

**Australia: Report on the Observance of Standards and Codes (ROSC)—Summary Assessments**

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FINANCIAL SECTOR ASSESSMENT PROGRAM UPDATE

AUSTRALIA

REPORT ON THE OBSERVANCE  
OF STANDARDS AND CODES  
(ROSCs) – SUMMARY  
ASSESSMENTS

OCTOBER 2012

INTERNATIONAL MONETARY FUND  
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**GLOSSARY**

AASB	Australian Accounting Standards Board
ACCC	Australian Competition and Consumer Commission
ADIs	Authorized Deposit-taking Institutions
AFSL	Australian Financial Services License
AIMA	Alternative Investment Management Association
APRA	Australian Prudential Regulation Authority
AML	Australian Market License
AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
ASIC	Australian Securities and Investments Commission
ASIC Act	Australian Securities and Investments Commission Act 2001
ASX	Australian Stock Exchange
AUASB	Auditing and Assurance Standards Board
AUSTRAC	Australian Transaction Reports and Analysis Centre
BCPs	Basel Core Principles
CA	Corporations Act 2001
CALDB	Companies Auditors and Liquidators Disciplinary Board
CDPP	Commonwealth Director of Public Prosecutions
CFR	Council of Financial Regulators
CIS	Collective Investment Scheme
CP	Core Principle
CRA	Credit rating Agency
CSFL	Clearing and Settlement Facility License
DDP	Director of Public Prosecutions
DMFs	Discretionary Mutual Funds
EMR	Emerging Risk Committee
FAs	Financial Advisers
FATA	Foreign Acquisitions and Takeovers Act 1975
FATF	Financial Action Task Force
FCS	Financial Claim Scheme
FIU	Financial Intelligence Unit
FRC	Financial Reporting Council
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSS	Financial Stability Standards
FSSA	Financial Sector (Shareholdings) Act 1998
FUM	Funds Under Management
GFC	Global Financial Crisis
GDP	Gross Domestic Product
IA	Insurance Act

IAASB	International Auditing and Assurance Standards Board
ICAAP	Internal Capital Adequacy Assessment Process
ICPs	Insurance Core Principles
IFRS	International Financial Reporting Standards
IOSCO	International Organization of Securities Commissions
IRRBB	Interest Rate Risk in the Banking Book
LAGIC	Life and General Insurance Capital Review
MABRA	Mutual Assistance in Business Regulation Act
MCR	Minimum Capital Requirement
MIR	Market Integrity Rules
MIS	Managed Investment Schemes
MMoU	Multilateral MoU
MoU	Memorandum of Understanding
MoC	Memorandum of Cooperation
NOHC	Non-Operating Holding Company
NZ	New Zealand
OECD	Organization for Economic Co-operation and Development
ORSA	Own Risk and Solvency Assessment
OTC	Over the Counter
PAIRS	Probability and Impact Rating System
PCR	Prescribed Capital Requirement
PHIAC	Private Health Insurance Administration Council
RBA	Reserve Bank of Australia
RBNZ	Reserve Bank of New Zealand
RE	Responsible Entities
RIA	Regulatory Impact Analysis
RIS	Regulation Impact Statement
SOARS	Supervisory Oversight and Response System
SRO	Self-Regulatory Organization
TTBC	Trans-Tasman Council on Banking Supervision
UFI	Unauthorized Foreign Insurers
\$	Australian Dollar

## I. BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

### A. Summary, Key Findings, and Recommendations

1. **Australia has a very high level of compliance with the Basel Core Principles for Effective Banking Supervision (BCPs).** The Australian banking system was more sheltered than a number of other countries and weathered the Global Financial Crisis (GFC) relatively well. This was in part due to the relative concentration of the system on a well-performing domestic economy, but also due to a material contribution from a well-developed regulatory and supervisory structure. Notable strengths of the Australian supervisory approach are its strong risk analysis and its focus on the responsibilities of the banks' boards regarding management and oversight. The Australian banking system is, however, still vulnerable to continuing aftershocks of the GFC, not least as banks' funding profiles could be a conduit of instability.
2. **The assessors saw many examples of high-quality initiatives and practices in the supervisory authority.** The response of the Australian Prudential Regulation Authority (APRA) to the GFC has been to intensify its supervisory practices and to move to an early, and conservative, adoption of key aspects of the international regulatory reform agenda, especially the Basel III capital and liquidity framework.
3. **However, the reform agenda presents implementation challenges for supervisors and firms alike.** Continued fragilities in the global system mean that further development of supervisory standards and firm-based practices in risk management and liquidity remain at a premium, and continued efforts are needed to advance the depth and intensity of the supervisory approach to liquidity. In addition, some aspects of the legislative framework need to be addressed to ensure that APRA will be able to act in a fully effective and efficient manner should weaknesses emerge within the banking system or within individual institutions.

### B. Introduction

4. **This assessment of the current state of the implementation of the BCPs in Australia has been completed as part of a Financial Sector Assessment Program (FSAP) undertaken by the International Monetary Fund (IMF) during 2012.** It reflects the regulatory and supervisory framework in place as of the date of the completion of the assessment. Importantly, it is not intended to assess the merits of the important policy and implementation issues regarding several aspects of the international regulatory framework that are yet to be decided in international forum and in Australia. An assessment of the effectiveness of banking supervision requires a review of the legal framework, both generally and as specifically related to the financial sector, and detailed examination of the policies and practices of the institutions responsible for banking regulation and supervision. In line with the BCP methodology, the assessment focused on the major banks and banking groups, and their regulation and supervision, given their importance to the system.

### C. Information and Methodology Used for Assessment

5. **The Australian authorities agreed to be assessed according to the Core Principles (CP) Methodology issued by the Basel Committee on Banking Supervision (Basel Committee) in October 2006.** The current assessment was thus performed according to a revised content and methodological basis as compared with the previous BCP assessment carried out in 2005. The assessment of compliance with each CP is made on a qualitative basis to allow a judgment on whether the criteria are fulfilled in practice. Effective application of relevant laws and regulations is essential to provide indication that the criteria are met.

6. **The assessment team reviewed the framework of laws, rules, and guidance, and held extensive meetings with officials of APRA, the Reserve Bank of Australia (RBA), and the Treasury, as well as banking sector participants.** The team also met the industry association representing banks, in addition to a number of domestic and non-domestic institutions. The authorities provided a high quality self-assessment of the CPs, as well as detailed responses to additional questionnaires, and facilitated access to supervisory documents and files.

7. **The team appreciated the very high quality of cooperation received from the authorities.** The team extends its thanks to staff of the authorities who provided excellent cooperation, including extensive provision of documentation, at a time when many other initiatives related to domestic and global regulatory initiatives are in progress.

8. **The standards were evaluated in the context of the Australian financial system's sophistication and complexity.** It is important to note that Australia has been assessed against the BCPs as revised in 2006. This is significant for two reasons: (i) the revised BCPs have a heightened focus on risk management and its practice by supervised institutions and its assessment by the supervisory authority; and (ii) the standards are evaluated in the context of a financial system's sophistication and complexity.

9. **An assessment of compliance with the BCPs is not, and is not intended to be, an exact science.** Reaching conclusions required judgments by the assessment team.<sup>1</sup> Banking systems differ from one country to another, as do their domestic circumstances. Furthermore, banking activities are undergoing rapid change after the crisis, prompting the evolution of thinking on and practices for supervision. Nevertheless, by adhering to a common, agreed methodology, the assessment should provide the Australian authorities with an internationally consistent measure of the quality of its banking supervision in relation to the revised Core Principles, which are internationally acknowledged as minimum standards.

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<sup>1</sup>The assessment team comprised Michael Deasy and Katharine Seal.

#### **D. Institutional and Macroeconomic Setting and Market Structure—Overview<sup>2</sup>**

10. **Australia’s financial sector is large and mature with assets totaling 330 percent of gross domestic product (GDP).** The financial sector has grown rapidly over much of the last two decades, and two types of assets have contributed significantly to its growth, i.e., home mortgages and superannuation funds (a retirement scheme comprising mandatory contributions by employers and voluntary and tax-concessional contributions by employees). Authorized deposit-taking institutions (ADIs), mostly banks, are the dominant group of financial institutions with 60 percent of financial sector assets, followed by superannuation funds (including investment-linked superannuation written by life insurance companies) with 25 percent. The non-life insurance sector is relatively small with 3 percent of financial sector assets, and non-superannuation managed funds have another 6 percent. The stock market had a capitalization of 80 percent of GDP at end-2011, although this was below the peak of 150 percent in mid-2007.

11. **Australia’s financial sector faces a unique set of risks.** Its concentrated banking sector is dominated by four large banks with broadly similar business models and reliance on offshore funding. This reflects long-standing structural issues that will remain key sources of risk over the medium term. Against a pessimistic global environment, these risks will need to be closely managed, particularly if the domestic economy slows sharply.

12. **Profitability of the Australian banking system remains strong and the banking system is well capitalized.** The four major Australian banks reported aggregated after tax profits of \$23.3 billion in the year ended June 2011, up from \$16.8 billion the previous year. The return on equity for the major banks over the last financial year was 15 percent and was 14 percent for all banks. Australian ADIs have been increasing regulatory capital in advance of the implementation of Basel III from 2013. APRA has taken a more conservative stance in certain areas than is required by the Basel Committee standards, including requiring banks to maintain higher quality capital (in terms of deductions) and to meet an accelerated timetable for meeting minimum requirements for Tier 1 capital. As of June 2012, the aggregate Tier 1 capital ratio for Australian banks was 10.5 percent of risk-weighted assets, up from 8.5 percent in 2009. The total capital ratio was 11.8 percent as of June 2012.

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<sup>2</sup>This section draws from the Financial System Stability Assessment (FSSA).



## E. Preconditions for Effective Banking Supervision

### Sound and Sustainable Macroeconomic Policies<sup>3</sup>

13. **Five years after the U.S. sub-prime debacle triggered the GFC, the Australian economy continues to thrive and the outlook remains favorable.** Australia is one of the few advanced economies to avoid a recession, in part because of strong fundamentals at the onset of the crisis. Growth dipped only briefly below trend during the crisis and rebounded quickly, supported by robust demand for commodities from China, which fueled a mining boom and pushed the terms of trade to 60-year highs. As a result, the current account deficit fell to about 2½ percent of GDP in the first half of 2011 from an average of 4½ percent for the previous 15 years. The economy and the financial sector continue to outperform most of the country's peers with the economy expected to grow close to trend at 3–3.5 percent annually in 2012 and 2013. Inflation, meanwhile, is expected to remain subdued and well within the authorities' target band of 2–3 percent over the medium term and the government has made returning to surplus by 2012/13 a major policy priority. In addition, unlike many other advanced economies, Australia's monetary policy space is still sizable and output is close to potential.

### A Well-Developed Public Infrastructure

14. **Policy coordination and cooperation between Australia's four main financial sector agencies is supported mainly through the Council of Financial Regulators (CFR).** The CFR is the primary coordinating body for Australia's main financial sector agencies: the RBA (Chair), APRA, the Australian Securities and Investments Commission (ASIC), and the Treasury. The CFR's objectives are specified in its Charter and require it to promote the stability of the Australian financial system and to contribute to the efficiency and effectiveness of financial regulation. The CFR does not have a legal personality, nor does it have powers separate from its member agencies. Its members share information and views and advise the Government on Australia's financial system architecture. APRA and the RBA both have mandates for financial stability and have legal gateways to share institution-level data that are needed for them to carry out their respective duties.

15. **A significant area of regulatory cooperation is the Trans-Tasman Council on Banking Supervision (TTBC).** The TTBC comprises representatives of the Australian and New Zealand Treasuries, the RBA, the Reserve Bank of New Zealand (RBNZ), and APRA. Trans-Tasman cooperation has been enhanced by legislation passed in 2005 by the Australian and New Zealand parliaments. These laws implement reciprocal obligations that require APRA and the RBNZ to support the other agency in meeting its statutory responsibilities for prudential regulation and financial stability. These laws also oblige the regulators to seek to

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<sup>3</sup>This section draws from the FSSA and the 2012 Article IV concluding statement.

avoid actions, where reasonably practicable, that are likely to be detrimental to the other country's financial stability. In 2010, the TTBC agencies, along with ASIC, signed a Memorandum of Cooperation on the management of trans-Tasman bank distress and, in 2011, the TTBC started developing guidance on the joint resolution of distress in a trans-Tasman bank.

**16. The common law system, as developed in the United Kingdom, forms the basis of Australian jurisprudence.** The Australian Constitution of 1901 established a federal system of government, under which powers are distributed between the Commonwealth and the six States. It defined exclusive powers, investing the federal government with the exclusive power to make laws on matters such as trade and commerce and taxation. The states and territories have independent legislative power in all matters not specifically assigned to the federal government. Where there is any inconsistency between federal and state or territory laws, federal laws prevail. Federal laws apply to the whole of Australia. In effect, Australia has seven legal systems—the six state and territory systems and one federal system. Each of the federal and state systems incorporates three separate branches of government—legislative, executive, and judicial. The Constitution grants the legislative power to Parliament. Proposed legislation must be passed by both Houses of Parliament—the Senate and House of Representatives. Only Parliament can pass Acts to create statute law, but these Acts often confer on the Executive the power to make regulations, rules, and by-laws pursuant to the particular Acts. The executive government administers the laws which the judiciary independently interprets and applies.

**17. There is a strict separation between the Judiciary and the Parliament and Executive.** Only the courts can exercise the judicial power of the Commonwealth to decide whether a person has contravened a law of the Commonwealth Parliament. Disputes in Australia can be settled through the judicial system. The High Court decides disputes concerning the meaning of the Constitution and is also the final court of appeal. The Australian legal system provides for enforcement of the judgments of Australian courts, including by courts in a different state from which a judgment was made. A foreign judgment has no inherent legal force in Australia. Therefore, to enforce a foreign judgment an applicant must seek recognition and enforcement under either the common law or a statutory regime. The Foreign Judgments Act 1991 provides a statutory regime for the recognition and enforcement of certain foreign judgments. Where the Act does not apply, the common law governs the recognition and enforcement of foreign judgments. Australia has a number of options available for alternative dispute resolution. These include mediation, conciliation, conferencing, neutral evaluation, and arbitration. In Australia there is generally no requirement to undertake alternative dispute resolution before seeking court resolution.

**18. Australia has implemented International Financial Reporting Standards (IFRS).** Accounting standards in Australia are made by the Australian Accounting Standards Board (AASB). The AASB's role changed following adoption of the International Financial Reporting Standards (IFRS) in Australia as it is now involved in the International Accounting

Standards Board's IFRS standard-setting process. The AASB reviews the IFRS text to ensure the standards are appropriate for Australia and issues Australian equivalent A-IFRS which apply to Australian companies with the force of law. The Financial Reporting Council, which is the body responsible for overseeing the effectiveness of the financial reporting framework in Australia, provides oversight of the AASB's activities. There is a full range of high-quality accountancy, audit, legal, and ancillary financial services available in the jurisdiction.

### **Effective Market Discipline**

19. **Australia's corporate financial reporting requirements are contained in the Corporations Act.** Australian auditing standards are made by the Auditing and Assurance Standards Board (AUASB) and are based on the International Auditing and Assurance Standards Board.

20. **Australia has a well-developed capital market.** The Australian stock exchange (ASX) functions primarily as a trading operator, clearing house, and settlements system facilitator. It oversees compliance with its listing rules, promotes standards of corporate governance among listed companies, and seeks to educate retail customers. It places particular emphasis on transparency and disclosure. Overall, capital market corporate governance systems comply with the OECD (Organization for Economic Co-operation and Development) Principles of Corporate Governance. The listed equity market is quite active with over 2,200 companies listed on the exchange. Its debt market is relatively underdeveloped and its over-the-counter market, though active, is small by international standards.

