

# **SUBMISSION BY THE AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION**

## ***Executive Summary***

ASIC has responsibility for the regulation of securities and some derivatives markets in Australia. These markets are becoming increasingly subject to global influences due to internationalisation of economies and developments in electronic trading systems and other technologies. Many of the participants in Australian securities and derivatives markets are large global financial institutions.

ASIC is an active participant in international forums dealing with issues of global financial regulation, particularly through its membership of the International Organisation of Securities Commissions (IOSCO). IOSCO's current and past work has included issues relating to market stability and disclosure by market participants. Additionally ASIC has been an active participant in the Joint Forum which comprises representatives of banking, insurance and securities regulators from thirteen countries and which is currently chaired by the Chairman of ASIC.

ASIC believes that it is important that strategies dealing with international financial markets are dealt with in an international context. The need for closer co-operation across the range of international regulatory bodies and international financial institutions is increasing. In addition to current international frameworks, there may be merit in considering a regional grouping involving policy makers, regulators and regional financial institutions.

## **Overview of ASIC's regulatory role**

As the government regulator of both the securities and futures industry, ASIC has primary responsibility for administering the Corporations Law which regulates the operation of securities markets and futures markets and participants within Australia.

“Securities” and “futures” are both defined in the Corporations Law. The definition of securities covers shares, bonds and options. The definition of futures is designed to catch exchange traded futures and some but not all over-the-counter (OTC) derivatives. Many OTC derivatives traded in Australia fall outside the definition in the Law of either “securities” or “futures contract” and are thus traded on unregulated OTC markets.

Under current proposals in the Government's Corporate Law Economic Reform Program, an integrated regulatory framework for financial products and markets would be introduced (see *Financial Products, Service Providers and Markets - An Integrated Framework: Implementing CLERP 6, Consultation Paper*). This regime would apply to virtually all existing financial products including securities, futures and other derivatives, and foreign exchange.

ASIC is the sole statutory regulator of exchanges and clearing houses and persons conducting securities and futures businesses. However, securities and futures business is often undertaken by firms who are also supervised as banks or insurance companies by the Australian Prudential Regulatory Authority (APRA) or by firms which are part of banking or insurance groups. ASIC maintains close regulatory contact with APRA through a Memorandum of Understanding. The chairman of ASIC is a member of the APRA board. Additionally, ASIC and APRA, together with the Reserve Bank of Australia, are members of the Council of Financial Regulators which deals with a range of cross-sectoral issues.

ASIC has formal agreements (Memoranda of Understanding) with both the Australian Stock Exchange (ASX) and the Sydney Futures Exchange (SFE) for the efficient, transparent and orderly operation of their markets and their clearing and settlement arrangements. Under these agreements ASIC has agreed that it will be most efficient for primary responsibility for supervision of exchange members to rest with the

exchanges and that ASIC should exercise its responsibility for securities and futures markets generally by overseeing the exchange's supervision of their markets. For market supervision and enforcement issues the agreements establish a cooperative regulatory framework involving both ASIC and the exchanges. ASIC has a separate Memorandum of Understanding with the ASX relating to the arrangements under which ASX, as a listed company, is regulated.

ASIC's objectives in its activities in relation to the operation of securities and derivatives markets and clearing houses are to give market users confidence that they will be adequately protected in the markets on which they buy and sell securities and confidence in the integrity of their markets and to promote efficiency and competitiveness in the Australian markets. "Market integrity" includes ensuring that markets are not subject to disruptive volatility, are transparent, have a reliable price formulation process and are free of misleading, manipulative or abusive conduct.

ASIC relies on exchanges being front line regulators of their markets and members. The exchanges conduct the routine supervision examination of their members and must refer actual and potential non-compliance with the Corporations Law, or with business or listing rules, to ASIC.

Australian securities and futures markets have significant participation by international investors. The reasons for this include the fact that Australia has many companies which comprise significant parts of the world resource indices<sup>1</sup>, Australian markets are perceived to be well regulated and efficient, and Australia's small investment base means that many Australian companies need to seek investment funds overseas.

There is significant international participation in Australia's futures markets. This is because of Australia's time position between the close of the American markets and the opening of the European markets, and the SFE's sophisticated commodities futures trading facility.

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<sup>1</sup> Importantly for international institutional investors, Australia comprises over 1% of the Morgan Stanley Capital Index, and other world capital indexes, which means that most international index investors will seek to keep Australian shares in their portfolios.

The growing use of screen based trading, in securities and futures markets, will make international participation in Australia's markets (and vice versa) much easier because investors will be able to invest in Australia's markets directly from their home offices (albeit still suffering some time zone problems).

