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FINANCIAL SYSTEM INQUIRY

The Financial System Inquiry (FSI or Committee) has been a valuable process, providing a holistic review of how the financial system has been performing and identifying reforms that can help ensure the system is well placed to support Australia's future economic growth and meet the needs of the community. ASX agrees with the overarching conclusion that the existing system is working relatively well, even in the face of such extreme events as the global financial crisis.

The Committee identified a range of largely sensible reforms which ASX believes the Government should implement. The attached table provides our views on those recommendations relating to capital market matters. We highlight one particular issue we believe is particularly worthy of the Government's early attention.

- **Corporate bonds:** Further simplification to align retail corporate bond disclosure with the approach in place for equity raising will help facilitate corporate bond issuance (without compromising investor protection). The proposals made in various submissions to the Murray Committee provide a clear way forward and should be implemented immediately.

If you have any questions on this submission please contact: Gary Hobourn, Senior Economic Analyst, Regulatory and Public Policy ((02) 9227 0930 or gary.hobourn@asx.com.au.)

Yours sincerely,

Amanda Harkness

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Group General Counsel and Company Secretary

ASX COMMENTS ON SPECIFIC FSI RECOMMENDATIONS

RESILIENCE

#	FSI Recommendation	ASX position	Comments
5	**Crisis management toolkit:** *Complete the existing processes for strengthening crisis management powers that have been on hold pending the outcome of the Inquiry.*	Implement	In the case of critical financial market infrastructure (FMI), powers for regulators can complement the other risk and crisis management measures of FMI operators. ASX already has strong risk management processes and is putting in place robust recovery tools for its clearing houses so they will be more resilient in response to any unforseen financial shocks. A specialised resolution regime for FMIs provides a framework within which regulators can respond to the (very remote) situation where recovery arrangements are not able to ensure the ongoing viability of the facility. It will enable the regulator to step-in and take measures to restore the financial viability of the facility or to oversee an orderly winding-up. Any effective policy framework also needs appropriate controls over foreign infrastructures providing services in Australia to protect Australia's financial stability. The Government is currently consulting on a resolution regime for licensed FMIs. ASX agrees with the key elements of the proposed regime and has submitted a detailed submission.
8	**Direct borrowing by super funds:** *Remove the exception to the general prohibition on direct borrowing for limited recourse borrowing arrangements by super funds.*	Implement with modification	The Committee was concerned with the growth of borrowing within self-managed superannuation funds, although acknowledging that the absolute level remains modest. The relaxation on the previous prohibition on borrowing using limited recourse arrangements was designed to permit SMSF's to invest in products (e.g instalment warrants) that can enhance the long-term accumulation of assets within the fund. If the Government shares the Committee's concerns with the growth in leverage, ASX believes that rather than reintroducing the prohibition it may be more appropriate to set a modest cap on the level of borrowing. This limits the fund's exposure to leverage while still enabling the prudent use leverage to bolster the accumulation of financial assets for retirement.

INNOVATION

#	FSI Recommendation	ASX position	Comments
18	**Crowdfunding:** *Graduate fundraising regulation to facilitate crowdfunding for both debt and equity and, over time, other forms of financing.*	Implement	An accommodative regulatory regime that appropriately balances the needs of issuers and investors is required to facilitate equity (and debt) crowdfunding. The existing small scale personal offer exemption for capital raisings made to 'wholesale' investors is not suited to meet the funding needs of many small firms. The options canvassed in the recent Treasury consultation paper on a new crowdfunding regime should improve its attractiveness for companies requiring early stage finance without undermining investor protection. While crowdfunding may not suit all small companies or all investors (given the risks associated with it), it can contribute to the funding of innovative Australian businesses. In its submission to the recent consultation paper, ASX supported the broad design features of the regulatory model proposed by CAMAC in June 2014. ASX believes that some of the investment caps proposed ($2,000 per investment and $10,000 in total) may need to be increased if crowdfunding is to become an attractive source of funding for small companies.