### **Financial Sector Safety Net**

21. **The Reserve Bank of Australia plays a key role in managing and providing liquidity to the financial system.** It is the ultimate provider of liquidity to the financial markets, and fosters lower inflation and sustainable growth. It also (i) seeks to ensure that the payment system is safe and robust; (ii) plays a key role in developing a framework for dealing with financial institutions in distress; and (iii) chairs the CFR. The main objectives of the CFR are to promote the stability of the Australian financial system and to contribute to the efficiency and effectiveness of financial regulation.

22. **A Financial Claim Scheme (FCS) was established in October 2008 for authorized deposit-taking institutions (ADIs) and general insurers.** The FCS is a form of deposit protection which provides for prompt access to deposits if an ADI fails. The FCS is activated for an ADI when APRA has determined that the ADI is insolvent and has applied to the Court to be wound up. The maximum payout to a depositor is \$250,000 (it had been \$1 million between 2008 and 1 February 2012 to foster confidence in the banking system). The FCS is *ex-post* funded; payouts will initially come from the Government but any eventual shortfall will be met by a levy on the industry.

## F. Main Findings

### Objectives, independence, powers, transparency, and cooperation (CP1)

23. **APRA has clear responsibility for the supervision of banks in Australia.** While Australia classifies APRA as an independent statutory authority, there are two areas where there is the potential for APRA's independence to be compromised. One relates to the fact that the Minister may give APRA a written direction about policies it should pursue, or priorities it should follow, in performing or exercising any of its functions or powers. Such a direction may only be given once the Minister has given APRA notice in writing of the proposed direction, and given the Chair of APRA an adequate opportunity to discuss with the Minister the proposed direction. Further, where a direction is given, that direction must be laid before each House of Parliament within 15 sitting days. The second relates to the fact that prudential regulations made by APRA must be tabled in each House of Parliament. After the prudential standards have been laid before each House, a notice of motion to disallow the prudential standards may be given within 15 sitting days. If the notice of motion to disallow is then passed within 15 sitting days after the giving of the notice, the regulations will cease to have effect. APRA has said that neither of these provisions has ever been invoked and that they are not likely to be. Nonetheless, they have the potential to compromise the independence of APRA.

24. **There is no provision mandating the public disclosure of the specific reasons for termination of the appointment of APRA Members** (i.e., its governing body).

25. **Membership of APRA's Risk Management and Audit Committee comprises both internal and external members.** It is recommended that a separate audit committee be established whose membership would comprise external members only.

### Licensing and structure (CPs 2–5)

26. **Although the Australian regulatory approach surrounding licensing and control is broadly appropriate and clearly articulated, one particular concern needs to be addressed.** Australian law permits the existence of non-authorized, non-supervised financial companies who are carrying out deposit-like activities. While the number of such institutions is small and the scale of their activities is mostly de minimis, some major global institutions are benefiting from this exemption. Moreover, with deposit-like facilities being offered to the public, APRA is currently subject to an unnecessary reputational risk arising from this source.

27. **There is some degree of legal restriction on APRA's powers concerning the right to object to or prevent a change in controlling ownership of an ADI.** The Treasurer, rather than APRA, has the power of approval for a change in controlling ownership of an ADI whose asset-size exceeds \$1 billion. The Treasurer is also legally responsible for approving the holding of a stake in any ADI in excess of 15 percent. However, the Treasurer

has delegated approval authority to APRA in cases where the ADI's assets are less than \$1 billion, and the Treasurer takes advice from APRA in relation to ADIs with assets greater than \$1 billion. Although there is no indication that the Treasurer would fail to abide by advice from APRA where the supervisor had concerns, it would support the clarity of APRA's responsibilities for it to be given a binding right of veto on prudential grounds concerning a change in controlling ownership of an ADI, irrespective of the scale of the entity.

### **Prudential regulation and requirements (CPs 6–18)**

28. **Australia has historically adopted a very conservative definition of capital.** This stance is being maintained with the advent of the revised Basel III capital framework, as APRA intends to remain super-equivalent to the Basel standard. This means that the capital levels in Australian banks can appear low relative to their peers, so it is important for the supervisor and the industry to press for strong and comparable disclosure standards so that the capital strength of the Australian banking sector can be accurately assessed and compared with the global community.

29. **APRA undertakes a well-structured Pillar 2 assessment.** However, while APRA reviews firms' Internal Capital Adequacy Assessment Process (ICAAP)—i.e., Pillar 2 assessments—it does not use this input as the sole or main determinant of the minimum level of capital that a bank must hold. Instead, APRA places greater weight upon its Probability and Impact Rating System (PAIRS) methodology as an input. This choice reflects a number of factors including the supervisor's view that the ICAAP process in banks is not sufficiently mature or robust to act as the sole determinant of the capital level. Thus, APRA continues to focus its efforts on improving the banks' ICAAP assessments. Banks are required to hold capital above the minimum level prescribed by APRA, but the size of the buffer is at the firm's individual discretion.

30. **Since APRA's supervisory approach is based squarely on the premise that risk management stems from the bank's board's responsibilities for management and oversight, boards need to focus on improving the quality of their institution's risk management.** The processes and procedures embedding good risk management within the banks are still undergoing seasoning, and not all firms have achieved the same level of expertise. While progress is generally being made throughout the industry, firms need to strengthen their current work on relating risk to capital. Stress testing practices also need further development.

31. **Credit risk management, including impaired assets and provisioning, is well developed in Australia.** APRA keeps track of emerging credit risk issues on an industry-wide basis, through its risk register, and this aids assessment of sectoral concentrations. There is a well-established policy on large exposures, which is currently being reviewed. In the context of a highly concentrated banking system, there is tension between cautious

prudential limits for the interbank market and the practical options open to institutions which APRA must consider. Similarly, appropriate limits with respect to sovereign risk must be assessed in the context of the forthcoming Basel III liquidity framework, which will generate concentrations. With the exception of domestic exposure, sovereign risk is not a major feature of the banking system but, despite its low levels, APRA monitors country risk and has given direction to the industry during the GFC.

32. **A notable feature of the Australian banking system at the time of the assessment is a significant exposure to overseas wholesale funding.** Consequently, the natural focus of much of APRA’s analytical work and engagement with the industry has been upon funding issues. Nevertheless, APRA must guard against too narrow a focus on the funding dimension of liquidity risk. Work undertaken in recent years to review liquidity standards, including contributing to the work on Basel III and intensifying off-site data analysis, needs to continue.

33. **A comprehensive regime for the oversight of money laundering and terrorism financing has been introduced only relatively recently.** Some banks, therefore, have yet to introduce a sufficiently advanced technology system that would eliminate possible errors using less sophisticated means.

#### **Methods of ongoing banking supervision (CPs 19–21)**

34. **APRA has a thorough understanding of the operations of individual banks and the banking system.** APRA operates a risk-based supervisory model that is informed by a peer review process and supported by an extensive and flexible information technology system. The rating methodology used in the risk assessment itself is supported by internal guidance and ratings criteria, which are subject to regular review and update. The ratings criteria provide a mix of concrete and judgmental factors, with the latter putting a premium on the skill set of staff to ensure the exercise of sound supervisory discretion. As in other jurisdictions, the continued evolution of the risk methodology to enhance its forward-looking dimension will be important. Much of APRA’s activity seeks to embed a common approach to the banking and insurance sectors, and this is evident in the issuance of joint prudential standards where possible (e.g., corporate governance). APRA is therefore in a strong position to analyze the relationship between these sectors in terms of risk and should begin to focus more on this area. The development of the “Level 3” (conglomerate) approach should be used as a platform to stimulate such work.

35. **While APRA conducts a well-planned and well-executed approach to on- and off-site supervision, the resource allocation to on-site reviews is modest.** The frequency and intensity of direct on-site supervision of the institutions has been increased since the GFC, and this heightened level needs to be maintained as a minimum. As a matter of importance, APRA should consider extending the duration of its formal on-site reviews so as

to fully scrutinize the institution's risk management practices and ensure that it has a sound understanding of risk management.

### **Accounting and disclosure (CP 22)**

36. **Accounting and Auditing Standards are set to a very high standard in Australia and are based on best international practice.** They are also implemented to a high standard. On the Accounting front, IFRSs were introduced in 2005 and Australia has also adopted the audit standards promulgated by the International Auditing and Assurance Board.

### **Corrective and remedial powers of supervisors (CP 23)**

37. **APRA has a wide range of supervisory tools to deal with problems arising in banks.** These include seeking to resolve the problem through standard supervisory actions; appointing a person to investigate and report on financial matters; issuing directions that embrace a wide set of powers (e.g., directing banks to cease or curtail business); removing directors, senior management or auditors; effecting a compulsory transfer of business; and revoking a license.

### **Consolidated and cross border banking supervision (CPs 24–25)**

38. **APRA meets the requirements for effective consolidated supervision.** APRA meets the standard in terms of overseeing group risk management structures, being informed of breaches of prudential standards on a group-wide basis, calculating the necessary ratios on a solo and consolidated basis, etc. APRA should consider extending the scope of its reviews to cover risks unique to non-banking activities carried on within the group, e.g., valuation of assets/pricing of units in the case of fund management.

39. **Table 1 below offers a principle-by-principle summary of the assessment results.**

**Table 1. Summary Compliance with the Basel Core Principles—ROSCs**

Core Principle	Comments
1. Objectives, independence, powers, transparency, and cooperation	
1.1 Responsibilities and objectives	
1.2 Independence, accountability and transparency	<p>APRA's independence could be compromised by the following provision:</p> <p>The Minister may give APRA a written direction about the policies it should pursue, or priorities it should follow, in performing or exercising any of its functions or powers.</p> <p>There is no mandated provision for the public disclosure of the terms relating to the termination or appointment of an APRA Member (i.e., a member of its governing board).</p>

	APRA has a risk management and audit committee whose membership comprises both internal and external members. Internal membership on an audit committee is contrary to good corporate governance practices.
1.3 Legal framework	Prudential regulations made by APRA must be tabled in each House of Parliament and may, in certain circumstances, be disallowed by parliament.
1.4 Legal powers	
1.5 Legal protection	Staff is protected against the costs of defending their actions and/or omissions made while discharging their duties in good faith; however, the provisions in the APRA Act do not explicitly detail costs.
1.6 Cooperation	
2. Permissible activities	Australian law permits the existence of non-authorized and non-supervised deposit-taking institutions. The number of such institutions is small and the scale of their activities is predominantly de minimis. However, some major global institutions are benefiting from this exemption within the Australian market. Moreover, deposit-like facilities are being offered to the public.
3. Licensing criteria	APRA has a clearly established process for the authorization of banks. APRA has clearly stated full powers to reject applications that do not meet the necessary standards and is not obliged to grant a banking license within a prescribed timeframe. However, APRA does not routinely undertake independent checks on new directors or shareholders under the fit and proper criteria, relying instead on scrutiny of information provided by the institution.
4. Transfer of significant ownership	APRA's powers concerning the right to object to or prevent a change in ownership of an ADI are subject to a particular restriction. This restriction applies to APRA in respect of all systemic banks and is thus material. APRA does not systematically check the ownership of ADIs. Typically there is a wide spread of ownership (in all but one case at present).
5. Major acquisitions	APRA has full powers to review major acquisitions or investments.
6. Capital adequacy	APRA has long adopted a conservative approach to the definition of capital; a stance that it will be maintaining through the transition to the Basel III framework.
7. Risk management	APRA's emphasis upon Board responsibility



	provides a sound foundation for good risk management governance. However, the processes and procedures embedding good risk management within the banks are still undergoing seasoning, and not all firms have achieved an appropriate standard of linking capital to risk.
8. Credit risk	Credit risk is the predominant risk within the Australian banks' balance sheets and APRA has a well-articulated, well-understood, and well-practiced approach to assessing the level of credit risk and the quality of credit risk management within the banking system.
9. Problem assets, provisions, and reserves	Impaired assets are at a low level within the Australian banking system, but APRA operates a prudent regime challenging banks to establish adequate policies and processes for managing problem assets and ensuring the adequacy of provisioning.
10. Large exposure limits	APRA has a clear set of policies on large exposures and concentration risk. These are due to be reviewed, an initiative that will be able to take account of the work conducted by the Basel Committee.
11. Exposure to related parties	APRA has (i) clear prudential standards governing lending to related entities, and (ii) powers to define a connected entity on a case-by-case basis. However, some relevant institutions may fall outside of the definition within the current prudential standard, even though there may be effective reporting. The prudential standard does not cover lending to connected individuals, and although corporate law governs some aspects of connected lending, it does not address all relevant individuals and applies only to public companies.
12. Country and transfer risks	APRA has few regulatory requirements specifically targeted at country and transfer risk, though it meets compliance with the standard largely through its comprehensive approach to credit risk management. In future, country and transfer risk may become a much more significant aspect of the banking system's risk profile and may merit more explicit attention within the prudential standards.
13. Market risks	APRA maintains and enforces clear standards and has close cooperation with the UK FSA, which is valuable in the context that the major Australian institutions have market operations that are run out of London.
14. Liquidity risk	APRA has undertaken significant work on its liquidity regime in recent years in both quantitative

	and risk management terms. Much progress has been made, notably in respect of data requirements from firms, but more is needed both in respect of data requirements and in terms of on-site inspection by APRA. A notable feature of the Australian banking system at the time of the assessment is a significant exposure to overseas wholesale funding. Consequently, the natural focus of much of APRA's analytical work and engagement with the industry has been upon funding issues. Nonetheless, it is important that APRA guards against too narrow a focus upon the funding dimension of liquidity risk.
15. Operational risk	
16. Interest rate risk in the banking book	
17. Internal control and audit	While all banks have a permanent compliance function, there is no explicit provision for banks to establish one.
18. Abuse of financial services	Because of the relatively recent introduction of a comprehensive regime for the oversight of money laundering and terrorism financing, some banks have yet to introduce a sufficiently advanced technology system that would eliminate possible errors using less sophisticated means.
19. Supervisory approach	APRA supervisors possess a comprehensive understanding of banks and banking groups.
20. Supervisory techniques	APRA conducts a well-planned and well-executed approach to on- and off-site supervision. The frequency and intensity of direct contact supervision with the institutions has been increased since the Global Financial Crisis.
21. Supervisory reporting	
22. Accounting and disclosure	
23. Corrective and remedial powers of supervisors	
24. Consolidated supervision	APRA's onsite review regime does not, as a matter of course, extend to a review of risks unique to non-bank activities.
25. Home-host relationships	

## G. Recommended Actions

**Table 2. Recommended Action Plan to Improve Compliance with the Basel Core Principles<sup>4</sup>**

Reference Principle	Recommended Action
1.2 Independence, powers, transparency and cooperation	<p>The assessment team recognizes the difficulties in seeking to address the independence issue and the fact that removing the relevant provisions would go beyond APRA to involve other statutory authorities. However, operational independence is a key factor in enabling a prudential financial regulator to carry out its function in the best interests of depositors and the financial system as a whole. It is therefore suggested that APRA explore with the Australian Government possible avenues which would ensure unambiguous independence within APRA.</p> <p>Legal provision should be made to mandate the public disclosure of the reasons for termination of the appointment of an APRA Member.</p> <p>APRA's Risk Management and Audit Committee should be split in two and the new audit committee should comprise solely external members.</p>
1.3 Legal framework	<p>Provide APRA with sufficient delegated powers, clearly circumscribed to the prudential sphere, to ensure that the supervisor can issue prudential regulations without additional Parliamentary procedures.</p>
2. Permissible activities	<p>Revise the conditions for exemption from section 11 of the Banking Act for Registered Financial Corporation to ensure, at a minimum, that such exemptions are limited to institutions reliant wholly on wholesale funding.</p>
3. Licensing criteria	<p>Evaluate proposed directors and senior management as to their expertise and integrity at point of authorization, on a complete and systematic basis, and independently from the information provided by the institution, to ensure the sound judgment of the supervisor that is not based on information that may be at risk of bias.</p>
4. Transfer of significant ownership	<p>Ensure that APRA has the legal right to prevent a change of control of ownership any ADI on prudential grounds.</p>

<sup>4</sup>Please note that this table does not contain all recommendations within the report. It highlights the main recommendations only.