### **Current requirements for disclosure by market participants**

Under the Corporations Law, any person who acquires an interest in more than 5% of the shares of a listed company is required to notify the company within 2 days of the acquisition (Corporations Law s 709). Changes of more than one per cent in interests over 5% are also required to be notified (s 710). A copy of the notice served on the company is also to be provided to the stock exchange (s 713) and becomes publicly available information. The proposals currently before the Parliament in the *Corporate Law Economic Reform Program Bill 1999* (the CLERP Bill) will also include large positions in options in the substantial shareholding disclosure regime.

Although there are no statutory disclosure requirements for large positions in other areas the clearing houses of both the stock exchange's derivatives market, and the futures exchange require clearing members to report large positions for both capital and market stability purposes and may require persons to unwind large positions.

### **Continuous disclosure by listed entities**

Companies listed on the ASX are subject to continuous disclosure requirements under the ASX Listing Rules which in turn are underpinned by the Corporations Law. In effect, the companies are required to keep the market informed of material developments (those that are likely to be price sensitive) on an ongoing basis. Consistent with the division of responsibility between the ASX and ASIC described above, the ASX is responsible for the day to day administration of the continuous disclosure requirements.

The securities of a number of Australian companies are traded on overseas exchanges in addition to being traded on the ASX. In those cases, the companies are also subject to the disclosure requirements of the relevant overseas exchange.

## ***Current international regulatory activity***

### **IOSCO**

ASIC is a member of the International Organisation of Securities Commissions (IOSCO). The members of IOSCO include securities and futures regulators from almost 100 jurisdictions together with affiliate members such as exchanges and industry associations. ASIC is a member of the Executive Committee and the Technical Committee of IOSCO and is also a member of the Asia-Pacific Regional Committee.

### **IOSCO principles of Securities Regulation**

In September 1998 IOSCO published a set of Objectives and Principles of Securities Regulation (available on the IOSCO website at [www.iosco.org](http://www.iosco.org)). The Principles set out practices for securities regulation which IOSCO considers form the basis for effective securities regulation while recognising that the manner in which different jurisdictions carry out regulation may vary. IOSCO has set up a Task Force on the Implementation of the IOSCO principles which is presently considering a process for assessing compliance with the principles amongst IOSCO members. The task force is also liaising with the International Financial Institutions (World Bank, IMF etc) in their use of the Principles. ASIC is a member of this task force.

A number of the IOSCO principles are relevant to the operation of secondary markets. These are:

#### **B. Principles for Self-Regulation**

6. The regulatory regime should make appropriate use of Self-Regulatory Organisations (SRO's) that exercise some direct oversight responsibility for their respective areas of competence, to the extent appropriate to the size and complexity of the markets.
7. SRO's should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.

#### **D. Principles for Co-operation in Regulation**

11. The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.
12. Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.
13. The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.

#### H. Principles for the Secondary Market

25. The establishment of trading systems including securities exchanges should be subject to regulatory authorisation and oversight.
26. There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.
27. Regulation should promote transparency of trading.
28. Regulation should be designed to detect and deter manipulation and other unfair trading practices.
29. Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.

#### **Hedge funds and Highly Leveraged Institutions**

In December 1998 IOSCO's Technical Committee established a task force on hedge funds and other highly leveraged institutions (HLI's). The task force has made significant progress.

The major focus of initial considerations of the task force has been:

- the risks for securities and futures firms, and to the system as a whole, by the existence of leverage, by the low level of information disclosure by HLI's to their counterparties and the market generally and the lack of direct regulatory controls
- what measures can be taken (including appropriate regulatory incentives) to ensure that securities and derivatives firms dealing with HLI's as counterparties, lenders or investors have appropriate risk management processes
- what information securities and derivatives firms should require from HLI's with which they deal and whether some or all of this information should be provided to regulators or the market generally
- whether disclosure obligations should be imposed directly on HLI's and the difficulties in doing this.

ASIC is a member of the task force and has contributed to the work of the task force, particular in relation to suggested information requirements for securities firms in their dealings with HLI's and the information that HLI's might be required to provide to regulated secondary markets about their positions.

A significant conclusion of the task force is likely to be that the principal members of the international community of securities regulators must act in harmony in relation to HLI's to ensure that HLI's cannot avoid the intended regulation or disclosure merely by migrating to less regulated jurisdictions.

