

CHAPTER 2

ADVANTAGES OF THE CURRENT FRAMEWORK

Introduction

2.1 This Chapter explores the Committee's first term of reference and sets out the advantages of the current framework, as identified in the evidence presented. The Chapter also briefly canvasses witnesses' and submitters' views about how well the framework functions.

2.2 A small number of submissions viewed the framework as flawed and in need of major change. However, the majority of organisations that made submissions, while not hesitating to make critical comment in some areas, generally supported the current supervisory framework and expressed the view that the ASX operates efficiently and with integrity. The predominant view was that the regulatory framework is generally appropriate.

Advantages of the current framework

2.3 A range of submissions and evidence identified advantages associated with the current framework. A major theme repeated on a number of occasions was that the market is well served by having as its front line supervisor an operator that is familiar with the day to day operations of the market and is able to respond quickly to developments in the market itself.

2.4 Advantages identified by ASIC and Treasury represent a fair cross section of those identified in other submissions. These included:

- the cost of market regulation is borne by market participants and users¹;
- the proximity of exchanges to market trading, activity and participants means that exchanges are well placed to supervise operations, transmit information and respond rapidly to irregularities in trading;
- the exchange's ability to adapt elements of supervisory arrangements through changes to operating rules to reflect the needs of the market and its users and cater for developments in business practices;
- the ability of exchanges to monitor market movements and respond quickly limits the potential for market abuse and aids the market as a reliable price discovery mechanism; and

¹ See Australian Securities and Investments Commission, Submission No. 8, p. 6.

- the framework bestows a commercial incentive on exchanges to ensure that they discharge their supervisory responsibilities effectively as they have a vested interest in maintaining reputation and attracting investment.²

2.5 The final point, the exchange having a commercial incentive to maintain standards, is particularly important. Because the ASX has a commercial incentive to maintain integrity, this may reasonably be expected to exert a counter to commercial pressures that might otherwise provide inducements to compromise integrity. In theory, this should result in the exchange being largely self policing. The ASX's key business asset is its reputation for integrity and efficiency and not one that it could compromise without threatening the value of its own business.

2.6 The ASX itself identified the advantages of the current framework as follows:

- in its detailed prescription of the activities of securities exchanges, its powers of intervention and calling to account, the framework promotes a high integrity environment; and
- in its strong self-regulatory emphasis, there is the ability to provide efficient market responsive rules and flexible and effective enforcement of them in a cost effective way for government.³

2.7 The ASX's submission summed up its own view of how well the current framework operates:

ASX believes that the co-regulatory model has served financial markets very well. Market operators like ASX have a strong vested interest in the efficient and robust regulation of the markets they provide. They are also better placed to respond quickly to develop best practice and to strive for improvements in the efficiency and transparency of market activity. The proximity of the market operator to the market and its participants allows it to respond quickly and cost effectively to changes in the market dynamic and indeed, to anticipate them. A change to the rules governing market activity – the contractual arrangements between the market operator and its customers, is a more expedient process than legislative change.⁴

2.8 The ASX's assessments of the advantages of the framework in which it operates are not disinterested. However, it is significant that a number of the other submissions and evidence received by the Committee during the inquiry also supported the co-regulatory model and supervisory framework and identified advantages flowing from them. For example, in its submission the Securities Institute of Australia said:

² See The Treasury, Submission No. 5, p. 4.

³ ASX, Submission No. 2, p. 4.

⁴ ASX, Submission No. 2, p. 5.

There are considerable advantages with the current supervisory framework of Australia's stock exchanges. These advantages revolve around having experienced, well-funded, independent experts who currently perform the role rather than regulators with little or no practical experience. Being close to the market is essential to this important function.⁵

2.9 The Chartered Secretaries Australia (CSA) also expressed confidence in the current arrangements:

Chartered Secretaries Australia is not aware of any major concerns among its members with respect to the present regulatory framework for Australia's stock exchanges...Chartered Secretaries Australia also believes that the current framework is appropriate for supervision of the activities of ASX.⁶

2.10 A possibility that major changes in the regulatory structure might be contemplated also appeared to concern the CSA, leading them to warn about the consequences of imposing additional regulation:

...CSA is concerned that any additional layers of regulation would increase costs that would ultimately be passed on to companies through listing fees. The ASX, and Australian companies, must remain competitive in worldwide terms. Any increase in the cost of doing business should be avoided.⁷

2.11 Representing Australia's institutional investment managers, the Investment and Financial Services Association (IFSA) also expressed general support for current arrangements, despite holding reservations about some aspects, as elaborated later in this report. Ms Lynn Ralph, Chief Executive Officer, told the Committee that:

I have to say that probably in general our view would be that the market works pretty well here in Australia, people have reasonable confidence in it. That is not to say that it is perfect by any sense of the imagination. Do we think that there needs to be a shift in response to some problems, concerns or lack of confidence? I would be surprised if my members felt that there should be some sort of conscious shift in the balance between listing and regulation and legislation at this time without some evidence that there was some serious problem and/or serious breach in the perceptions that people had about how the market was operating.⁸

2.12 The Australian Shareholders' Association (ASA), representing the individual investors who comprise 26 per cent of the Australian equities market,⁹ while expressing reservations about some aspects of the framework, (in particular the

⁵ Securities Institute of Australia, Submission No. 1, p. 1.

⁶ Chartered Secretaries Australia Limited, Submission No. 6, p. 2.

⁷ Chartered Secretaries Australia Limited, Submission No. 6, p. 2.

⁸ Evidence, p. 38.

⁹ Australian Shareholders' Association, Submission No. 12, p. 1.

perception of conflicts between ASX supervisory and commercial roles) also appeared to generally support the current framework:

Subject to the following comments we agree with ASIC in supporting the continuance of the current legislative model as modified by the changes which we understand are proposed by the Financial Services Reform Bill.¹⁰

2.13 The ASA continued:

While we support the present co-regulatory framework involving ASX, ASIC and the Minister we agree with the Securities Institute that a disadvantage of the current framework is the possibility of a perceived conflict between the role of the ASX as a profit making company and its supervisory role.¹¹

IOSCO view

2.14 The self-regulatory model is also viewed favourably by the International Organization of Securities Commissions (IOSCO). In a recent review of self-regulation, IOSCO was of the view that self regulatory models have a number of advantages resulting from their familiarity with the industry and can be efficient and cost effective:

Overall, self-regulation fosters integrity in the marketplace and among participants. Moreover, it is an effective method of regulation because self-regulatory organizations are familiar with the increasingly complex nature of the industry as well as the products developed and marketed by members and member organizations. SROs [self regulating organisations], therefore, have the specific knowledge and ability to effectively implement and conduct efficient and cost-effective regulatory programs.

2.15 IOSCO emphasised that there is a need to subject SROs to appropriate accountability mechanisms ‘to ensure that regulatory responsibilities are discharged properly and that the regulated markets operate in accordance with general performance standards in the public interest’. IOSCO noted that properly implemented self-regulatory regimes can produce ‘efficient rules, wide compliance with and acceptance of those rules, timely adjustment of rules to meet changing conditions, and flexible and effective enforcement’.¹²

¹⁰ Australian Shareholders’ Association, Submission No. 12, p. 3.

¹¹ Australian Shareholders’ Association, Submission No. 12, p. 5.

¹² Model for Effective Regulation – Report of the SRO Consultative Committee of the International Organization of Securities Commissions, May 2000.