Reference Principle	Recommended Action
	Ensure that requirements are in place for a bank or ADI to notify the supervisor, at a minimum on an annual basis, of major shareholders including ultimate beneficial shareholders.
7. Risk management	Put in place more guidance or regulation on APRA expectations for enterprise risk management, in particular with respect to capital planning related to risk. Continue to subject banks to regular detailed APRA assessments and feedback to achieve appropriate levels of practice in firms.
11. Exposure to related parties	Review and amend prudential standards to ensure that all lending transactions with related parties—both entities and individuals—above a threshold (whether on normal terms or not) are approved by the board.
14. Liquidity risk	Increase the frequency and duration of formal on-site reviews of liquidity risk management. Finalize the program for the enhanced liquidity risk regime, including revised reporting standards to ensure that firms are capable of providing accurate, system-wide comparable data on a daily basis if required. Also, ensure that the general principles of liquidity risk management are applied to and adhered to by all institutions.
17. Internal control and audit	An explicit requirement should be introduced for banks to have a permanent compliance function.
18. Abuse of financial services	Banks should be given a deadline within which they must install the necessary technology to enable them to meet effectively the obligations under the AML/CFT legislation.
24. Consolidated supervision	APRA should extend its onsite supervisory regime to include an examination of risks unique to non-banking activities carried on within the bank/group as a matter of course, e.g., valuation of assets/pricing of units in the case of fund management activity.

## H. Authorities' Response to the Assessment

40. **The Australian authorities wish to express their appreciation to the IMF and its assessment teams for their assessment.** Australia is strongly committed to the FSAP process and the insights that the FSAP provides into a country's financial sector. Australia acknowledges that it is important to continually review and seek to improve the regulatory framework and supervision practices.

41. **The Australian authorities share the view expressed in the report that Australia has a very high level of compliance against the Basel Core Principles.** There are some assessments, however, with which the Australian authorities disagree.

42. **Importantly, the Australian authorities consider that any assessment of a country's supervisory framework should appropriately reflect the outcomes of that framework.** The strength of Australia's banking system – particularly in the face of the global financial crisis – demonstrates the robustness of Australia's supervisory approach.

43. **The Australian authorities consider that there are some principles for which the assessment does not reflect the strengths and performance of Australia's supervisory approach or where the issues raised are more theoretical than reflective of actual deficiencies in practice or outcomes.**

## II. ASSESSMENT OF INSURANCE CORE PRINCIPLES

### A. Introduction and Scope

44. **This assessment provides an update on the significant regulatory and supervisory developments in the insurance sector of Australia since 2006.**<sup>5</sup> Australia undertook an initial Financial Sector Assessment Program (FSAP) in 2006, which included a formal assessment of its observance of the Insurance Core Principles (ICPs) issued by the International Association of Insurance Supervisors (IAIS) in 2003. The Financial Stability Board has conducted a peer review of the authorities' implementation of the recommendations arising from the 2006 assessment and issued its report in September 2011.

45. **The current assessment is benchmarked against the ICPs issued by the IAIS in October 2011.** The ICPs apply to all insurers, whether private or government-controlled. Specific principles apply to the supervision of intermediaries. The ICPs are presented according to a hierarchy of supervisory material:

- a) ICP statements prescribe the essential elements that must be met in order to achieve observance;
- b) Standards are linked to specific ICP statements and set out the key high-level requirements that are fundamental to the implementation of the ICP statement; and
- c) Guidance material provides details on how to implement an ICP statement or standard.

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<sup>5</sup>The current assessment was conducted by Michael Hafeman (IMF external expert) and Su Hoong Chang (Senior Financial Sector Expert, IMF) from April 30–May 15, 2012.

46. **The assessment is based solely on the laws, regulations, and other supervisory requirements and practices that were in place at the time of the assessment.** Ongoing regulatory initiatives are noted by way of additional comments, e.g., proposed Level 3 supervision of financial conglomerates and the Life and General Insurance Capital Review (LAGIC). A comprehensive self-assessment and other pertinent information (reports, studies, consultation papers, public statements, directives, etc.) provided by the authorities facilitated a meaningful assessment. The assessors also benefited from the valuable inputs and insightful views from meetings with insurers, industry and professional organizations, as well as representatives of the Private Health Insurance Administration Council and the Motor Accidents Authority of New South Wales, which are responsible for overseeing specific segments of the insurance market.

47. **The assessors are grateful to the authorities for their full cooperation and thoughtful logistical arrangements, including the helpful co-ordination of various meetings with industry participants.** Technical discussions with and briefings by officials from APRA and ASIC have enriched the analysis in this report.

## B. Main Findings

The main findings are contained in the table below.

**Table 3. Summary of Compliance with Insurance Core Principles**

Insurance Core Principle	Overall Comments
1 - Objectives, Powers and Responsibilities of the Supervisor	The responsibilities for insurance supervision in Australia are shared among a number of authorities, each of which has a clearly-defined mandate and objectives. However, elsewhere in this assessment, instances are described where a weakness of powers could compromise the achievement of the overall objectives of insurance supervision. For example, as noted under ICP 20, ASIC does not have the power to impose disclosure requirements beyond those set out in the Corporations Act 2001 (CA) or the accounting standards, while APRA has not issued disclosure standards other than on capital adequacy, on the basis that disclosure is not a prudential matter.
2 - Supervisor	Several elements of the Australian regulatory framework need to be carefully considered in order to assess the extent of operational independence, accountability, transparency and adequacy of resources of APRA and ASIC. In light of the standards under ICP 2, they relate in particular to the following:  The relevant Minister has been provided with powers ranging from the possibility of giving policy directions to APRA and ASIC, to being in charge of certain supervisory

Insurance Core Principle	Overall Comments
	<p>decisions, such as regarding the suitability of controlling shareholders of an insurer. Their use is generally subject to a clear and transparent process set out in legislation, which includes a requirement that decisions are made on the basis of the advice of the supervisory agency. Some of these powers have been rarely, if ever, used, and they do not generally include decision-making on day-to-day technical matters affecting particular regulated entities. However, the existence of these powers remains a concern, because they could potentially be exercised in a manner that would adversely affect supervisory policy.</p> <p>APRA and ASIC are dependent on the approval of the Government for their funding. A significant amount of ASIC's funding is non-core funding earmarked for specific projects. The relative share of this non-core funding has been increasing in the last few years, with the budget for 2012–13 continuing this trend. This raises concerns about the ability of ASIC to decide on the operational allocation of a significant part of its resources.</p> <p>Also, as highlighted under ICP 9, resources allocated by ASIC to proactive surveillance are very limited and leave a significant part of the regulated population, including insurance intermediaries, subject to largely reactive surveillance. While currently there are no indications of political interference in the supervision of insurers or insurance intermediaries, approval of the budgets of APRA and ASIC by elected government officials leaves them exposed to cutbacks for financial or political reasons.</p> <p>If an APRA Member or an ASIC Commissioner is removed from office, the reasons are not required to be publicly disclosed and the Government considers mandated disclosure to be inappropriate.</p>
3 - Information Exchange and Confidentiality Requirements	<p>APRA is empowered to obtain and exchange information with other relevant supervisors and authorities subject to confidentiality, purpose, and use requirements. It is signatory to a network of bilateral MoUs and the IAIS Multilateral MoU. APRA has also established close collaboration with relevant supervisors, domestically and internationally, which facilitates proactive information exchange. The existence of an agreement or understanding on information exchange is not a prerequisite for information exchange. The effectiveness of APRA's information exchange could be enhanced by clear internal policies and procedures on notifying other relevant supervisors in advance of taking action against an insurer.</p>

Insurance Core Principle	Overall Comments
4 - Licensing	<p>Insurance activities within Australia can only be conducted by authorized insurers. APRA is the licensing authority under the Insurance Act and Life Insurance Act and has established appropriate licensing requirements in line with international best practices. Licensing procedures are clear and APRA establishes internal guidelines and ensures the consistency of licensing decisions. The licensing process involves significant interaction with the applicants and APRA exercises appropriate due diligence. APRA publishes the licensing requirements and maintains a register of licensed insurers on its website. The authorities are monitoring the level of activities of the unauthorized foreign insurers (UFIs) and discretionary mutual funds (DMFs) to determine the need to subject such entities to prudential supervision.</p>
5 - Suitability of Persons	<p>APRA requires responsible persons of insurers and their Non-Operating Holding Companies (NOHCs) to meet fitness and propriety criteria commensurate with their respective roles. Significant owners must have the financial soundness and integrity necessary to ensure the sound and prudent operations of insurers. Compliance with fit and proper standards is monitored by APRA through its prudential supervision and reporting framework. Where necessary, APRA may direct insurers to remove responsible persons who are not fit and proper for their appointments. In addition, APRA may also remove or apply to the Federal Court to disqualify a responsible person.</p> <p>However, there is no explicit requirement for insurers to notify APRA of any circumstances that may materially and adversely affect the suitability of significant owners. While key persons in 'Control Functions' are covered under the scope of Responsible Persons through the definition of Senior Managers, there are merits to clarifying the scope of "responsible persons" to include an explicit category of "Key Persons in Control Functions", to enhance transparency and to highlight the need for independence of control functions from senior management.</p>
6 - Changes in Control and Portfolio Transfers	<p>The FSSA sets clear ownership and control thresholds above which approval is required. The Treasurer, or APRA as the delegated authority, is empowered to approve proposals to acquire or increase significant ownership or interest in an insurer. In practice, APRA assesses all proposals as if they were initial license applications. While insurers are not explicitly required to notify APRA in the case of a significant decrease in</p>



Insurance Core Principle	Overall Comments
	<p>ownership by a person(s) below the pre-determined control level, such cases may be identified through APRA's supervisory process.</p> <p>Insurers need to obtain approvals from APRA and/or the Federal Court to transfer all or part of their business to another insurer. Prior approval of the Minister is required for transferring 15 percent or more of the insurance business of an insurer.</p>
7 - Corporate Governance	<p>Corporate governance requirements for insurers are extensive and the assessment of corporate governance is a key element of APRA's supervisory assessments. Nonetheless, there is scope to enhance corporate governance requirements for insurers to reflect evolving international best practices.</p> <p>Only listed insurers are required to disclose comprehensive information on their governance.</p>
8 - Risk Management and Internal Controls	<p>In recent years, APRA has strongly emphasized the importance of risk management and internal controls, and some insurers have sophisticated systems in place. In some jurisdictions, each insurer is required to designate a compliance officer.</p>
9 - Supervisory Review and Reporting	<p>APRA's risk-based supervision framework is anchored on PAIRS and the Supervisory Oversight and Response System (SOARS), designed to facilitate better supervisory risk assessment as well as prompt and consistent supervisory actions. There is a baseline supervisory program for all insurers. APRA collects extensive regulatory and statistical information from insurers, and the reporting obligations of general insurers extend to their NOHC and related companies within an insurance group. APRA may also request supervisory information on an <i>ad hoc</i> basis. There are clear scoping statements and processes for onsite reviews. APRA issues formal review reports on its findings and remedial measures in a timely manner and monitors the implementation of required measures. APRA is empowered to inspect service providers of outsourced functions and has conducted such inspections.</p> <p>Given its broad mandate in supervising a large number of licensees, ASIC typically monitors insurers' compliance with conduct of business requirements through desktop reviews. Onsite reviews of insurers are mainly conducted in response to suspected or identified misconduct or other concerns. While ASIC does not issue any report to individual insurers arising from its thematic reviews, it discusses its findings with the insurers concerned. Where</p>

Insurance Core Principle	Overall Comments
	<p>appropriate, ASIC may exercise compulsory information gathering powers against service providers of functions that have been outsourced by insurers.</p> <p>Feedback from industry participants suggested that there is scope for ASIC to have more proactive engagement on conduct of business issues and a more consultative approach. There are merits in promoting more effective on-going dialogue and monitoring to prevent breaches rather than having to manage the consequences of systemic misconduct.</p>
10 - Preventive and Corrective Measures	<p>The SOARS framework supports the progressive escalation of actions or remedial measures. APRA has wide powers to initiate timely and proportionate preventive and corrective measures where insurers are unable or unwilling to adequately address supervisory concerns. While the conduct of unauthorized life insurance business is not explicitly an offence under the LIA, APRA would address such cases through indirect means including cooperating with ASIC. APRA may commence civil proceedings in its own name and at its own initiative. Where APRA considers criminal prosecution is appropriate, APRA may refer the matter to the DPP to decide whether to prosecute. There have been no instances of civil or criminal proceedings being commenced in respect of unauthorized insurance activities taken since 2006.</p>
11 - Enforcement	<p>In 2008, the enforcement powers of APRA were broadened to include power to issue directions and appoint judicial managers. APRA enforces corrective action and imposes sanctions, where necessary. Enforcement action is taken in accordance with applicable legislative criteria and guided by an Enforcement Manual, which is publicly available. There is a dedicated Enforcement Unit to deal with matters escalated by frontline supervisors. APRA's Enforcement Committee promotes consistency in its approach to enforcement. APRA has taken enforcement actions in respect of a number of general insurers, but it has not had cause to exercise enforcement powers in respect of life insurers since 2006.</p>
12 - Winding-up and Exit from the Market	<p>Insolvency is defined in the CA, and APRA has extensive powers to take timely intervention by requiring the discontinuance of insurance business, and the orderly exit of an insurer. The winding-up of insurers is based on the procedure set out in the CA, subject to certain insurance specific modifications set out in IA and LIA.</p> <p>There is no formal requirement under the IA that policy</p>

Insurance Core Principle	Overall Comments
	<p>liabilities of a general insurer must be met ahead of liabilities to other unsecured creditors. However, the requirement that an insurer must hold assets in Australia of a value which equals or exceeds its liabilities in Australia, gives a large measure of protection to policyholders. This protection is supplemented by the establishment of the Policyholder Compensation Facility.</p> <p>Life policyholders have priority of claims over unsecured creditors in the same statutory fund. Capital requirements must be met for each statutory fund. However, where their policy liabilities cannot be met from that fund, policyholders may rank behind the unsecured creditors of another statutory fund that has surplus assets. The Court may take into account the interests of policyholders in deciding on the distribution of the surplus assets of any fund that has first met its obligations to the unsecured creditors of that fund. The authorities may also consider invoking appropriate resolution measures, including the use of public funds available under the LIA to fund the transfer of a life insurance portfolio, to protect policyholders.</p>
13 - Reinsurance and Other Forms of Risk Transfer	Australia's exposure to natural catastrophes makes strong reinsurance coverage essential to the insurance market and overall economy. APRA reviews the reinsurance strategies and programs of insurers, and assesses the exposure of both individual insurers and the industry to the various reinsurers that are providing coverage.
14 - Valuation	The risk margins in general insurance liabilities are calculated to meet a specified level of uncertainty. However, the risk margins in life insurance solvency liabilities are calculated using specified assumptions, which means that the risk margins can vary depending on the current best estimate assumptions. The risk margins in life insurance capital adequacy liabilities are explicit, but can be selected from prescribed ranges, which means that the level of uncertainty provided for by the margins can vary.
15 - Investment	Insurers have a very broad choice of investment assets and many of the requirements are qualitative and principles-based in nature. Responsibility for the proper management of investment risks lies with the insurer, supported by adverse treatment under the capital adequacy standards in respect of risky or concentrated investments, along with rigorous supervisory assessments. Such a regime is appropriate for a developed market and supervisory system like Australia,

Insurance Core Principle	Overall Comments
	but some additional quantitative restrictions might nevertheless be useful.
16 - Enterprise Risk Management for Solvency Purposes	Enterprise risk management is an evolving field, both in Australia and internationally. Some Australian insurers have sophisticated enterprise risk management systems, while others are at earlier stages of development. The LAGIC project is intended to strengthen the regulatory framework in areas relevant to enterprise risk management, and its implementation should be helpful in that regard.
17 - Capital Adequacy	Rather than defining solvency control levels as part of the requirements, APRA requires insurers to establish their own solvency control levels, which must be agreed with APRA. This approach helps to ensure that insurers are actively involved in assessing their capital needs and developing appropriate capital plans. However, the resulting solvency control levels are not transparent to the market and might not provide a consistent level of sufficiency at which intervention would be triggered.
18 - Intermediaries	The regulatory regime for insurance intermediaries is mature, well-understood, and has a broad coverage. ASIC has established clear licensing guides and regulatory guides on the supervision of representatives of Australian Financial Services License (AFSL) holders, including minimum training standards. The CA gives ASIC adequate powers to take action in relation to breaches. However, to supervise the large numbers of licensees with limited resources, ASIC has adopted a more reactive approach to supervising intermediaries (see ICP 19). There is also scope to have explicit and more comprehensive corporate governance requirements for intermediaries.
19 - Conduct of Business	The current regulatory regime, which sets high-level principles for conduct of business in the area of fair treatment of customers, should be supported by clearer regulatory guidance in line with international best practices. In particular, the current minimum training and competency standards for intermediaries should be strengthened. Gaps exist in ASIC's legal authority and regulatory requirements; such gaps may affect ASIC's ability to supervise insurers' claim practices and policy servicing and may dilute the effectiveness of the conduct of business supervision. Partly due to limited supervisory resources, ASIC's supervisory approach is predominantly based on desk-top reviews and relies heavily on self-reporting of breaches of regulatory requirements or third-party notifications (ICP 9).