The task force is also considering ways in which IOSCO, the other international financial regulatory bodies and other interested parties might collaborate to improve regulatory standards in this area. Some of the other bodies considering these issues include the Basel Committee on Banking Supervision (the Basel Committee), the US President's Working Group on Financial Markets, the Counterparty Risk Management Policy Group (established by twelve major international banks and securities firms), the Financial Stability Forum and the Committee on the Global Financial System.

### **Trading and Derivatives Disclosure of Banks and Securities Firms**

In February 1999 the Basel Committee and the IOSCO Technical Committee issued a consultative paper with recommendations for public disclosure of the trading and

derivatives activities of banks and securities firms (available on the IOSCO website at [www.iosco.org](http://www.iosco.org)). The paper recommends that institutions should provide financial statement users with a clear picture of trading and derivatives activities. This should include both quantitative and qualitative descriptions and disclose major risks. Also institutions should disclose information produced by their internal risk measurement and management systems on their risk exposures and their actual performance in managing these exposures.

### **International standards**

The Technical Committee of IOSCO also has recently completed or has work in progress on a range of other matters which are likely to significantly influence the international approach to regulation of securities markets. These include:

- the possible adoption of international accounting standards<sup>2</sup> for cross border reporting purposes
- standards for cross border initial public offers and listing of equity securities
- cross border screen based trading
- global securities lending
- improvement and harmonisation of standards for regulated exchanges and clearing houses
- implications of the internet for securities exchanges.

ASIC is an active participant in much of this work. In regard to international accounting standards, it is noted that the CLERP Bill sets out a framework for, among other things, the potential harmonisation of Australian standards with international standards.

### **Joint Forum**

The emergence of financial conglomerates and the blurring of distinctions between the activities of firms in each financial sector has heightened the need for cooperative efforts to improve the effectiveness of supervisory methods and approaches. The Joint Forum on Financial Conglomerates was established in early 1996 by IOSCO, the Basel Committee and the International Association of Insurance Supervisors (IAIS), to

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<sup>2</sup> Standards issued by the International Accounting Standards Committee.



address the major supervisory issues relating to financial conglomerates that operate on an international basis. Its role is now being extended to deal more generally with cross sectoral supervisory issues and other matters of mutual interest to the parent bodies (and accordingly it has been renamed as the Joint Forum).

The Joint Forum is comprised of bank, insurance and securities supervisors representing each supervisory constituency. Thirteen countries are represented on the Joint Forum: Australia, Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Spain, Sweden, Switzerland, United Kingdom and United States. The EU Commission attends in an observer capacity.

ASIC is an active participant in the work of the Joint Forum. The Chairman of ASIC currently chairs the Joint Forum. In addition an ASIC officer is a member of the Forum; and ASIC together with the Basel Committee provide a secretariat for the Forum. APRA also participates in the work of the Joint Forum.

The Joint Forum has made significant progress in the development of principles and supervisory techniques for addressing some of the most significant issues involved in the supervision of financial conglomerates. This work is reflected in the Joint Forum's February 1999 papers (available on the iosco website at [www.iosco.org](http://www.iosco.org)) which include the following:

- the *Capital Adequacy Principles Paper*, which deals with the assessment of capital adequacy on a group wide basis, including dealing with issues of excessive gearing
- the *Fit and Proper Principles Paper* which provides guidance which is intended to insure that supervisors of entities within a conglomerate are able to exercise their responsibilities to assess whether those entities are soundly and prudently managed
- the *Principles for Supervisory Information Sharing Paper* which sets out guiding principles intended to assist supervisors in enhancing information sharing arrangements that will contribute to a more effective supervisory framework
- the *Coordinator Paper* which provides guidance to supervisors for the possible identification of a coordinating supervisor and a catalogue of possible roles and responsibilities in emergency and non emergency situations.

## ***International Enforcement Activities and Initiatives***

### **Information sharing and international investigative assistance**

ASIC has power to share information in its possession with Australian exchanges, with agencies of a foreign government and potentially with overseas exchanges (s 127 ASC Law). The *Mutual Assistance in Business Regulation Act 1992* gives ASIC power to obtain information and evidence on behalf of foreign regulators. ASIC has entered into Memoranda of Understanding with 20 foreign regulators to provide a framework for the exchange of information.

ASIC and the SFE are both signatories to the Declaration on Co-operation and Supervision of International Futures Markets and Clearing Organisations. The SFE is also a signatory to the International Information Sharing Memorandum of Understanding and Agreement. The Declaration and the Memorandum and Agreement provide for more timely and complete sharing among futures regulatory authorities and self-regulatory organisations, such as exchanges, of information about large futures exposures on exchanges that might put a futures trading firm, a related firm or a market at risk.