CONSUMER OUTCOMES

#	FSI Recommendation	ASX position	Comments
23	**Facilitate innovative disclosure:** *Remove regulatory impediments to innovative product disclosure and communication with consumers, and improve the way risk and fees are communicated to consumers.*	Implement	Removing impediments to innovative disclosure and communications can promote greater electronic product disclosures, offering significant efficiencies for both product issuers and investors. This can cut costs and deliver better disclosure for investors. ASX supported proposals in the recent ASIC CP 224, *Facilitating Electronic Financial Services Disclosure* namely: • Mandating electronic distribution as the default option for disclosure, while continuing to provide more traditional options for the shrinking group of investors who are unable to access electronic formats; and • Allowing providers to make most Chapter 7 disclosures available through a website or other electronic facility.

REGULATORY SYSTEM

#	FSI Recommendation	ASX position	Comments
27	**Regulator accountability:** *Create a new Financial Regulator Assessment Board to advise Government annually on how financial regulators have implemented their mandates.* *Provide clearer guidance to regulators in Statements of Expectation and increase the use of performance indicators for regulator performance.*	Implement accountability framework	The principle of greater regulator accountability and monitoring of performance is a critical element of a well-functioning regulatory regime. Measures to enhance existing accountability would promote continual improvement, and greater efficiency, in how regulatory outcomes are achieved. ASX does not believe that another new body is required to advise government, particularly given the judgement involved in assessing matters such as market integrity and financial stability. Reporting lines are well established and accountability is a management process.
28	**Execution of mandate:** *Provide regulators with more stable funding by adopting a three-year funding model based on periodic funding reviews, increase their capacity to pay competitive remuneration, boost flexibility in respect of staffing and funding, and require them to undertake capability reviews.*	Implement with controls	Providing a stable funding base for regulators will allow them to effectively manage resources and build the organisation's skills to help to deliver the outcomes required by government. This needs to be implemented within a transparent accountability framework. A three-year funding cycle may also allow for a more disciplined way of delivering on efficiency targets that require process re-engineering.
29	**Strengthening ASIC's funding and powers:** *Introduce an industry funding model for the Australian Securities and Investments Commission (ASIC) and provide ASIC with stronger regulatory tools.*	Implement with controls	A cost-recovery model can make an important contribution to industry funding of regulatory arrangements. This needs to be implemented within a transparent accountability framework. It should not be the only source of funding as many regulatory arrangements promote a more broadly balanced public interest purpose and other services can be effectively priced. The proposal in Recommendation 28 (above) to establish a three year funding cycles for regulators provides a framework that could ring-fence overall costs within a series of annual budget caps. This would provide certainty for industry on the aggregate costs to be recovered. Industry based funding is already a feature in a number of areas including for ASIC's market supervision. Market operators and participants share these costs based on a methodology that seeks to allocate ASIC's costs to relevant stakeholders. Processes are needed to govern any cost-recovery mechanism, including consultation with affected industry stakeholders to provide transparency into the drivers of regulator costs and to seek input on the methodology to ensure it complies, as much as practicable, with the Government's user-pays principle.