Insurance Core Principle	Overall Comments
	<p>To enhance the protection of policyholders, there is scope to broaden ASIC's authority in ensuring fair treatment of customers, e.g., supervising insurers' claims handling practices; introducing requirements for the servicing of policies until their expiry; and product development. It is also critical for ASIC to be adequately resourced to supervise the conduct of business of about 1,560 AFSL holders.</p>
20 - Public Disclosure	<p>Public disclosure is receiving increasing emphasis internationally as a key element of the framework for supervising financial institutions. It is one of the main elements of the IAIS Framework for insurance supervision, and the requirements under this ICP were considerably strengthened in the 2011 revisions. The disclosure requirements applicable to insurers in Australia have not kept pace with these developments. Some of the types of disclosure called for by ICP 20 are required only of listed insurers in Australia, while some of the specific items are not required to be disclosed at all.</p> <p>This situation, at least in part, arises from a gap in supervisory responsibilities and powers. ASIC does not have the power to impose disclosure requirements beyond those set out in the CA or the accounting standards, while APRA has not issued disclosure standards other than on capital adequacy.</p>
21 - Countering Fraud in Insurance	<p>Fraud in insurance is an illegal act punishable by law. APRA assesses insurers' fraud risk management frameworks, determining their appropriateness and effectiveness for managing the fraud risk exposures. ASIC may undertake surveillance visits where it becomes aware of any deficiencies in an insurer's compliance obligations in relation to identifying and managing fraud risk. ASIC and APRA cooperate, coordinate and exchange information with other competent authorities, including foreign supervisory authorities.</p>
22 - Anti-Money Laundering and Combating the Financing of Terrorism	<p>APRA and ASIC are aware of the money laundering and terrorism financing risks of the insurance industry and have effective mechanisms to cooperate, coordinate and exchange information with both domestic and foreign supervisors/FIUs.</p> <p>Financial Action Task Force (FATF) standards apply at a minimum to the underwriting and placement of life insurance and other investment-related insurance. However, in some jurisdictions, money laundering activities have extended to the general insurance sector. Accordingly, where the non-life sector, or part of that sector, is assessed by a jurisdiction as posing a ML/FT</p>

Insurance Core Principle	Overall Comments
	<p>risk, the FATF standards require that the jurisdiction considers applying the FATF standards to that sector. In Australia, general insurance is subject to the Financial Transactions Reports Act, but is not subject to the more comprehensive AML/CFT requirements prescribed by the AML/CFT Act.</p>
23 - Group-wide Supervision	<p>APRA has established an effective and efficient framework for supervision of general insurance groups. The Level 2 supervision framework has been designed to enable a better understanding of group risks and address potential contagion from both regulated and non-regulated entities. APRA has adequate powers and flexibility to determine the scope of Level 2 groups and effectively supervise insurance groups, and has exercised sound supervisory discretion in applying the framework. Although APRA has powers to set requirements for life insurance groups including on an individual group basis, an equivalent Level 2 supervision framework has not been developed for life insurers. This will be largely addressed by the impending Level 3 supervision of financial conglomerates.</p> <p>ASIC's supervision of market conduct is at the legal entity level and there are no group-wide market conduct requirements.</p>
24 - Macroprudential Surveillance and Insurance Supervision	<p>APRA has a comprehensive set of processes and tools that support its ability to perform macroprudential surveillance and insurance supervision. Its plans to make increasing use of stress testing in the future should further strengthen its quantitative analyses of industry-wide risks.</p>
25 - Supervisory Cooperation and Coordination	<p>APRA has in place coordination arrangements with other relevant domestic and foreign supervisors, which facilitate effective prudential supervision on a legal-entity and a group-wide basis. Where appropriate, APRA coordinates with relevant agencies from other sectors, including central banks and government ministries. Domestically, APRA liaises closely with all relevant agencies involved in Australia's financial sector supervision, both bilaterally and at the CFR level, and has formalized some of the arrangements through bilateral and joint MoUs.</p> <p>At the international level, APRA has established coordination arrangements and regularly shares information with relevant foreign regulators, particularly with RBNZ in view of the significant operations of a few Australian insurers in New Zealand. Where APRA is the designated group-wide supervisor, it establishes the key functions of supervisory colleges and other coordination</p>

Insurance Core Principle	Overall Comments
	mechanisms as the key coordinator or chairman of the supervisory college.
26 - Cross-border Cooperation and Coordination on Crisis Management	APRA maintains effective working relationships with relevant foreign home and host supervisors, particularly in jurisdictions where the cross-border insurance activities are systemically important. These relationships assist in facilitating effective, coordinated cross-border crisis resolution in the event of need. The MoU on financial distress management executed by the CFR agencies also applies to cross-border financial stress. APRA is well equipped with the necessary statutory powers and tools to respond effectively to a cross-border crisis involving insurers. There is currently no requirement for insurers to maintain recovery or resolution plans.

### C. Recommended Actions

**Table 4. Recommendations to Improve Observance of ICPs**

Insurance Core Principle	Recommendations
1 - Objectives, Powers and Responsibilities of the Supervisor	Legislation should be amended to give ASIC the power to make rules, which will help to close gaps in the current regulatory framework for conduct of business.
2 - Supervisor	<p>The authorities should take the following steps to strengthen the ability of APRA and ASIC to exercise their functions and powers in a more effective and operationally-independent manner:</p> <ul style="list-style-type: none"> <li>a) Eliminate or further restrict the ability of the Minister to give directions to APRA and ASIC on matters of supervisory policy;</li> <li>b) Eliminate or further restrict the involvement of the Minister in decisions related to individual regulated entities or individuals; and</li> <li>c) Consider the various possibilities to arrange the funding of APRA and ASIC in such a manner that will ensure they will have the resources needed to respond to the current and emerging supervisory challenges.</li> </ul>
5 - Suitability of Persons	<p>The current suitability requirements could be enhanced by:</p> <ul style="list-style-type: none"> <li>a) requiring insurers to notify APRA of any circumstances that may materially and adversely affect the suitability of significant owners; and</li> <li>b) separating “Key Persons in Control Functions” from the definition of “senior manager” under “responsible</li> </ul>

Insurance Core Principle	Recommendations
	persons.”
6 - Changes in Control and Portfolio Transfers	Insurers should be required to notify APRA of any significant decrease in ownership by a person(s) below the pre-determined control level approved by the Minister.
7 - Corporate Governance	<p>Corporate governance might be further enhanced by amending the requirements to more explicitly indicate the responsibility of Boards to maintain and enforce policies to deal with conflicts of interest.</p> <p>All insurers should be required to disclose their governance practices in their annual reports, which would make important information on governance available to all relevant stakeholders.</p>
8 - Risk Management and Internal Controls	APRA should consider requiring each insurer to designate an officer with overall responsibility for compliance, which could both reinforce accountability and facilitate communication between the insurers and their supervisors.
9 - Supervisory Review and Reporting	<p>The authorities are advised to:</p> <ul style="list-style-type: none"> <li>a) review the effectiveness of ASIC’s current predominantly desktop approach to supervising insurers’ conduct of business;</li> <li>b) empower ASIC to inspect the service providers of functions outsourced by insurers; and</li> <li>c) ensure that ASIC is equipped with adequate supervisory resources, including the technical capacity for effective and proactive supervision of insurers’ conduct of business.</li> </ul>
11 - Enforcement	Significant progress has been made in strengthening and harmonizing the enforcement powers of APRA in dealing with life and general insurers. However, differences remain, e.g., lack of power to revoke the license of a life insurer directly. Thus, the current momentum for the on-going review on harmonizing the powers of APRA across the financial sector should be maintained.
12 - Winding-up and Exit from the Market	The authorities should consider providing for the legal priority of claims by policyholders of general insurers over unsecured creditors, as well as the greater legal priority of life policyholders’ claims to the assets of other statutory funds, ahead of unsecured creditors.
14 - Valuation	APRA should consider specifying the level of uncertainty to be provided for by the risk margins in life insurance liabilities.
15 - Investment	APRA should consider the establishment of additional quantitative restrictions, for example, on large exposures, investments with related parties, more-complex and less-



Insurance Core Principle	Recommendations
	<p>transparent classes of assets, and investments in markets or instruments that are subject to less governance or regulation. Such restrictions might be useful in the supervision of both insurers and insurance groups.</p> <p>As noted under ICP 23, APRA should also formally extend its supervision to life insurance groups, which would include relevant investment requirements.</p>
16 - Enterprise Risk Management for Solvency Purposes	<p>Whether through LAGIC or otherwise, APRA should enhance the requirements on enterprise risk management. In particular, insurers should be required to explicitly describe the relationship between their risk tolerance limits, regulatory capital requirements, economic capital, and the processes and methods for monitoring risk. They should be required to (i) document their approach to measuring risks; (ii) establish quantitative and qualitative risk tolerance levels; (iii) define risk tolerance limits which take into account all relevant and material categories of risk and the relationships between them; and (iv) make use of such limits in their business strategy and day-to-day operations. APRA should also provide more explicit guidance regarding the performance of own risk and solvency assessments.</p>
17 - Capital Adequacy	<p>APRA should take steps to increase the transparency and ensure the consistency of the solvency control levels.</p>
19 - Conduct of Business	<p>The authorities should strengthen the current regime for conduct of business by:</p> <ul style="list-style-type: none"> <li>a) implementing the enhanced training and competency standards proposed by ASIC;</li> <li>b) requiring insurance intermediaries to ensure the privacy protection of customers;</li> <li>c) empowering ASIC to establish or enforce regulatory requirements to ensure fair treatment of customers and product development; and</li> <li>d) ensuring that ASIC is adequately resourced to conduct proactive supervision to prevent misconduct instead of the current more reactive approach to deal with identified breaches and shortcomings.</li> </ul>
20 - Public Disclosure	<p>APRA and ASIC should cooperate to identify and deal with the shortcomings in the disclosure requirements. As noted in the description, the shortcomings include:</p> <ul style="list-style-type: none"> <li>a) the exemption of small and unlisted insurers from many disclosure requirements;</li> <li>b) the limited details disclosed on the capital adequacy of life insurers;</li> </ul>

	<p>c) the need for disclosure of an analysis of sources of earnings; and</p> <p>d) the need for comprehensive disclosures on corporate governance, risks, and risk management.</p> <p>The authorities should consider requiring all insurers to make their audited financial statements and required disclosures available to the public at no cost.</p>
21 - Countering Fraud in Insurance	Consistent with the recommendations under ICP 9, ASIC might further strengthen its oversight of the fraud controls of AFSL holders by adopting a more proactive inspection program.
22 - Anti-Money Laundering and Combating the Financing of Terrorism	The authorities should periodically reconsider whether or not general insurance should be subject to the more comprehensive requirements prescribed by the AML/CFT Act.
23 - Group-wide Supervision	The impending introduction of Level 3 supervision of financial conglomerates will formalize group regulatory requirements for life insurers. The authorities should incorporate group-wide market conduct requirements in both Level 2 and Level 3 supervision frameworks.
26 - Cross-border Cooperation and Coordination on Crisis Management	The authorities should implement the requirement for insurers to establish and maintain contingency plans and procedures for use in a going- and gone-concern situation.

#### D. Authorities' Response to the Assessment

48. **The Australian authorities wish to express their appreciation to the IMF and its assessment teams for their assessment.** Australia is strongly committed to the FSAP process and the insights that the FSAP provides into a country's financial sector. Australia acknowledges that it is important to continually review and seek to improve the regulatory framework and supervision practices.

49. **The Australian authorities share the views expressed in the report that Australia has a high level of observance with the Insurance Core Principles.** In Australia's view, robust supervision by APRA and ASIC is a key factor in this. There are, however, some areas where the Australian authorities disagree with the assessment or do not consider that the recommendations will necessarily support better regulatory outcomes.

50. **The Australian authorities consider that there are some principles for which the assessment does not reflect the strengths and performance of Australia's supervisory approach or where the issues raised do not reflect actual deficiencies in practice or outcomes.**

### III. IOSCO OBJECTIVES AND PRINCIPLES FOR SECURITIES REGULATION

#### A. Summary

51. **The Australian legal and regulatory framework for securities markets exhibits a high level of compliance with the International Organization of Securities Commissions (IOSCO) Principles.** However, a few remaining concerns need to be resolved, including some identified in the 2006 assessment. The Australian Securities and Investments Commission's (ASIC) operational independence and sufficiency of resources are overarching concerns, which impair its ability to discharge its supervisory functions adequately and effectively across the entire regulated population.

52. **Despite being primarily a market conduct regulator, ASIC is also responsible for the overall supervision of a significant number of market intermediaries.** This includes monitoring their compliance with obligations of a prudential nature, including those relating to capital requirements and risk management. This requires ASIC to remain alert to the prudential regulatory challenges it faces.

53. **The capital adequacy requirements need to be strengthened to improve the manner in which they address the risks to which various types of intermediaries are subject.** With regard to other risks, ASIC has responded to the need to focus on systemic and emerging risks in securities markets. It is important to continue to further develop the work of the Emerging Risk Committee (ERC) and to ensure that potential important findings relating to the securities market and its participants are appropriately channeled for discussion at the Council of Financial Regulators (CFR).

54. **ASIC shares its regulatory responsibility for Clearing Participants with the Australian Stock Exchange Group (ASX), which sets and monitors their capital requirements.** Australian Prudential Regulation Authority's (APRA) role in their supervision is very limited, even though it is the primary prudential regulator in Australia. The splitting of prudential supervisory responsibilities emphasizes the need for close cooperation, which is currently undertaken through the CFR and bilaterally. However, there seems to be a need to assess whether the current regulatory structure is best suited to respond to the present and future challenges.

55. **ASIC is an enforcement focused regulator.** In recent years, its reputation as an effective and credible enforcer of market regulation and corporate law has been enhanced through a series of high profile and successful prosecutions. It is less focused on ongoing, proactive supervision, which is an area that requires increased attention to complement the current enforcement efforts and to add to their deterrent effect.

56. **ASIC prioritizes cooperation and information sharing with regulators in other jurisdictions.** Current legislation is hampering its efforts here as the focus globally moves to cooperation on supervisory as well as enforcement matters. The Government is progressing

amendments to the relevant law and regulations, which are intended to remove at least some of the existing restrictions and bolster ASIC's capacity for international regulatory cooperation on supervisory matters; these amendments are expected to be in place by late 2012.

