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REVIEW OF THE AUSTRALIAN SECURITIES AND INVESTMENT COMMISSION

Submission to the Financial Regulator
Assessment Authority

ABOUT US

CHOICE is the leading consumer advocacy group in Australia. CHOICE is independent, not-for-profit and member-funded. Our mission is simple: we work for fair, just and safe markets that meet the needs of Australian consumers. We do that through our independent testing, advocacy and journalism.

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INTRODUCTION

We welcome the Financial Regulator Assessment Authority ('**FRAA**') reviewing the Australian Securities and Investment Commission's ('**ASIC**') effectiveness and capability. The Australian community needs an effective corporate regulator that is empowered to enhance the long-term welfare of consumers. It is important ASIC has the correct regulatory powers and approach to ensure that financial markets operate fairly.

This submission will focus on two of the three key themes of the FRAA's targeted review, namely strategic prioritisation and surveillance. Strategic prioritisation is a critical element of being an effective regulator. Setting enforcement and compliance priorities is the foundation of effective regulatory oversight. ASIC is faced with the problem of having limited resources and a financial marketplace that has more issues than the regulator can work on. ASIC can draw valuable lessons from the Australian Consumer and Competition Commission's ('**the ACCC**') approach to strategic prioritisation and enforcement. CHOICE considers ACCC's approach to strategic prioritisation best practice in Australia. The ACCC consults widely to select strategic issues to work on and effectively communicates these issues to the marketplace. This submission will provide a more detailed analysis of ACCC's process, which may be helpful in guiding the FRAA in its inquiry.

ASIC's surveillance function is an important tool that supports its regulatory mandate.¹ Surveillance powers allow ASIC to monitor financial markets and evaluate whether markets and products sold are working in a competitive and fair manner for consumers and the community. CHOICE's submission has two detailed case studies of ASIC using its surveillance powers effectively to improve consumer outcomes. The use of surveillance powers in the mortgage broking and contracts for difference ('**CFDs**') markets both illustrate how targeted surveillance activities can be used as a foundation to rectify market failures.

¹This submission will focus on ASIC's use of surveillance and monitoring of markets and regulated entities, and not surveillance of individual firms for misconduct.

1. Strategic prioritisation, planning and decision making

A critical component of being an effective regulator is being selective in the issues on which it will focus. This is especially important given the limitations on regulator resources.

CHOICE considers the Australian Competition and Consumer Commission's process of selecting its compliance and enforcement priorities best practice in Australia. The ACCC has a clear and effective process to select its annual compliance and enforcement priorities. It is also effective in communicating these priorities to the market. CHOICE believes that FRAA can learn useful lessons from the ACCC's approach which may help guide its inquiry into ASIC. We will outline the ACCC's approach to strategic prioritisation and outline key learnings that ASIC could adopt from its regulatory counterpart.

Case study - the ACCC's strategy process

The ACCC has an effective process of external stakeholder engagement to help it set annual compliance and enforcement priorities. Every year, the ACCC conducts a strategic review allowing businesses and consumers to comment on the ACCC's compliance and enforcement priorities. This allows the ACCC to "ensure that [its] resources are utilised in the most effective way possible."² The ACCC also undertakes regular and targeted external consultations with stakeholders. This includes consulting the ACCC's Consumer Consultative Committee ('ACCC-CCC').³ Membership of the ACCC-CCC comes from a broad range of consumer organisations, including casework organisations. Consumer groups play an important role in early identification of issues in the marketplace through complaints services, legal advice and assistance services, financial counselling, and market monitoring. Consultation with consumer groups is useful in early identification and measuring degree of harm, both important indicators for regulator prioritisation.

