1. prudential regulation within the financial system of any licensed or approved financial entity, under Commonwealth jurisdiction;
2. issuing and revoking authorities for deposit taking institutions;
3. administration and enforcement of the requirements relating to superannuation, with a few exclusions to be administered by the Australian Taxation Office; and
4. management and control, under defined provisions, of any licensed financial entity which fails or (perhaps more importantly) is considered likely to fail.

The Inquiry also recommended establishment of a **single regulator for conduct and disclosure** in the financial system, responsible for financial market integrity, regulation of corporations, and financial sector consumer protection.

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But what is market integrity regulation ? It encompasses legislative and self-regulation arrangements which aim to ensure efficient, orderly and fair market participation, by improving the efficiency of pricing, allocation of capital, management of risk and the avoidance of fraud.

There are two categories of market integrity regulation:

1. disclosure rules - which address information gaps that investors can take appropriate risks based on the information provided to them; and
2. conduct rules - which aim to promote orderly and efficient price discovery, trading and settlement, as well as legal prohibitions on unfair trading and market manipulation.

The existence of market integrity promotes investor confidence and attracts foreign investment, whilst at the same time imposing costs and restrictions on market participants. There is consequently a need to strike a balance so as not to hamper competition and efficiency of financial markets by imposing unreasonably high costs or excessive restrictions and yet maintain high market standards.

In submissions to the Inquiry, synergies identified between market integrity and consumer protection regulation suggested that these roles should be the responsibility of a single agency. The Inquiry noted that market integrity regulation is conducted on a functional basis with responsibility vested in one regulator - the then-ASC, but that consumer protection was conducted in varying degrees by any one of three Commonwealth regulators, depending on the type of institution offering the product or service.

The Inquiry, at page 243 of the Final Report, considered that:

"Maintaining several specialised consumer protection regulators is unlikely to facilitate responsiveness to ... changes [in the financial system including new products, new modes of delivery, new entrants and changes in the mix of products offered]. Moreover, it results in financial service providers having to deal with several regulators and creates confusion for customers seeking to understand and compare substitutable products (often offered by the same financial group) or seeking redress when problems arise. It also requires regulatory agencies whose primary focus is prudential regulation to maintain expertise and powers in the quite different field of consumer protection."

The Inquiry went further to state that "...the tasks of consumer protection, market integrity and corporations regulation are more complementary than conflicting..", and recommended that the agency which is now ASIC should administer all consumer protection laws for financial services.