57. **There is a good level of protection for shareholders in Australia, and accounting and auditing standards are high.** Australia devotes considerable resources to ensure that its standards and their application and enforcement continue to match best global practice and to influence global developments.

58. **The regulatory framework and supervisory practices for collective investment schemes (CIS) need to be improved to comply with the IOSCO Principles.** ASIC has recently expanded its supervisory activities on hedge funds, but is constrained by lack of powers on wholesale hedge funds and on cross-border supervisory cooperation. It is also improving the coverage of its risk-based supervisory approach applicable to market intermediaries. However, ASIC's supervisory program would benefit from further expansion and uniform prioritization across the organization.

59. **The opening of Australia's securities markets to competition in the provision of execution venues has been the catalyst for significant changes in market regulation.** ASIC has taken over many of the key responsibilities for market oversight and the regulation and supervision of non-clearing participants from ASX and other smaller domestic market operators. This has brought some changes to its rule writing powers and funding arrangements.

60. **Banking, insurance, and securities regulators, both in Australia and globally, continue to face significant regulatory challenges in the increasingly complex markets.** New risks can arise in areas that have traditionally been considered to be of low risk. Against this background, it is important to remain alert to the evolving risks and, if needed, adjust the regulatory priorities and responsibilities accordingly to ensure an optimal structure. A key element in this is the monitoring of developments on the basis of timely, comprehensive, and robust data.

## **B. Introduction**

61. **An assessment of the level of implementation of the IOSCO Principles in Australia was conducted from April 23 to May 11, 2012 as part of the Financial Sector Assessment Program (FSAP).<sup>6</sup>** An initial IOSCO assessment was conducted in 2006. At that time, several weaknesses in the scope and effectiveness of securities market regulation

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<sup>6</sup>The assessment was conducted by Eija Holttinen (Monetary and Capital Markets Department of the IMF) and Richard Britton (IMF external expert).

were identified. Since then, ASIC has undergone a major structural reorganization intended, among other objectives, to bring staff closer to those they supervise so as to enable them to understand the businesses better and to promote a positive approach to compliance among the various classes of stakeholders.

### **C. Information and Methodology Used for the Assessment**

62. **The assessment was conducted based on the IOSCO Principles and Objectives of Securities Regulation approved in 2010 and the Methodology updated in 2011.** As has been the standard practice, Principle 38 was not assessed due to the existence of separate standards for securities settlement systems and central counterparties.

63. **The IOSCO methodology requires that assessors not only look at the legal and regulatory framework in place, but also at how it has been implemented in practice.** The ongoing global financial crisis has reinforced the need for assessors to take a critical look at, and to make a judgment about supervisory practices, and to determine whether they are effective enough. Among others, such a judgment involves a review of the inspection programs for different types of supervised entities, the cycle, scope, and quality of inspections, as well as how the agency follows up on findings, including by using enforcement actions.

64. **The assessors relied on:** (i) an extensive self-assessment prepared by ASIC staff, which included detailed descriptions on the legal basis for the exercise of ASIC's powers; (ii) reviews of the relevant legislation and other documents published by ASIC and other authorities; (iii) meetings with staff from ASIC, APRA, the Reserve Bank of Australia (RBA), the Treasury, the Financial Reporting Council, the Takeovers Panel, and the Commonwealth Director of Public Prosecutions; and (iv) meetings with market participants, including banks, fund managers, exchanges, the Alternative Investment Management Association (AIMA), Australian Accounting Standards Board (AASB), AUASB, Australian Financial Markets Association, Australian Shareholders' Association, Financial Services Council, and Law Council of Australia.

65. **The assessors want to thank ASIC and its staff for their full cooperation and willingness to engage in discussions on the many complex issues covered by the Methodology.** The team is especially grateful to Steven Bardy and his colleagues Marian Kljakovic, Ruchi Sharma, and Trudy Bannister for responding to frequent requests for more data and other information and for organizing the schedule with great efficiency and good humor.

### **D. Regulatory Structure**

66. **ASIC is the corporate, markets, and financial services regulator in Australia.** It is a body corporate established under the Australian Securities and Investments Commission Act 2001 (ASIC Act). ASIC's primary role is to regulate Australian companies, financial

markets, financial services, organizations, and professionals who deal and advise in investments, superannuation, insurance, deposit taking and credit. The ASIC Act requires ASIC to:

- Maintain, facilitate, and improve the performance of the financial system and entities in it;
- Promote confident and informed participation by investors and consumers in the financial system;
- Administer the law effectively and with minimal procedural requirements;
- Enforce and give effect to the law;
- Receive, process, and store, efficiently and quickly, information given to ASIC; and
- Make information about companies and other bodies available to the public as soon as practicable.

67. **The Australian Prudential Regulation Authority (APRA) is in charge of the prudential supervision of banks, insurers, and superannuation (pension) fund trustees.** Under s912A Corporations Act 2001 (CA), those Australian Financial Services License (AFSL) holders that are “bodies regulated by APRA” are waived from the requirements of the CA relating to financial, technological, and human resources and risk management, because APRA’s requirements are considered to be sufficient to address these issues.

68. **ASIC supervises all other AFSL holders, including for compliance with requirements of a prudential nature.** However, ASX continues to have a significant role in the supervision of Clearing Participants. Despite the transfer of Market Participant supervision to ASIC in August 2010, the capital requirements of Clearing Participants are still set and monitored by ASX Clear and ASX Clear (Futures), subject to the oversight of ASIC.

**The roles of ASIC, APRA, and ASX in the prudential supervision of Market and Clearing Participants and operators of retail CIS in Australia are demonstrated in the tables below.** Supervision of the majority of the most important Market Participants (i.e., exchange members) is shared between ASIC and the operators of ASX Group’s clearing facilities, given that most of the Market Participants are also Clearing Participants. In contrast, APRA has a role in the prudential supervision of many of the most important operators of retail CIS, i.e., Responsible Entities (REs) of Managed Investment Schemes (MIS).

**Table 5. Trading Volume, Market Share, and Regulatory Status of the 20 Most Important ASX Members in 2011**

Name	Equity Trades (\$bn)	% Share of Total Trades	APRA Regulation	ASX Clearing Participant Capital Requirements
UBS Securities Australia Ltd	407.4	13.85	No	Yes
Citigroup Global Markets Australia Pty Ltd	407.2	13.84	No	Yes
Deutsche Securities Australia Ltd	258.1	8.78	No	Yes
Goldman Sachs Australia Pty Ltd	235.6	8.01	No	Yes
Macquarie Securities (Australia) Ltd	224.7	7.64	Level 2	Yes
Credit Suisse Equities (Australia) Ltd	189.5	6.44	No	Yes
Morgan Stanley Australia Securities Ltd	164.4	5.59	No	Yes
Merrill Lynch Equities (Australia) Ltd	129.5	4.40	No	Yes
Commonwealth Securities Ltd	120.6	4.10	Level 2	Yes
JP Morgan Securities Australia Ltd	113.3	3.85	No	Yes
RBS Equities (Australia) Ltd	97.0	3.30	No	Yes
BBY Ltd	33.1	1.12	No	Yes
Nomura Australia Ltd	47.0	1.60	No	No <sup>1</sup>
Etrade Australia Securities Ltd	42.0	1.43	Level 2	Yes
Susquehanna Pacific Pty Ltd	39.3	1.34	No	No <sup>2</sup>
Australian Investment Exchange Ltd	31.6	1.07	Level 2	Yes
Instinet Australia Pty Ltd	31.2	1.06	No	Yes
ABN AMRO Clearing Sydney Pty Ltd	30.0	1.02	No	Yes
IMC Pacific Pty Ltd	25.6	0.87	No	No <sup>3</sup>
Macquarie Equities Ltd	24.3	0.83	Level 2	Yes
Total	2,651.4	90.14		

Source: ASIC.

<sup>1</sup> ASIC Market Participant capital requirements.

<sup>2</sup> AFSL requirements since only principal trader.

<sup>3</sup> AFSL requirements since only principal trader.

**Table 6. Funds Under Management (FUM)<sup>1</sup> by 20 Largest Responsible Entities on December 31, 2011**

Licensee	APRA Regulated <sup>2</sup>	Corporate Group	Wholesale FUM (\$ bn)	Retail FUM (\$ bn)	Total FUM (\$ bn)
Colonial First State Investments Ltd	RSEL	CBA	38.49	30.22	68.71
Vanguard Investments Australia Ltd	RSEL		24.42	1.26	25.68
Macquarie Investment Management Ltd	RSEL	Macquarie	10.82	7.46	18.28
Perpetual Investment Management Ltd <sup>3</sup>	No	Perpetual	8.58	5.24	13.82
Platinum Investment Management Ltd	No			11.28	11.28
BT Funds Management Ltd	RSEL	Westpac	0.97	9.97	10.93
Schroder Investment Management Australia Ltd	No		10.68		10.68
IPAC Asset Management Ltd	L2 (NOHC)	AMP	7.19	1.31	8.50
DFA Australia Ltd	No		7.50		7.50
BlackRock Asset Management Australia Ltd	RSEL		7.32		7.32
Equity Trustees Ltd	RSEL		6.41	0.90	7.31
Advance Asset Management Ltd	L2 (ADI)	Westpac	5.42	0.74	6.16
IOOF Investment Management Ltd	RSEL	IOOF	0.24	5.87	6.11
ANZ Trustees Ltd	L2 (ADI)	ANZ		5.81	5.81
MLC Investments Ltd	L2 (ADI)	NAB	2.10	3.46	5.56
BT Investment Management (RE) Ltd	L2 (ADI)	Westpac	5.13		5.13
Fidante Partners Ltd	L2 (NOHC)	Challenger	1.29	3.73	5.02
UBS Global Asset Management (Australia) Ltd	No	UBS	4.32		4.32
Ibbotson Associates Australia Ltd	No	Morningstar	4.28		4.28
Ausbil Dexia Ltd	No	Dexia	3.78		3.78

Source: ASIC.

<sup>1</sup>The funds under management include funds in MIS and superannuation funds. The data is not available separated between these two categories. The table therefore primarily demonstrates the number of firms among the most important fund managers where ASIC and APRA share the supervisory responsibilities and where APRA is therefore responsible for certain requirements as described in paragraph 17.

<sup>2</sup>RSEL means registered superannuation entity licensee (Level 1 regulation by APRA); L2 (ADI) means Level 2 regulation by APRA as a subsidiary of an authorized deposit-taking institution; L2 (NOHC) means Level 2 regulation by APRA as a subsidiary of a registered non-operating holding company.

<sup>3</sup>Approximately \$4 billion of total FUM is managed by a related entity, Perpetual Superannuation Ltd, which is an RSEL. This \$4 billion is retail FUM.



69. **The Reserve Bank of Australia (RBA) has responsibility for monetary policy, payment system oversight, and overall financial stability in Australia.** ASIC, APRA, the RBA, and the Australian Treasury are members of the Council of Financial Regulators (CFR). The CFR has a role in identifying and addressing regulatory overlaps and gaps, and advising the Australian Government on the adequacy of Australia's financial system architecture in light of ongoing developments. It also provides a forum for cooperation and collaboration among its members.

70. **The Australian Competition and Consumer Commission (ACCC) is responsible for administering a range of general consumer protection provisions contained in the Australian Consumer Law.** However, the consumer protection provisions in relation to financial services and credit activities have been carved out from the general jurisdiction of the ACCC and assigned to ASIC. The Australian Transaction Reports and Analysis Centre (AUSTRAC) is responsible for protecting the integrity of Australia's financial system and contributing to the administration of justice in countering money laundering and the financing of terrorism.

71. **The relevant Parliamentary Minister has the main responsibility for granting the licenses and approving the rules for holders of the Australian Market License (AML) and the Clearing and Settlement Facility License (CSFL).** The Minister makes these decisions on the basis of advice from ASIC. In relation to CSFL applications, the RBA assesses compliance with the Financial Stability Standards.

### E. Legal Framework

72. **The principal legislative acts governing the structure and conduct of securities markets and their participants are the Corporations Act 2001 (CA) and the ASIC Act 2001.** Market intermediaries are required to obtain an Australian Financial Services License (AFSL) from ASIC. While the concept of providing financial services or offering financial advice is defined very broadly in the legislation, a license is issued for specific itemized activities and financial products. A person wishing to operate an exchange is required to obtain an AML. The concept of what constitutes an exchange (or financial market) is also broadly defined. The appropriate license—the CSFL—is also required in order to operate a clearing and/or settlement facility.

73. **ASIC has only recently been given the power to draft legally enforceable market integrity rules for licensed markets and their participants.** The market integrity rules require ministerial consent. Generally, the Minister proposes regulations under the Corporations Act, which are made by the Governor-General. ASIC implements legislation, regulations, and the market integrity rules. ASIC can and does issue Regulatory Guides that set out how it interprets the legislation and regulations that it administers.

74. **ASIC also has the statutory power to grant relief to a person or a class of persons from certain provisions of the CA.** The power is broad. ASIC can exempt a person

or a class of persons from provisions of the CA, or declare that one provision of the CA applies even if another provision was omitted, modified or varied. All class order relief, with a Regulatory Impact Statement where required, must be tabled in each House of Parliament and can be disallowed by negative resolution. All class order relief is required to be registered and published on an electronic register maintained by the Attorney-General's Department. Most, but not all individual relief is required by the CA to be published by ASIC. ASIC also publishes a quarterly report that sets out the main themes of recent relief granted. References to individual relief granted would be included in this compendium only if they contributed to a theme for a particular report.

## F. Market Structure

### Market Intermediaries

75. **As at April 2012 there were 137 Market Participants in Australia.** All Market Participants are members of a licensed financial market (e.g., ASX, ASX 24 and Chi-X). ASIC has authorized 2,991 AFSL holders to access the market through a Market Participant, although not all of them in fact do so. It estimates that approximately 700 of these AFSL holders, Indirect Market Participants, are currently actively providing services similar to Market Participants under their licenses.

76. **The top 20 Market Participants' market share at ASX amounted to approximately 90 percent in 2011.** Trading on ASX is dominated by Australian subsidiaries of global investment banks. All top 20 Market Participants are regulated by ASIC rather than APRA. However, for the majority of them (those that are also Clearing Participants), it is ASX Clear that sets and monitors their capital requirements under the supervision of ASIC.

77. **3,345 AFSL holders are authorized to act as investment advisors and provide personal advice.** Some of these advisors are individuals rather than firms. ASIC estimates that 2,055 of these AFSL holders are permitted to deal on behalf of clients, have custody of assets, or manage client accounts.

## G. Collective Investment Schemes

**The amount of funds under management in Australian CIS is relatively small, whereas the funds managed by superannuation funds are at a high level.** A minimum investment in superannuation funds is compulsory, and additional investments are subject to tax benefits up to a yearly limit. The definition of a CIS (called Managed Investment Scheme) is broad. Details of funds under management in Retail MIS<sup>7</sup> at the end of 2011 are given in Table 7.

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<sup>7</sup>This table does not include information on investments in Wholesale MIS, see Principle 24 for further details.

**Table 7. Funds Under Management in Retail MIS at December 31, 2011**

Type of fund	\$ billion
Listed property trusts	127.4
Unlisted property trusts	3.6
Exchange Traded Funds	4.7
Other listed equity trusts	29.5
Money Market Trusts	23.7
Unlisted equity trusts	54.4
Unlisted mortgage trusts	3.8
Unlisted other trusts	16.2
Total	263.3

Source: ASIC.

## Markets

78. **The overwhelmingly dominant exchange market group in Australia is the ASX Group.** It has approximately 98 percent of the total volume of on-exchange trading in equities and derivatives. ASX Group was created by the merger of the Australian Stock Exchange and the Sydney Futures Exchange in July 2006 and is today one of the world's top 10 listed exchange groups measured by market capitalization. ASX Group functions as a market operator and clearing house. It also oversees compliance with its Operating Rules and promotes standards of corporate governance among Australia's listed companies. Until late 2011 it had no significant competition in Australia. The following figures relate to the ASX markets only. All data are for year-end 2011 unless otherwise mentioned.