The ACCC then announces two types of compliance and enforcement priorities. The first are "enduring priorities". These are "forms of conduct so detrimental to consumer welfare and the

²ACCC, 2021, 2021 Strategic Review - external stakeholder survey

¹<https://consultation.accc.gov.au/compliance-strategies/2021-strategic-review-external-stakeholder-survey>

³ACCC 2021, Consumer Consultative Committee

<https://www.accc.gov.au/about-us/consultative-committees/consumer-consultative-committee>

competitive process that the ACCC will always regard them as a priority.”⁴ Enduring priorities include product safety, cartel conduct, anti-competitive conduct, conduct impacting Indigenous Australians, and consumers experiencing vulnerability or disadvantage.⁵ The second type of priorities are annual priorities. These priorities are reviewed and assessed annually, and reflect emerging risks and changes to the external environment. The ACCC’s 2021 priorities include consumer issues related to the COVID-19 pandemic, competition and consumer issues related to digital platforms, and competition and consumer issues in the funeral services sector. The ACCC then uses the appropriate mix of regulatory powers for each of these priorities, which may include community and industry engagement, surveillance activities, and enforcement action, to address consumer harms identified in these areas.

The ACCC is also effective in communicating these annual priorities to the Australian community, including to businesses and the marketplace. Annual priorities are often announced in a speech by the Chair of ACCC which attracts coverage in major press publications across Australia. While ASIC releases priorities in its Corporate Plan, this tends not to attract the same level of attention as the ACCC’s approach.

The ACCC’s approach ultimately facilitates efficient use of regulatory resources because it:

- signals to businesses in a particular sector that their practices may be subject to scrutiny, providing them with an opportunity to improve compliance to avoid being the subject of regulatory action;
- provides a basis for industry and consumer education; and
- allows the ACCC to identify particular practices or businesses that should then be subject to more targeted regulatory action.

The ACCC’s work on consumer protection issues in the airline industry illustrates these points. In 2017, the ACCC identified the airline industry as a compliance and enforcement priority, based in part on risk flags by CHOICE.⁶ In December 2017, the ACCC released a report that questioned the legality of a number of some common industry practices.⁷ In December 2018 the ACCC initiated action against Jetstar for making false or misleading representations about

⁴ACCC, 2021, Compliance & enforcement policy & priorities, <https://www.accc.gov.au/about-us/australian-competition-consumer-commission/compliance-enforcement-policy-priorities>

⁵ACCC, 2021, Compliance & enforcement policy & priorities

⁶ACCC, 2017, Compliance and Enforcement Policy,

<https://www.accc.gov.au/system/files/ACCC%20Compliance%20and%20Enforcement%20Policy%202017.pdf>

⁷ACCC 2017, Airlines: Terms and conditions report, <https://www.accc.gov.au/publications/airlines-terms-and-conditions-report>

consumer guarantee rights under the Australian Consumer Law.⁸ Jetstar ultimately admitted liability and entered an enforceable undertaking to amend its practices.⁹ The ACCC's overall approach ultimately led to the elimination of non-compliant practices without the need for extensive or costly litigation.

Key learnings for ASIC's strategic process

Key learning #1 - When setting strategic priorities, ASIC should conduct targeted consultation with external stakeholders including consumer groups.

ASIC's approach to consultation with consumer groups about strategic priorities is currently more limited than the approach of the ACCC. While ASIC's Consultative Panel, which includes CHOICE, is usually consulted about key threats and risks as part of the process of identifying ASIC priorities, other organisations with valuable insights are not represented on the Panel. Consumer groups - including those that provide legal assistance and financial counselling services - are a valuable source of information for regulators as they are in a position to identify issues that emerge in the market at an early stage. ASIC has an existing Consumer Advisory Panel that may be used to consult on annual priorities.

Key learning #2 - ASIC should state compliance and enforcement priorities in a clear and concise manner.