#	FSI Recommendation	ASX position	Comments
			As part of an equitable and efficient cost-recovery arrangement the Government should also consider hypothecating fines and penalties from ASIC's enforcement activities to reduce the overall industry burden and recover costs from those who drive ASIC's costs.
30	**Strengthening the focus on competition in the financial system:** *Review the state of competition in the sector every three years, improve reporting of how regulators balance competition against their core objectives, identify barriers to cross-border provision of financial services and include consideration of competition in ASIC's mandate.*	Implement	ASX 's experience has been that regulators do generally consider the impact of their actions on competition as well as other key regulatory objectives. Some government policy decisions already have an explicit focus on market structure and competition issues (e.g. the current review of the moratorium on clearing competition in cash equities). The growth in cross-border provision of financial services also highlights the importance of ensuring regulatory settings balance the interests of competition, financial stability and consumer protection, and that domestic regulators have appropriate controls over these activities. Periodic reviews of key sectors of the economy may be a useful tool for building a competitive and sustainable economy over the mid to long term.
31	**Compliance costs and policy processes:** *Increase the time available for industry to implement complex regulatory change.* *Conduct post-implementation reviews of major regulatory changes more frequently.*	Implement	ASX's experience is that the cost and complexity of change is often not understood. In the case of securities markets, for example, these changes have reached beyond market or facility operators to changes required of market participants and third party vendors. Financial institutions can also face a range of regulatory changes that need to be implemented at the same time. This requires regulators to plan, prioritise and coordinate regulatory changes to minimise the risk of multiple projects making simultaneous demands on businesses. Industry needs sufficient time to make these technical, operational and compliance changes and regulators should ensure generous transitional arrangements unless there are compelling reasons for a truncated period. Policy makers and regulators also need to take real world experience of "what it takes" into account when designing new and complex regulatory change. Post-implementation reviews, particularly for major regulatory changes, should be a standard feature, to ensure that lessons learned are captured and used to improve future processes.

SIGNIFICANT MATTERS

#	FSI Recommendation	ASX position	Comments
33	**Retail corporate bond market:** *Reduce disclosure requirements for large listed corporates issuing 'simple' bonds and encourage industry to develop standard terms for 'simple' bonds.*	Implement as soon as possible	This is an important proposal and should be implemented as soon as possible. It would play a role in addressing one of the major shortcomings in the existing capital markets - an underdeveloped corporate bond market. The Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2014 was a good first step in simplifying the disclosure regime for retail corporate bonds and those measures should be progressed. However further reform is needed to fully realise the potential benefits for issuers and investors. Aligning the disclosure requirements for retail debt issuance with those already in place for equity raisings, makes sense and contains appropriate investor protections. The regime would require a standard, short-form term sheet and a cleansing notice to confirm the entity is in compliance with its continuous disclosure obligations. ASX supports that the policy is to be limited to the top 150 listed companies in the initial stage. ASX believes that practical implementation may require a second 'trigger' (eg listed entities in the top 150 <u>or</u> with market capitalisation above $1.5 billion).
38	**Cyber security:** *Update the 2009 Cyber Security Strategy to reflect changes in the threat environment, improve cohesion in policy implementation, and progress public–private sector and cross-industry collaboration.* *Establish a formal framework for cyber security information sharing and response to cyber threats.*	Implement within existing processes	Effective responses to the growing threat of cyber-attacks require the Government and financial sector organisations to work together. As a provider of critical financial market infrastructure, ASX already has close working contacts with key government agencies and appreciates the information exchange that assists industry to monitor emerging threats, identify vulnerabilities and develop the appropriate responses to any risks. ASX is a member of the National Critical Infrastructure Group and has regular engagement with government, relevant agencies (such as CERT Australia) and other critical infrastructure providers on cyber security matters. The Commonwealth Government's cyber security review provides an opportunity to further refine these arrangements and ensure that information also filters out to smaller financial institutions which may be the target of future attacks.

#	FSI Recommendation	ASX position	Comments
44	***Corporations Act 2001* ownership restrictions:** *Remove market ownership restrictions from the Corporations Act 2001 once the current reforms to cross-border regulation of financial market infrastructure are complete.*	Implement	The implementation of stronger domestic regulatory controls over FMIs has removed one of the outstanding rationales for maintaining the separate ownership restriction. These powers will be complete once the resolution regime for FMIs is put in place by the RBA, giving it the ability to step-in when a facility's financial viability is questioned. Once the regulatory controls are in place, complemented by domestic location requirements for critical FMI with a sufficient connection to Australia, regulators will have full control of critical infrastructure under any ownership scenario. It is appropriate that ASX has the same ownership rules as other systemically important financial sector entities (currently banks and insurance companies) - that is the general 15% ownership limit. The Treasurer retains important powers which can be exercised in the national interest. This legislative change would simplify and clarify the process for approval of ownership above the threshold.