- There were 1,983 domestic listed equity issuers and 96 foreign listed equity issuers. The total number of issuers, including listed issuers of debt securities, was 2,222.
- Domestic market capitalization was USD 1,187 billion. This is equivalent to 82.2 percent of Australia's GDP.
- Market capitalization of the top 10 companies totals \$527 billion. This equals 37.1 percent of GDP.
- Total cash market traded value was USD 1.3 trillion.
- Average daily turnover was USD 5.4 billion.
- The proportion of market turnover accounted for by the two most actively traded companies (BHP Billiton Ltd and Rio Tinto Ltd) was 15.8 percent.
- The number of new publicly listed companies was 133.
- Share ownership by Australians (direct and indirect) rose from 41 percent in 2008 to 43 percent in 2010.

- Foreign sourced investment activity in the shares of Australian companies was estimated to be in excess of 40 percent of the market.

79. **Derivatives are traded on-exchange and over-the-counter (OTC).** Instruments traded on ASX 24 are equity and index options, index futures, interest rate futures and options, grain futures and options, wool futures and options, and futures and options over a range of energy and environmental products. Instruments traded OTC include swaps, forward rate agreements, interest rate options, credit derivatives, and currency options.

80. **Corporate bond issuance and trading is limited, although in principle there is scope for expansion.** The government issues little debt anywhere along the yield curve, and crowding out of corporate issuers is therefore not a problem. Credit conditions are tightening and companies could therefore be expected to have more interest in issuing bonds. Banks are significant users of the market, issuing residential mortgage backed securities (RMBS), but the residential housing market has slowed, which may provide opportunities for other issuers. One often-quoted reason for the low volumes is said to be Australians' historic preference for equity over fixed income investments, supported by tax advantages on dividend payments (although the process of retirement of the so-called —baby boomer” post-war generation is said to be slowly rebalancing this bias).

81. **In practice, ASX lists only 3 corporate bonds, 14 floating rate notes, 15 convertible notes and 24 hybrid securities.** On-exchange traded volumes are not available. Volume in OTC trading of non-government debt securities in 2011 was approximately \$908 billion (versus government bond trading of \$1,483 billion and on-exchange equity trading of \$2.02 trillion).

82. **Exchange Traded Funds (ETF) are slowly growing in importance.** The market currently stands at around \$5 billion.

83. **ASX offers a trading facility for an array of financial products from simple to exotic or complex.** There is a significant market in (equity) warrants, although the volumes have declined sharply from a peak of \$11.2 billion in 2008 to \$2.9 billion in 2011. ASX also trades an assortment of retail oriented products under the generic title of Contracts for Difference (CFD). These include products where the underlying instrument may be an equity index, equity, commodity or currency. Many managed investment schemes are also quoted on ASX. Overall volumes by instrument type over the last five years are set out below.

**Table 8. Trading Volumes by Instrument Type on ASX from 2006-07 to 2010-11**

<b>\$billion (turnover)</b>	<b>2006-07</b>	<b>2007-08</b>	<b>2008-09</b>	<b>2009-10</b>	<b>2010-11</b>	<b>% change since 2006</b>
<b>Over-the-counter (OTC)</b>						
Government Debt Securities	772	716	792	928	1,483	92.0%
Non-Government Debt Securities	605	637	494	675	908	50.0%
Negotiable & Transferable Instruments	4,665	5,871	5,543	4,112	3,676	-21.2%
Repurchase Agreements	4,415	3,885	5,147	5,418	7,364	66.8%
Swaps	4,962	6,099	5,725	5,923	6,809	37.2%
<b>Overnight Index Swaps</b>	<b>2,660</b>	<b>1,846</b>	<b>1,031</b>	<b>3,000</b>	<b>7,425</b>	<b>179.1%</b>
Forward Rate Agreements	4,241	5,833	5,424	4,519	5,857	38.1%
Interest Rate Options	361	425	285	379	370	2.4%
Credit Derivatives	135	255	247	247	317	133.9%
Foreign Exchange	46,690	45,837	44,303	41,436	44,569	-4.5%
Currency Options	1,110	745	834	706	730	-34.2%
<b>Total OTC</b>	<b>70,617</b>	<b>72,149</b>	<b>69,825</b>	<b>67,343</b>	<b>79,507</b>	<b>12.6%</b>
<b>Exchange Traded</b>						
Equities	1,816	2,199	1,503	1,864	2,020	11.2%
Futures	38,259	41,496	27,192	34,338	47,702	24.7%
<b>Total Exchange Traded</b>	<b>40,075</b>	<b>43,695</b>	<b>28,695</b>	<b>36,202</b>	<b>49,722</b>	<b>24.1%</b>
<b>ALL FINANCIAL MARKETS</b>	<b>110,692</b>	<b>115,844</b>	<b>98,519</b>	<b>103,544</b>	<b>129,229</b>	<b>16.7%</b>

Source: Australian Financial Markets Association report 2011

### Competition in Trading Venues

84. **In 2010, the Australian Government announced support for competition between exchange markets for trading in listed shares in Australia.** There had been a number of steps to allow for the announcement of support for competition, including the earlier announcement of the transfer of market and participant supervision from ASX to ASIC in 2009. Chi-X Australia was the first (and so far only) competing trading venue to successfully complete its license application. Chi-X Australia began operating in November 2011. It operates a trading platform in the 200 shares that comprise the S&P/ASX 200, ASX quoted ETFs, and approximately 12 shares outside the S&P/ASX 200 selected on the basis of demand from participants.

85. **In contrast, to date no overseas exchange merger has been determined to be in the national interest.** In April 2011, the Deputy Prime Minister and Treasurer made an order under the Foreign Acquisitions and Takeovers Act 1975 prohibiting the acquisition of ASX by Singapore Exchange Limited (SGX). In his decision he referred to advice from ASIC and

the RBA that not having full regulatory sovereignty over the ASX-SGX holding company would present material risks and supervisory issues impacting on the effective regulation of the ASX's operations, particularly its clearing and settlement functions. The Government is currently consulting with the public on the CFR proposals to make legislative changes to address these concerns.

**86. ASIC's role has changed as part of the response to opening the market to competition.** Following on from its decision to open the Australian securities market to competition in the provision of exchange services, the government recognized the need to introduce new rules governing the operation of exchanges and the conduct of participants dealing on the exchanges for their own account and for the account of clients. There were several elements to the situation.

**87. Firstly, the ASX had been responsible for monitoring trading on its platform.** This covered indications of manipulative or other abusive trading practices, insider dealing and member regulation. The imminent opening of Chi-X, which was to provide a competing platform for trading the ASX's top 200 stocks, made this situation untenable. The solution decided upon was to transfer the powers and responsibilities for market surveillance to ASIC and to resource it sufficiently to enable it to install and operate the technology with which to conduct surveillance of both markets in real time. This was done in August 2010. The second issue to resolve was securing the interconnectivity of Chi-X and ASX so as to (i) enable the creation of a consolidated (national) best bid and offer price (NBBO) for the purpose of enabling participants to obtain best execution of their client orders, and (ii) require market participants to link to both exchanges.

**88. The transfer of market and participant supervision to ASIC was accompanied by ASIC introducing seven sets of Market Integrity Rules (MIR).** There is one set for each of the domestic markets that ASIC supervises and one set of Competition MIRs for the two markets (ASX and Chi-X) on which the same products are (competitively) traded. The first set of rules applies to market operators and market participants, and largely replicates the operating rules that were in the operators' trading rule books prior to the transfer, regulating conduct in relation to secondary trading. The Competition MIRs apply to market operators and market participants where the same product is traded on more than one market (ASX and Chi-X) and cover topics such as best execution and pre- and post-trade transparency in a multi-market environment. Their main purpose is to ensure that the same equity market products are treated in the same manner on both exchanges. They also provide best practice standards for data consolidators.

**89. In terms of the overall regulatory architecture, the key element of this process was that ASIC, for the first time, was empowered to write rules directly applicable to license holders.** This was achieved by an amendment to the CA. Ministerial approval for the rules is still necessary (except in an emergency) and the rules have to be laid before Parliament and are subject to negative resolution. Furthermore, it was decided that the cost to

ASIC of installing and operating the technology necessary to conduct proper surveillance of the markets should not fall on the taxpayer but should be borne directly by the industry on a cost recovery basis.

## **H. Preconditions for Effective Securities Regulation**

### **The Legal System**

90. **The Commonwealth of Australia has a federal system of government which consists of the Commonwealth Government, six State Governments, and two Territory Governments.** The Australian Constitution (1901) establishes the Federal government and sets out the basis for relations between the Commonwealth and the States. It also establishes the system of separation of powers by providing for the Parliament, the Executive Government, and the Judiciary. The Constitution gives the legislative power to Parliament. Proposed legislation must be passed by both Houses of Parliament (the House of Representatives and the Senate) to become law. The Houses are elected by the Australian people and have equal powers, with minor exceptions.

91. **The nominal head of state is the Queen's representative in Australia, the Governor-General, who acts on the advice of the Executive Government.** The Executive Government administers the law and carries out the business of government through such bodies as government departments, statutory authorities, and the defense forces. Only Parliament can pass Acts to create statute law, but these Acts often confer on the Executive the power to make regulations, rules, and by-laws in relation to matters relevant to the particular Acts.

92. **Australia is subject to the rule of law.** The essence of the rule is that all authority is subject to, and constrained by, the law. The rule of law also means that each citizen is equal before the law; that laws must be predictable and known to all; and that laws must be fair and apply equally to the government as well as to those it governs. This includes the openness of courts, judicial independence from government, and the presumption of innocence. English common law and equitable principles are the foundation of Australian laws.

93. **The Australian court system has two arms: Federal and State/Territory.** The constitution provides that the judicial powers of the Commonwealth are vested in the High Court of Australia. High Court judges are appointed by the Governor-General in Council, after extensive consultation and upon the basis of merit. Australian State and Territory courts have original jurisdiction under all matters brought under State or Territory laws and in other matters where the jurisdiction has been conferred on the courts by the Commonwealth Parliament. Only a court may exercise judicial power and examine the question of whether a person has contravened a law of Parliament.

## The Insolvency Regime

94. **The Corporations Act deals with corporate insolvency.** The relevant provisions are primarily concerned with efficient procedures for the winding-up of companies, the orderly realization of available assets of those companies, and the equitable distribution of the proceeds to creditors, employees, and shareholders. There are also provisions governing the appointment of receivers or other persons who are entitled to assume control over particular assets of the company; the reconstruction of companies; arrangements and compromises with creditors; and the voluntary winding-up of solvent companies.

95. **There are three types of external administration of insolvent companies: liquidation, receivership, and voluntary administration.** A company comes under external administration when its directors must relinquish direction of its affairs to a receiver, administrator, provisional liquidator or liquidator. Directors have to consider the options for external administration because they are under a legal obligation to cause an insolvent company to cease trading. If they fail to do so, they may be held personally liable for the company's debts.

### I. Main Findings

96. **Principles relating to the Regulator:** ASIC has the primary responsibility for the regulation of securities markets and entities active on them in Australia. In some areas it shares the responsibilities with APRA, the RBA, and ASX. Cooperation is undertaken through the CFR and bilaterally, but the division of responsibilities for the prudential supervision of AFSL holders has created a complex supervisory structure. The extent of the powers of the responsible Minister remains a concern, even though they do not generally include decision-making on day-to-day technical matters. The independence and sufficiency of resources of ASIC are hampered by the flattening of its overall operating funding over the last three years and a not insignificant dependence on non-core funding. ASIC has a wide set of powers, for the use of which it is accountable. It has focused on its ability to identify systemic risks and address issues arising from products and activities falling outside the regulatory perimeter.

97. **Principles for self-regulation:** No organizations have formal self-regulatory organization (SRO) status in Australia and therefore none have powers formally delegated to them by ASIC. However, operators of exchanges and clearing and settlement facilities perform certain functions that could be regarded as self-regulatory. They have statutory obligations concerning the admission of participants, ongoing obligations to monitor and regulate members, and the power to impose meaningful sanctions on them. They also have statutory obligations to cooperate fully with ASIC, are subject to the oversight of ASIC, and are required to observe standards of fairness and confidentiality. The recent transfer of responsibility to ASIC for monitoring secondary trading in the market and market



participants has significantly reduced the self-regulatory functions of the domestic market license holders (except as regards the listing function and clearing and settlement).

98. **Principles for the enforcement of securities regulation:** ASIC's enforcement powers are generally of long-standing and well understood by licensees and the public. It has no reluctance to use its powers to enforce compliance. ASIC has a well-constructed process for filtering potential cases, for determining which cases to pursue through enforcement mechanisms and which by other means, and how to employ resources in the most efficient and effective way. ASIC is an enforcement focused regulator seeking outcomes that support its regulatory objectives. Intelligence gathering and analysis appear to work well and investment in investor education is believed to be making an important contribution to enabling retail investors to better protect themselves, recognize scams, and provide ASIC with more timely information on misconduct. ASIC has a good record in prosecuting cases, and in cooperation with the Commonwealth Director of Public Prosecutions (CDPP). Its success rate, particularly in the more serious cases, is high.

99. **Principles for cooperation in regulation:** Responsibility for responding under the Mutual Assistance in Business Regulation Act (MABRA) to requests for assistance from overseas regulators has been transferred from the Attorney-General's Department to the Treasury, which has dedicated resources to making speedy decisions. ASIC lacks authority to respond under MABRA on its own volition. The growing recognition that cross-border regulatory cooperation should encompass on-going supervision as well as enforcement highlights the limitations on ASIC's legal authority to obtain information on behalf of other regulators for supervisory purposes. Until the law is satisfactorily amended, ASIC is likely to become increasingly isolated as the scope of global inter-regulatory cooperation expands through mechanisms such as supervisory colleges and memoranda of understanding focused on supervisory rather than enforcement matters. The Government is currently in the process of progressing amendments to the Act and MABRA Regulations, which are intended to provide ASIC with the capacity to respond to requests for information from individual foreign regulators for supervisory purposes. However, the issue of sharing supervisory information in international supervisory colleges remains currently unresolved.

100. **Principles for issuers:** ASIC has issued a series of Regulatory Guides on prospectus disclosure to assist issuers and their advisors in producing disclosure documents that help retail investors better assess the offer. Australian listed companies and some others operate under a legislative requirement for immediate and continuous disclosure to the public of significant information, with the objective of securing a fully informed market. ASIC has a long-standing policy of bringing cases to court against companies, company directors, and their professional advisors for breach of their obligations under the continuous disclosure regime. Recent court decisions in several high profile cases have found in favor of ASIC, usually on appeal. ASIC is the regulator of corporate conduct, takeovers, and other control transactions. The Takeovers Panel is a peer-based dispute resolution mechanism with the courts as the final backstop. Australia has adopted a comprehensive body of accounting

standards, which follow the International Financial Reporting Standards (IFRS). The annual accounts of a listed company must be audited, with the half-yearly reports subject to either review or audit.

101. **Principles for auditors, credit rating agencies, and other information service providers:** Australia has adopted auditing standards based on the International Standards on Auditing. The cooperation between the relevant public interest bodies, ASIC (which supervises auditors and enforces standards), the Financial Reporting Council (FRC), the AUASB, the Companies Auditors and Liquidators Disciplinary Board (CALDB), and the auditors' professional bodies appears effective. The regime for licensing and supervising credit rating agencies (CRAs) is fully operational. CRAs are required to meet all the requirements set out in the IOSCO Code of Conduct Fundamentals for CRAs. Research report providers are regulated as AFSL holders, which ensures that they are subject to comprehensive requirements to manage any conflicts of interest.