CHOICE considers that ASIC's strategy priorities could be communicated in a more concise way. For example, one of ASIC's four priorities is:

"Promoting economic recovery – including through better and more efficient regulation, facilitating innovation, and targeting regulatory and enforcement action to areas of greatest harm"¹⁰

⁸ACCC, 2018, 'Jetstar in court for misleading claims on refunds', <https://www.accc.gov.au/media-release/jetstar-in-court-for-misleading-claims-on-refunds>

⁹ ACCC, 2019, 'Jetstar to pay \$1.95 million for false or misleading claims on refunds' <https://www.accc.gov.au/media-release/jetstar-to-pay-195-million-for-false-or-misleading-claims-on-refunds>

¹⁰ ASIC, 2021, 'ASIC Corporate Plan 2021–25', p. 5

¹⁰<https://download.asic.gov.au/media/qzcaljce/asic-corporate-plan-2021-25-focus-2021-22-published-26-august-2021.pdf>

This compares with ACCC's annual enforcement and compliance priorities which includes a priority to address:

*"Competition and consumer issues in the funeral services sector."*¹¹

While ASIC's priority may be commendable, it lacks specificity. We would encourage ASIC to have annual enforcement and compliance priorities that are specific, measurable, and tied to specific financial products, services or industries that cause consumer harm.

We note that ASIC's Corporate Plan does break down planned actions by industry. However, this is a detailed document, and this level of detail may not capture the public attention in the same way as the ACCC's clearly stated priorities.

Key learning #3 - ASIC should have a more effective public communications strategy to share these priorities with the Australian community and regulated entities

We would encourage ASIC to improve the way it communicates its enforcement and compliance strategy to the marketplace. An enforcement and compliance strategy is more effective if regulated entities and the marketplace are aware of it. It is an important means in encouraging businesses to improve their conduct. We acknowledge that ASIC does put out a media release highlighting its four-year Corporate Plan. However, this fails to garner the same attention as the ACCC's annual compliance and enforcement priorities.

An example of where ASIC's media strategy fell short was the fees-for-no-service ('FFNS') scandal. ASIC was aware of FFNS as early as 2015.¹² ASIC does not have the regulatory powers to direct remediation programs. Instead, ASIC worked with industry and put out a number of media releases and reports responding to the FFNS issue. However, ASIC failed to capture widespread media coverage. It was only until the Financial Services Royal Commission that the FFNS scandal received sufficient media attention. A well-designed media strategy may have applied greater public pressure on advice firms who were engaging in FFNS to improve their conduct.

¹¹ ACCC, 2021, Compliance & enforcement policy & priorities,

<https://www.accc.gov.au/about-us/australian-competition-consumer-commission/compliance-enforcement-policy-priorities>

¹² ASIC, 2015, 15-081MR ASIC update on Wealth Management Project - Investigation into charging of advice fees without providing advice,

<https://asic.gov.au/about-asic/news-centre/find-a-media-release/2015-releases/15-081mr-asic-update-on-wealth-management-project-investigation-into-charging-of-advice-fees-without-providing-advice/>

Key learning #4 - ASIC should regularly report in the effectiveness in achieving their strategic priorities

We would encourage ASIC to publicly report the success against the priorities set in previous years. This is an important measure that would increase ASIC's accountability and transparency. For example, the ACCC publishes its annual Telecommunications Report.¹³ This report outlines changes to the telecommunications markets, including changes in price, competition, and services in the industry. The report also outlines key activities undertaken by the ACCC, including enforcement and compliance. The report is useful as it links changes in market outcomes with ACCC's regulatory interventions. We would recommend that ASIC adopts a similar approach.

¹³ACCC, 2021, 'Communications market report', <https://www.accc.gov.au/system/files/Communication%20Monitoring%20report.pdf>

2. Surveillance

ASIC's surveillance function is an important tool that supports its regulatory mandate. Our observations about ASIC's approach focus on ASIC's surveillance of markets and regulated entities, and not surveillance of individual firms for misconduct.