### **Enforcement Workshop**

ASIC is hosting an international enforcement workshop in November this year with the intention of sharing recent experiences and gaining some fresh insights from similar jurisdictions, particularly those operating in a common law environment including Canada, China, India, Malaysia, New Zealand, Singapore, the United Kingdom and the United States. The issues to be considered are expected to include gathering of evidence, document control and management; investigation planning, in particular the application of project management methodologies in a law enforcement environment; information technology support for investigations and enforcement activity generally; performance measurement; resource allocation and case selection criteria; accountability issues; and decision making processes in enforcement generally.

### **IOSCO Enforcement Working Party**

ASIC is a member of IOSCO's Working Party on Enforcement and Exchange of Information. A current mandate of the Working Party is cooperation between law enforcement authorities and regulators. This mandate seeks to improve and maintain legitimate assistance and information flow between agencies.

### ***Regional initiatives***

ASIC plays an active role in promoting and contributing to training initiatives in our region, both on its own behalf, and as a participant in initiatives sponsored by international organisations such as APEC, the Asian Development Bank and IOSCO. In particular, ASIC is represented on the Advisory Group developing and implementing an APEC financial regulators training initiative. This initiative aims to strengthen training processes in securities regulatory authorities; develop national training programs, by developing model curricula for securities regulators training; and coordinate regional and international training programs for financial supervisors.

In addition, ASIC continues to run a week-long residential Summer School each year. The ASIC Summer School is a postgraduate level, intensive forum for overseas and Australian market and regulatory participants. Overseas participants are mainly drawn from the Asia-Pacific region and (to a smaller extent) from further afield. Each year the School is organised around a topical theme which allows for the discussion and analysis of Australian market, regulatory and financial issues in the context of broader regional and international debates. For example, the 1999 ASIC Summer School focused on the current debates about the need to strengthen the infrastructure of domestic and global financial markets in the light of recent regional and international financial market volatility.

ASIC participated in a recent OECD Round Table on Securities Markets Reforms in the face of the Asian Financial Crises (proceedings available on the publications page of the Asia Development Bank Institute website at [www.adbi.org](http://www.adbi.org)).

### ***Influences on domestic regulatory approaches***

The global nature of financial markets mean that effective regulatory responses must often best be developed in an international context. This is particularly the case when the regulation seeks to impose requirements on firms and institutions which themselves have presences or bodies in many jurisdictions, and are able to move their operations easily between regulatory regimes.

Some examples where ASIC's domestic regulatory policy reflect international influences of this kind include the following:

- *Foreign securities prospectus relief* (ASIC Policy Statement 72): ASIC will exercise its discretionary powers to facilitate some offering in the Australian market of securities issued by foreign companies. This includes allowing the use of foreign prospectuses provided that they are accompanied by any additional information necessary to meet local disclosure requirements.
- *Offers of securities on the Internet* (ASIC Policy Statement 141): ASIC has a policy of focusing its regulatory/enforcement effort on those internet securities that are aimed at Australian investors. This approach is consistent with that taken by securities regulators in other jurisdictions and avoids the practical difficulties of seeking to regulate all offers placed on the internet on a global basis that may potentially be accessed by Australian investors.
- *Market stabilisation*: Consistent with the practice in major overseas jurisdictions, ASIC has permitted persons involved in significant initial public offerings to engage in market stabilisation activities whereby if necessary they acquire the securities on the secondary market for a short period after the initial quotation of the securities (and thereby provide price support). This practice helps ensure the success of major floats.
- *Multi jurisdictional takeover bids*: ASIC has recently exercised its discretionary powers to facilitate a takeover offer for certain 'stapled' securities consisting of a share of an Australian company and a share in a United States company. This was necessary to overcome problems arising from different requirements under applicable Australian and United States law.

### ***Future regulatory developments***

As discussed above, ASIC is an active participant in current international initiatives relating to the regulation of securities and futures markets. Increasingly ASIC is taking account of the fact, and advising Government that its, and Australia's regulatory and domestic activities take place in an international and not just domestic framework. Additionally, financial markets cannot be satisfactorily regulated without recognising the cross-sector issues. Matters involving not only securities and futures, but also banks, insurance and other financial products and markets must be taken into account in developing regulatory policies. The Wallis inquiry into the financial system and the subsequent reorganisation of regulatory structures in Australia in 1998 was in part driven by the Government's recognition of this integration of financial products

New international frameworks, such as the Financial Stability Forum, are providing an important forum by which both the international and cross-sectoral issues in financial regulation can be considered. In addition regional frameworks and institutions such as APEC and the Asian Development bank continue to have significance in developing effective financial regulation.