102. **Principles for collective investment schemes:** All CIS operators are required to be authorized and are subject to conduct of business, capital, and organizational requirements. Retail CIS need to be registered with ASIC and comply with the requirements set out in the CA and ASIC regulatory guides, whereas there are no regulatory requirements on Wholesale CIS. ASIC's proactive supervision is currently limited. The assets of a CIS have to be adequately segregated, but self-custody or related party custody is allowed subject to certain additional requirements that do not appear to be sufficiently stringent. Initial, ongoing, and periodic disclosure requirements apply, but there are no standardized formats for all disclosures. There are requirements on valuation and pricing of CIS units. The regulatory framework for CIS applies to hedge funds and their operators, but ASIC lacks certain powers needed for effective oversight and cooperation.

103. **Principles for market intermediaries:** Market intermediaries need to hold an AFSL specifying the services and products they are authorized to provide. The licensing process appears thorough; however, the assessment of the applicant does not extend to its controllers. Capital requirements are largely not risk-based. Intermediaries are subject to a suite of prudential, organizational, and conduct of business requirements, whereas internal controls are addressed only indirectly. There is no general statutory requirement to act in the best interest of clients; however, there are specific requirements for certain market intermediaries relating to best interest type duties. Even though a significant number of intermediaries may still remain uninspected for extended periods of time, ASIC has expanded its supervisory reach during the past few years. ASIC, jointly with other CFR members, has plans in place to deal with the failure of a systemically important financial institution. ASIC's own plans address the possible failure of non-systemic entities.

104. **Principles for secondary markets:** The power to grant licenses to exchanges and clearing and settlement facilities and to approve their operating rules resides with the Minister. ASIC processes license applications and all rule changes prior to submitting them

to the Minister with a recommendation. ASIC's oversight of the exchanges is effective. The transfer of responsibility for surveillance of secondary trading activity to ASIC in August 2010 has somewhat reduced the role of the exchanges in ensuring that their markets are fair, orderly, and transparent. Exchanges (market operators) have, however, retained rules and procedures concerning, among others, participant admission, order types, and trading arrangements. They have also retained responsibility for listing and monitoring compliance by listed entities with their continuous and periodic disclosure obligations. The primary regulator of the clearing and settlement facilities is the central bank (RBA). The principal tool used by the RBA is its continuous assessment of a CSFL holder's performance against the Financial Stability Standards (FSS) it has developed. Prudential regulation of off-exchange business, where AFSL holders are not regulated by APRA or as Clearing or Market Participants, is a source of weakness.

**Table 9. Summary Implementation of the IOSCO Principles—Detailed Assessments**

Principle	Findings
Principle 1. The responsibilities of the Regulator should be clear and objectively stated.	The responsibilities of ASIC are clearly set out in the CA and ASIC Act. It has wide powers to provide relief and exemptions under the CA, which it exercises in a transparent manner within the current constraints of the law. The sharing of supervisory responsibilities for market intermediaries between ASIC, APRA and operators of the ASX Group's clearing facilities has created a complex supervisory structure. The Minister retains certain responsibilities for the AML and CSFL holders, and the RBA is involved in setting standards for clearing and settlement facilities. Cooperation arrangements between the authorities have been established.
Principle 2. The Regulator should be operationally independent and accountable in the exercise of its functions and powers.	Certain features of the CA and ASIC Act have the potential of impacting on the independence of ASIC. These relate in particular to the powers of the responsible Minister to give directions to ASIC, express his expectations, and decide on matters relating to AML and CSFL holders. There is no evidence of the interference of the Minister in the day-to-day decision making of ASIC. ASIC's operational independence is constrained by increased dependence on non-core funding. Sufficient accountability measures are in place, and the decisions of ASIC are subject to the requirement to provide reasons as well as an appropriate review mechanism.
Principle 3. The Regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its	ASIC has a wide set of powers that enable it to discharge its duties under the CA and the ASIC Act. Its funding level, although sufficient to

powers.	undertake its current tasks, does not enable it to reach a level of proactive supervision necessary in the increasingly complex markets. ASIC is also dependent on non-core funding allocated to specific regulatory tasks. It has been able to retain and attract a mix of staff with varying backgrounds. Its governance practices and policies are well established and it is very active in investor education.
Principle 4. The Regulator should adopt clear and consistent regulatory processes.	ASIC has a well-developed consultation process that is subject to a requirement to conduct a regulatory impact analysis. Its website includes extensive information on its policy making procedures and the guidance and decisions it has issued. It is required to apply procedural fairness in its decision making, including a right to a hearing, where appropriate.
Principle 5. The staff of the Regulator should observe the highest professional standards, including appropriate standards of confidentiality.	ASIC Commissioners and staff are subject to a code of conduct pertaining to avoidance of conflicts of interest. Relevant members of staff are subject to trading restrictions. Strict confidentiality and data protection requirements apply to staff, with sanctions applied on non-compliance.
Principle 6. The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.	ASIC has established an internal Emerging Risks Committee (ERC) tasked to deepen its understanding of emerging risks in securities markets, including any systemic risks. ASIC also works with other domestic regulators, primarily through the Council of Financial Regulators, to decide on appropriate regulatory responses to risks facing the Australian financial system.
Principle 7. The Regulator should have or contribute to a process to review the perimeter of regulation regularly.	The ERC is the main vehicle through which ASIC identifies and assesses the continued appropriateness of its regulatory framework in light of financial innovation. The ERC uses various mechanisms to identify any emerging risks, including analysis of market trends and surveillance observations of ASIC stakeholder teams. The specific regulatory actions taken on the basis of the ERC work are still limited.
Principle 8. The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.	The regulatory framework requires all regulated entities to have in place appropriate processes to identify and manage actual and potential conflicts of interest. ASIC monitors compliance with these requirements through its supervisory activities. It has also taken measures to address misaligned incentives among issuers and regulated entities.
Principle 9. Where the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight	No organizations have formal SRO status in Australia and none have powers formally delegated to them by ASIC. Exchanges and

<p>responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.</p>	<p>clearing and settlement facilities have statutory obligations to have membership criteria, to regulate the conduct of their members, and to impose sanctions for rule breaches. They are subject to intensive oversight by ASIC. As a consequence of ASIC's assumption of responsibility for market supervision in 2010, the exchanges are now responsible for enforcing a smaller suite of operating rules.</p>
<p>Principle 10. The Regulator should have comprehensive inspection, investigation and surveillance powers.</p>	<p>ASIC has comprehensive powers over regulated and other persons to obtain information. This is reinforced by dissuasive sanctions for refusal to comply and supported by extensive record-keeping requirements on the corporate and business sectors.</p>
<p>Principle 11. The Regulator should have comprehensive enforcement powers.</p>	<p>ASIC's enforcement powers are long-standing and well understood by licensees and the public. It has no reluctance to use its powers to enforce compliance. ASIC has a well-constructed process for filtering potential cases, for determining which cases to pursue through an enforcement mechanism and which by other means, and how to employ resources in the most efficient and effective way.</p>
<p>Principle 12. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.</p>	<p>ASIC is an enforcement-focused regulator and devotes considerable time and resources to determining the outcomes it seeks and prioritizing cases to achieve those outcomes. In recent years its successful prosecution of several high profile cases has increased its credibility as the enforcer of securities and company law. While enforcement by ASIC is effective and credible, the performance of certain supervisory functions has relative weaknesses in terms of proactive as distinct from reactive supervision.</p>
<p>Principle 13. The Regulator should have authority to share both public and non-public information with domestic and foreign counterparts.</p>	<p>The global financial crisis has highlighted the need for regulators to move beyond sharing information on enforcement matters to supervisory matters, particularly for systemically important financial institutions and other complex global groups. Legal limitations on ASIC's power to share information for supervisory purposes bilaterally and in colleges of supervisors risk its increasing isolation from international supervisory cooperation. The Government is progressing amendments to the relevant law and regulations; these are expected to be in place by late 2012 and are intended to remove at least some of these limitations and bolster ASIC's capacity for international regulatory cooperation on supervisory matters. However, the</p>

	issue of sharing supervisory information in international supervisory colleges currently remains unresolved.
Principle 14. 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.	ASIC's work in this area is in the forefront of regulators striving to improve information sharing (subject to the limits on its powers as described in Principle 13). Arrangements with Hong Kong and New Zealand to encourage cross-border offerings of securities and CIS are particularly innovative and contribute to enhancing global trade in financial services subject to appropriate regulatory oversight.
Principle 15. 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.	ASIC has a demonstrably good record in providing assistance to foreign regulators, subject only to the limitations identified in Principle 13.
Principle 16. There should be full, accurate and timely disclosure of financial results, risk and other information that is material to investors' decisions.	The Regulatory Guides that ASIC has recently released on the disclosure regime for public offerings have elevated the regime to the standard required. ASIC's long-standing policy of bringing cases to court against companies, company directors, and their professional advisors for breach of their obligations has recently shown a significantly improved success rate. These cases have sent clear signals to directors as to the full scope of their legal responsibilities. In so doing, they have enhanced ASIC's ability to enforce the corporate disclosure regime.
Principle 17. Holders of securities in a company should be treated in a fair and equitable manner.	The separation of powers, where ASIC regulates the conduct of takeovers and other means of securing or changing control, while the Takeovers Panel operates as a peer-based dispute resolution mechanism, appears to work effectively. It has widespread acceptance among corporations, their professional advisors, and the public. ASIC is sensitive to the need to be alert to new financing techniques with the potential to reduce the accuracy and timeliness of shareholder information.
Principle 18. Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality.	The standard setting process is of a high quality with the appropriate mix of development by the AASB and other stakeholders in a fully transparent manner. It ensures that Australian standards remain fully consistent with IFRS. ASIC's regulatory role in securing compliance with accounting standards appears to work well in detecting errors and mandating corrections in financial reports. It is supported by dissuasive sanctions for dishonest contraventions.

<p>Principle 19. Auditors should be subject to adequate levels of oversight.</p>	<p>ASIC has significant powers of investigation, inspection and information gathering in relation to auditors and audit practices, which it exercises in a coherent and consistent manner. Its interactions with the Government funded Companies Auditors and Liquidators Disciplinary Board (CALDB) appear effective. ASIC is alert to the global phenomenon of pressure on audit fees and the risks that can arise to the quality of an audit due to the competitive nature of the audit profession.</p>
<p>Principle 20. Auditors should be independent of the issuing entity that they audit.</p>	<p>Constraints on auditors and audit companies carrying out non-audit work for the same client are extensive, well defined and consistent with international norms.</p>
<p>Principle 21. Audit standards should be of a high and internationally acceptable quality.</p>	<p>As with accounting standards, Australia has adopted auditing standards based on the International Standards on Auditing (ISA). One role of the Government appointed standard setter, the AUASB, is to ensure that Australian auditing standards are maintained at that level.</p>
<p>Principle 22. Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.</p>	<p>ASIC has acted in a timely and comprehensive manner to implement the IOSCO Code and to impose a fully compliant supervisory program on CRAs. It may prove over time that the attempt to prevent retail investors from accessing CRA ratings because five of the six CRAs have opted for “wholesale only” licenses will be ineffective in practice.</p>
<p>Principle 23. Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.</p>	<p>Research report providers are required to hold an AFSL and are therefore subject to all the regulatory requirements applicable to AFSL holders, including those on conflicts of interest. ASIC has issued specific guidance to research report providers. With regard to other providers of evaluative services, ASIC has given guidance to experts emphasizing their need to act independently. It has also identified other possible providers of evaluative services that might warrant regulation.</p>
<p>Principle 24. The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme.</p>	<p>All CIS operators are required to be authorized as AFSL holders and are subject to a full range of conduct of business and organizational requirements (see Principle 29), with REs of Retail CIS required to fulfill certain additional criteria. Retail CIS need to be registered with ASIC and comply with requirements set out in the CA and ASIC RGs, whereas Wholesale CIS are not subject to any regulatory requirements. ASIC’s supervision is focused on reactive and desk-based activities rather than full-fledged on-site</p>

	inspections.
Principle 25. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.	A CIS is broadly defined in the CA, but in practice most take the legal form of investment trusts. The requirement to lodge the constitution of a Retail CIS with ASIC ensures that the form and structure requirements are complied with. The assets of a CIS have to be adequately segregated, but it is possible for them to be held in custody by the RE itself or by a related entity. In those cases, safeguards are not strong enough.
Principle 26. Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.	A potential investor in a Retail CIS needs to be provided with a Product Disclosure Statement. PDS. From June 2012 onwards, the PDS for a Simple CIS is required to comply with a standard eight page format. The PDS used for other types of CIS and other disclosure documents are not required to be in a standard format. Wholesale CIS are not subject to disclosure requirements. ASIC has the possibility to intervene in case of non-compliance with regulatory requirements when the PDS is filed with ASIC. There are rules and guidance on periodic reporting and advertising, and the investment policy of a Retail CIS and information on asset valuation need to be disclosed.
Principle 27. Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.	The constitution of a Retail CIS has to set out the rules for valuation of scheme assets. ASIC and APRA have issued further guidance on valuation. Independent auditors are required to assess compliance of the valuations with accounting standards. The constitution of a Retail CIS needs to address the subscription and redemption rights of unit holders, including pricing. Treatment of pricing errors and possibility of suspending redemptions are addressed in the regulatory framework.
Principle 28. Regulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight.	Retail hedge funds and their REs are subject to the same requirements as other Retail CIS and their operators. The same applies to disclosure requirements. ASIC has the power to collect information from hedge fund operators, subject to existing restrictions in sharing that information with foreign regulators (see Principles 13 and 15). Hedge fund operators have recently become subject to increased ASIC supervision.
Principle 29. Regulation should provide for minimum entry standards for market intermediaries.	Market intermediaries need to hold an AFSL specifying the services and products they are authorized to provide. ASIC applies a comprehensive desk-based licensing process that can be varied depending on the applicant and the



	<p>services and products it seeks authorization for. ASIC has a variety of powers relating to the licensing decisions. Controllers, other significant shareholders, and those with significant voting power are not assessed as part of the licensing process. The authorization requirement covers all types of investment advisers.</p>
<p>Principle 30. There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.</p>	<p>Initial and ongoing capital requirements apply to all AFSL holders. With the exception of bodies regulated by APRA and direct members of financial markets and clearing facilities, they are not adjusted for risk and there is no periodic reporting to ASIC other than annually. Additional reporting requirements apply in case of deteriorating financial conditions. The annual reports of AFSL holders need to be audited by independent auditors. The capital requirements do not take into account risks arising from unlicensed affiliates. ASIC is currently undertaking a progressive review of the financial resources requirements applying to all AFSL holders; the compliance of the envisaged new requirements with Principle 30 was not assessed</p>
<p>Principle 31. Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters.</p>	<p>AFSL holders are required to maintain appropriate risk management and compliance systems. There is no general statutory requirement to act in the best interest of clients; however, there are specific requirements for certain market intermediaries relating to best interest type duties. There is no specific regulatory requirement to maintain sufficient internal controls. Client asset protection rules, know-your customer-rules, record-keeping requirements and key conduct of business requirements apply to AFSL holders. Direct market participants are subject to a risk-based supervisory program with a three year cycle, and ASIC is in the process of extending its proactive supervision to the most important indirect market participants, and to a lesser extent, investment advisors.</p>
<p>Principle 32. There should be procedures for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.</p>	<p>ASIC, jointly with other CFR members, has plans in place to deal with the failure of a systemically important financial institution. ASIC's own plans address the possible failure of non-systemic entities. ASIC has various powers to deal with an intermediary's failure, including the power to immediately cancel a license in case of insolvency. Market operators are required to maintain a guarantee fund applicable to their participants. Other AFSL holders are subject to a requirement to hold professional indemnity insurance but there is no investor compensation scheme in Australia.</p>

<p>Principle 33. The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.</p>	<p>The CA definition of a financial market is very broad. It, however, fails to capture some trading systems which, in terms of the policy rationale for defining a financial market, should be regulated. The regulation of market infrastructure providers may not be sufficiently efficient, particularly in light of the increased pace of innovation and change in trading practices and the growing inter-connectivity of Australian markets.</p>
<p>Principle 34. 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.</p>	<p>The current position, where exchange competition has existed only since November 2011, is viewed by ASIC and others as a transitional phase which has not yet been completed. As a result, there appear to be a number of areas where not all those involved in the market understand yet whether the responsibility for monitoring and enforcing particular rules falls to ASIC or the relevant exchange. This can lead to uncertainty among licensees on the rulebook they should look to for compliance.</p>
<p>Principle 35. Regulation should promote transparency of trading.</p>	<p>The regulatory framework includes appropriate requirements for timely pre- and post-trade transparency, subject to standard derogations. ASIC's analytical work on dark pools, dark liquidity and high frequency trading is well regarded by the industry. While opinions differ as to ASIC's conclusions to date, there appears to be a consistent view that the work is based on a sufficient amount of accurate data and has been properly and impartially carried out having regard to ASICs regulatory priorities to secure fair, orderly, and transparent markets.</p>
<p>Principle 36. Regulation should be designed to detect and deter manipulation and other unfair trading practices.</p>	<p>Australia has a comprehensive legal framework to deal with market manipulation, insider dealing, and other types of market abuse, supported by dissuasive sanctions. ASIC has employed a range of systems and human resources to monitor markets and detect possible offenses. The working relationship between ASIC and the office of the Commonwealth Director of Public Prosecutions (CDPP) appears to be effective and efficient. The CDPP and the judiciary appear fully cognizant of the need to pursue white-collar crime as vigorously as other forms of crime.</p>
<p>Principle 37. Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.</p>	<p>There are no rules governing the proper management of large exposures, default risk, and market disruption that arise from bilateral transactions involving AFSL holders that are not supervised by either APRA, ASX as Clearing Participants or ASIC as Market Participants. Some</p>

	questions have been raised about the legal provision concerning the powers of the clearing facility operator to transfer client positions from a failing firm to a viable one.
Principle 38. Securities settlement systems and central counterparties should be subject to regulatory and supervisory requirements that are designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.	Not assessed.