Surveillance powers allow ASIC to monitor markets, investigate the benefits and harms of financial products or markets, as well providing the necessary evidence base to propose regulatory intervention to correct market distortions. The data that ASIC collects can also play a valuable role as an evidence base for the Federal Government in considering legislative reform to improve standards of conduct within an industry.

Our experience is that surveillance activities work best over a longer-term time horizon. This provides ASIC with the data needed to assess improvements in market outcomes and to measure if regulatory interventions have been effective. A long-term view of surveillance also allows ASIC to measure changes in competition, consumer outcomes, and to stay informed about new product offerings in an industry.

Further, CHOICE sees it is important for ASIC to draw upon a broad range of surveillance techniques so as to match the surveillance to the form of risk that ASIC is trying to understand.

Where ASIC needs to gather evidence on services provided in an individual setting, techniques like shadow shopping exercises and reviews of individual client files are particularly important, as demonstrated by ASIC's shadow shops of financial advice over a number of years. These ultimately provided the objective evidence base for the landmark Future of Financial Advice reforms.

In other areas, targeted or industry-wide data collection may be more appropriate, as highlighted in the following two case studies.

Case study #1 - the contracts for difference market

ASIC's regulation of the contracts for difference ('CFD') market is a valuable example of how surveillance can be used as the basis for effective regulatory action. Contracts for difference are a type of 'over-the-counter' ('**OTC**') derivative. CFDs are a complex, leveraged derivative contract that allows investors to trade on the change of value of an underlying asset. They are harmful and high-risk financial products that overwhelmingly lose consumers' money.

Over the past seven years, ASIC has used targeted surveillance to:

- understand the size and scale of the emerging CFD market;
- quantify the nature and types of consumer harm in the CFD market;
- justify using the product intervention powers (PIPS) to fix significant consumer detriments; and
- evaluate the effectiveness of its use of the product intervention powers.

We would encourage the FRAA to consider this intervention as a model for how ASIC can use targeted and effective surveillance to improve consumer outcomes in a complex financial market. We expect that with the increased proliferation of financial products and markets, ASIC will need to continue developing these specialist surveillance skills.

ASIC has conducted four surveillance activities into the OTC sector in Australia. First, in 2016, ASIC released a risk-based review of AFS licensees in Australia that sold OTC products, including CFDs.¹⁴ The review found that over 70% of AFS licensees reviewed had, "demonstrated issues with three or more of the seven compliance risks."¹⁵ In its report, ASIC provided an opportunity for the industry to improve its conduct without any further regulatory intervention. ASIC stated, "we expect AFS licensees to take note of our findings and proactively remediate any areas requiring improvement."¹⁶

¹⁴ASIC 2016, REP482, Compliance review of the retail OTC derivatives sector, <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2016-releases/16-197mr-asic-releases-report-highlighting-significant-failures-in-the-retail-otc-derivatives-industry/>

¹⁵ASIC 2016, REP482, p.9

¹⁶ASIC 2016, REP482, p.5

In June 2018, ASIC released REP 579 into the OTC derivatives sector.¹⁷ This report sought to “gauge the size of the industry, the products offered and the risks posed to investors.” ASIC provided a snapshot of the industry, outlining the size of the industry, products offered, and potential harms to investors.

In August 2019, ASIC released a report REP626 into the consumer harm from OTC binary options and CFDs.¹⁸ The report found widespread significant consumer detriment. The report found:

- 72% of people who trade CFDs lose money, with many losses exceeding initial investment;
- there was 9 million CFD margin close-outs in 2018;
- 32% of OTC clients have annual incomes of less than \$37,000 per annum;
- over 225,000 OTC clients were given inducements to trade which attracted “financially vulnerable consumers”;
- complaints about operators who sold CFDs dramatically increased and accounted for over one third of markets-related complaints to ASIC and AFCA; and
- there was unclear or confusing presentation of information about risks, pricing and costs.

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REP626 was released alongside a proposal for ASIC to exercise its product intervention powers to place restrictions on the issue and distribution of contracts for difference. In October 2020, ASIC made a product intervention order (‘CFD Order’) restricting the amount of CFD leverage offered to retail clients as well as restricting other harmful conduct.²⁰

In October 2021, ASIC analysed “data obtained from licensed CFD issuers for a 15-month period that spans the period before and after the measures in the CFD Order”.²¹ ASIC’s analysis found that there is a significant reduction in consumer harm since the introduction of the CFD order. This includes a:

- 94% reduction in retail clients net losses from \$377m to \$22m;

¹⁷ASIC 2018, REP579, Improving practices in the retail OTC derivatives sector, <https://download.asic.gov.au/media/4780400/rep579-published-28-june-2018.pdf>

¹⁸ASIC 2019, REP626, Consumer harm from OTC binary options and CFDs, <https://asic.gov.au/regulatory-resources/find-a-document/reports/rep-626-consumer-harm-from-otc-binary-options-and-cfds/>

¹⁹ASIC 2019, REP626

²⁰ASIC 2020, 20-254MR ASIC product intervention order strengthens CFD protections <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2020-releases/20-254mr-asic-product-intervention-order-strengthen-s-cfd-protections/>

²¹ASIC 2021, CP348, Extension of the CFD product intervention order, <https://download.asic.gov.au/media/2v2br3vw/cp348-published-18-october-2021.pdf>

- 50% reduction in the average loss per retail loss-making account from \$1962 to \$986; and
- significant decline in negative balances and margin close-out for retail clients.²²

CHOICE encourages the FRAA to further examine ASIC's intervention in the CFD market as best practice for effective use of surveillance to address significant consumer harms.

Case study #2 - the mortgage broker market

ASIC's review of the mortgage broker industry is another example of how surveillance can be used effectively to improve outcomes in a financial services market. It is also a useful example of how the Federal Government and ASIC can work together to improve consumer outcomes and competition in a financial services market.

At the request of the Federal Assistant Treasurer, ASIC conducted a comprehensive review of the mortgage broking industry to analyse "the effect of current remuneration structures on the quality of consumer outcomes."²³ ASIC gathered four years of data, collecting 157 data points from 1.4 million customers, including gathering information on borrower characteristics, loan features, and loan pricing.²⁴ ASIC also surveyed over 3000 consumers to 'better understand perceptions and experiences with brokers'. Using this data, ASIC was able to report findings on:

- the commission-based remuneration structure of mortgage brokers;
- competitive outcomes in the home-loan market;
- how commissions impact on the price, quality and risk of mortgages sold by brokers; and
- how ownership structures and distribution channels impact the quality of loans offered.²⁵

ASIC's research found that mortgage brokers were not providing borrowers with cheaper priced loans than going direct to the lender.²⁶ ASIC also found that mortgage brokers were selling people into riskier loans that are more likely to fall into arrears and take longer to pay back.

²² ASIC 2021, CP348

²³ASIC, 2017, REP 516, Review of mortgage broker remuneration, p.5, <https://download.asic.gov.au/media/4213629/rep516-published-16-3-2017-1.pdf>

²⁴ASIC, 2017, ASIC's review of mortgage broker remuneration: What we did, https://download.asic.gov.au/media/4184775/mortgage_broker_review_what_we_did.pdf

²⁵ASIC, 2017, REP 516, p.9-23

²⁶ASIC, 2017, REP 516, p.15

ASIC's investigation led to six proposals "to improve consumer outcomes and competition in the home loan market".²⁷ ASIC's surveillance findings was an important evidence base for the Federal Government to legislate a new best interests duty for mortgage brokers, as well as passing legislation to ban conflicted campaign and volume-based commissions. This is an example of how ASIC can use its surveillance powers to work with the Federal Government to improve consumer outcomes and competition in financial services markets.

²⁷ASIC, 2017, REP 516, p.23-27