**Table 10. Recommended Action Plan to Improve Implementation of the IOSCO Principles**

<b>Principle</b>	<b>Recommended Action</b>
Principle 1	<ol style="list-style-type: none"> <li>1) ASIC, APRA, and ASX are encouraged to continue to further develop their cooperation mechanisms to ensure appropriate supervision of jointly supervised entities.</li> <li>2) Going forward, the Government and the supervisory authorities should assess whether the current regulatory set-up continues to best ensure the protection of investors and the reduction of systemic risk.</li> <li>3) In order to provide the maximum transparency possible, the Government and ASIC should consider the continued appropriateness of the legal prohibitions against publication of certain individual relief instruments.</li> </ol>
Principle 2	<ol style="list-style-type: none"> <li>1) The Government should consider the continued appropriateness of the extent of the powers assigned to the Minister to ensure sufficient independence of ASIC. Particular attention should be paid to the role of the Minister in relation to licensed markets and clearing and settlement facilities.</li> <li>2) The Government should explore ways to secure the stability of ASIC's core funding.</li> </ol>
Principle 3	<ol style="list-style-type: none"> <li>1) The Government should ensure that ASIC's core funding will be sufficient to meet the future regulatory and supervisory challenges, also in light of the global regulatory commitments.</li> <li>2) ASIC should aim at allocating more resources to reach sufficient levels of proactive supervision of all types of entities under its supervision.</li> </ol>
Principles 6 and 7	ASIC is encouraged to continue to develop the ERC and to ensure that its focus on emerging and systemic risks is maintained. ASIC could consider using it as a vehicle to identify risks from existing regulatory gaps (see also recommendations

	for the Principles for CIS).
Principle 9	In light of the reduced responsibilities of exchanges for market monitoring, ASIC should continue to refine its oversight role to focus on those areas where the functions undertaken by the exchanges are key to effective implementation of ASIC's objectives.
Principle 12	ASIC should reinforce its initiative to develop proactive supervision as regards MIS, REs, and market intermediaries including investment advisors.
Principles 13 and 15	The Government should complete the legislative process to expand ASIC's powers to share supervisory information with foreign regulators on the basis of participation in supervisory colleges as well as bilaterally.
Principle 24	<ol style="list-style-type: none"> <li>1) ASIC should allocate more resources to the proactive supervision of REs and MIS.</li> <li>2) ASIC and APRA should cooperate to ensure that all REs, independent of their primary prudential regulator, are subject to similar supervision of risks arising from their role as fund manager.</li> <li>3) ASIC should gain access to sufficient information on the Wholesale Funds sector to ensure it is subject to appropriate regulation that takes into account the risks to investor protection and financial stability.</li> </ol>
Principle 25	The Government and ASIC should increase safeguards to ensure sufficient client asset protection in case of self-custody and related party custody by, for example, requiring the custodian to hold a higher amount of capital, by providing additional guidance on operational safeguards, and by requiring independent verification on the robustness of the custodial arrangements.
Principle 26	<ol style="list-style-type: none"> <li>1) The Government and ASIC should seek further harmonization of the content and format of all disclosure documents to assist investors in comparing various investment opportunities.</li> <li>2) The Government and ASIC should consider the continued appropriateness of the lack of disclosure requirements for Wholesale Funds.</li> </ol>
Principle 28	Refer to recommendations for Principles 13, 15, 24 (1 <sup>st</sup> and 3 <sup>rd</sup> item) and 26.
Principle 29	The Government should extend the good fame and character test to controllers, other significant shareholders, holders of a significant amount of voting power, and those that are otherwise in a position to materially influence a license applicant.
Principle 30	ASIC should introduce risk-based capital requirements and periodic capital adequacy reporting for all AFSL holders. This would provide an opportunity to seek ways to simplify and harmonize the current complex regime.

Principle 31	<ol style="list-style-type: none"> <li>1) The Government and ASIC should introduce appropriate requirements for internal controls for all AFSL holders, and require adequate periodic evaluation of these controls and risk management arrangements.</li> <li>2) The Government should ensure that a requirement for AFSL holders to act in the best interest of clients applies to all market intermediaries.</li> <li>3) ASIC should extend its proactive supervision program to sufficiently cover all types of market intermediaries.</li> </ol>
Principle 32	The Government should consider the additional investor protection benefits that an investor compensation scheme would bring.
Principle 33	<ol style="list-style-type: none"> <li>1) The Government may wish to consider whether, in the light of technology-driven changes to securities markets globally, and the recent adoption in Australia of a competitive market for the provision of trading platforms, the current two-stage process of licensing and rule approval for exchanges and clearing and settlement facilities should be simplified and the powers transferred to ASIC.</li> <li>2) Consistent with the above, the Government may wish to consider amending the definition of a financial market in the CA to provide a better tool with which to regulate the evolving structure and diversity of financial markets in Australia.</li> </ol>
Principle 34	ASIC should give priority to eliminating any remaining overlaps and ambiguities emerging from the transfer of responsibility to ASIC for market surveillance and the supervision of non-clearing ASX members.
Principle 37	<ol style="list-style-type: none"> <li>1) In addition to ASX Clearing Participants, ASIC should extend the large exposure requirements to all AFSL holders whose license conditions potentially enable them to acquire large exposures relative to their capital base, so as to match global best practice.</li> <li>2) The Government and ASIC should analyze any issues concerning the powers of ASIC or the clearing facility operator to transfer client positions from a failing firm to a viable one and seek appropriate remedies, if necessary.</li> </ol>

## **J. Authorities' Response to the Assessment**

### **Introduction**

105. **The Australian authorities welcome the comprehensive assessment of Australian securities regulation as part of the IMF's Financial Sector Assessment Program.** The authorities broadly consider that the assessment is tough but fair.

106. **The authorities welcome the IMF's assessment** that the Australian legal and regulatory framework reflects a high degree of compliance with the IOSCO objectives and principles of securities regulation.

107. **Australia is already taking steps to implement some of the IMF's recommendations.** The assessment underscores the importance of work already in train. The authorities will carefully consider the other recommendations, as discussed below.

108. **We also comment below on certain other aspects of the assessment.**

### **Independence of the Regulator**

109. **The Australian authorities do not consider that the Minister's power to direct ASIC impedes ASIC's independence in any way** (Principle 2, Recommendation 1).

110. **ASIC has complete independence in relation to the performance of its functions and exercise of its powers under the corporations legislation.** While the IOSCO principles require an additional degree of autonomy in relation to regulatory policies and funding, it is difficult to reconcile the IOSCO approach to independence with notions of ministerial accountability.

111. **The authorities do not consider that the Minister's powers impair or interfere with ASIC's ability to discharge its functions.** The Minister's power to issue a direction to ASIC with respect to policies and priorities is limited and has only been exercised once and then some 20 years ago. Although the Minister has the power to revoke a direction given by ASIC, this has never happened. If it did, the Minister's powers are circumscribed by the law. The theoretical and unlikely possibility of inappropriate intervention does not, in fact, impair ASIC's operational independence or its ability to discharge its functions.

112. **The authorities agree that there could be room to streamline the licensing process for exchanges and clearing and settlement facilities** (Principle 33, Recommendation 1) and will consider how best to respond to this recommendation.

### **Funding of the Regulator**

113. **In general, the Australian authorities note that the Government's overall approach to fiscal policy in which all public sector spending is subject to robust discipline, has served Australia well,** ensuring adequate funding for government services and agencies while producing a degree of sustained fiscal responsibility unmatched by many other OECD economies.

114. **In relation to stability of funding (Principle 2, Recommendation 2), the Australian Government has supported ASIC's regulatory role with funding increases over recent years.** Funding for ASIC has grown since the FSAP was last conducted in 2006,

with total forecast operating revenue rising from \$261.3m in 2007-08 to peak at \$360.6m in 2010-11 (reflecting temporary funding to assist ASIC to deal with a spike in work flowing from the financial crisis) to \$352.7m in 2012-13, and is projected to remain at roughly this level across the forward estimates. The Government will continue to ensure the stability of ASIC's funding.

**115. In relation to adequacy of funding (Principle 3, Recommendation 1), the authorities agree that it will be important to ensure that ASIC's funding continues to be sufficient to meet the regulatory and supervisory challenges it faces, in light of global regulatory commitments.**

### **Transparency**

**116. The authorities will consider the continued appropriateness of laws prohibiting the publication of certain individual relief instruments (Principle 1, Recommendation 3).** The authorities note that ASIC publishes a quarterly report which provides an overview of circumstances in which ASIC has exercised or refused to exercise its exemption or modification powers.

### **Relations with other Regulators**

**117. The authorities welcome the endorsement of the Council of Financial Regulators (CFR) as a forum for cooperation and collaboration between its members.**

**118. The assessment recommends that the authorities should assess whether the current regulatory set-up continues to best ensure investor protection (Principle 1, Recommendation 2).** The authorities will consider how best to respond to this recommendation.

**119. The authorities note that the division of roles among the CFR agencies is generally well understood and Australia's regulatory set-up has stood Australia in good stead through the crisis.** However, the authorities will continue to work towards furthering their cooperation mechanisms to ensure appropriate supervision of entities which are subject to supervision by both APRA and ASIC in line with IMF recommendations (Principle 1, Recommendation 1 and Principle 24, Recommendation 2).

### **Systemic Risk**

**120. The authorities appreciate the encouragement given to ASIC's Emerging Risks Committee and will work to ensure it continues to focus on emerging and systemic risks (Recommendation under Principles 6 and 7).**

## **Investor Protection**

121. **The assessment recommends that the Government should consider the additional investor protection benefits that an investor compensation scheme would bring (Recommendation on Principle 32).** The Government is currently reviewing the costs and benefits of a statutory investor protection scheme. The authorities will consider how best to respond to the recommendation based on the outcome of that review.

## **Proactive Supervision**

122. **The authorities note the IMF's comments on the need for proactive supervision of particular parts of its regulated population, subject to available funding.** ASIC has begun work on a program designed to standardize its approach to surveillance, and will take these comments into account in refining its approach to supervision (Principle 3, Recommendation 2; Recommendation on Principle 12; Principle 24, Recommendation 1 and Principle 31, Recommendation 3).

## **International Information Sharing and Cooperation**

123. **The Australian Government is progressing amendments to the law to allow ASIC to collect information in response to requests from foreign regulators in a broader range of circumstances than at present.** The authorities will consider whether it is appropriate also to permit the collection of information for and sharing of information with supervisory colleges (Recommendation on Principles 13 and 15).

## **Regulation of Collective Investment Schemes**

124. **The authorities agree with the recommendation that ASIC should collect data so it can continue to be confident that the wholesale sector is subject to appropriate regulation that takes into account the risks to wholesale investors and financial stability (Principle 24, Recommendation 3).**

125. **The authorities note that Australia has a tailored regulatory framework, based on the degree of protection required.** This is the rationale behind the current distinction between wholesale and retail clients under which retail collective investment schemes and their operators are subject to a significantly higher level of regulation and oversight.

126. **The authorities will nevertheless consider the continued appropriateness of the lack of disclosure requirements for wholesale funds (Principle 26, Recommendation 2).**

127. **The authorities will also consider whether further harmonization of the content and format of disclosure documents will assist investors in comparing investment options (Principle 26, Recommendation 1).** There are minimum requirements for content and format requirements for certain types of collective investment schemes. While the



current requirements work well in practice, the authorities will consider where improvements can be made.

128. **The authorities will consider the IMF’s suggestion that safeguards should be increased to ensure sufficient client asset protection in case of self custody and related party custody (Recommendation on Principle 25).** The authorities note that ASIC is currently reviewing custody standards, including financial requirements, applying in relation to custody (including self custody) of property in retail collective investment schemes.

### **Authorization and Ongoing Obligations of AFSL Holders**

129. **The assessment makes the following recommendations about authorization and ongoing obligations of AFSL holders:**

- a. The good fame and character test (applicable at the time of authorization) should be extended to controllers, other significant shareholders, holders of a significant amount of voting power, and those that are otherwise in a position to materially influence a license applicant (Recommendation on Principle 29);
- b. Appropriate internal control requirements for market intermediaries and periodic evaluation of such requirements should be introduced (Principle 31, Recommendation 1); and
- c. The requirement to act in the best interest of clients should apply to all market intermediaries (Principle 31, Recommendation 2).

130. **The authorities will consider the appropriateness of these recommendations for Australia, noting, in particular, the large scope of the second requirement.** In relation to the ‘best interests’ requirement, the authorities note that the Future of Financial Advice reforms have introduced a duty for financial advisers to:

- a. Act in the best interests of their clients (subject to a ‘reasonable steps’ qualification); and
- b. Place the best interests of their clients ahead of their own when providing personal advice to retail clients.

### **Risk-based Capital Requirements**

131. **The assessment recommends that ASIC should introduce risk-based capital requirements and periodic capital adequacy reporting for all AFSL holders (Recommendation on Principle 30).**

132. **ASIC has commenced a process to review capital requirements for all entities it licenses, in line with the IOSCO Principles.** However, the authorities consider that risk-based capital requirements and periodic capital adequacy reporting are not necessarily appropriate for all AFSL holders. Some AFSL holders are very small entities that do not hold

client assets or are not significant enough to warrant risk-based capital requirements and periodic capital adequacy reporting.

### **Market Oversight**

133. **The authorities welcome the positive comments about the effectiveness of ASIC's oversight of exchanges and Australia's framework for dealing with market abuse.**

134. **The assessment recommends that ASIC continue to refine its market oversight role (Recommendation on Principle 9) and give priority to eliminating any overlaps and ambiguities emerging from the transfer of market surveillance and supervision of non-ASX members (Recommendation on Principle 34).** ASIC notes these recommendations and will continue to work with industry to refine its oversight role as markets develop.

135. **The authorities will also consider the costs and benefits of amending the definition of financial market in the Corporations Act to better regulate the evolving structure and diversity of financial markets (Principle 33, Recommendation 2).**

136. **The authorities will also analyze any issues concerning the powers of ASIC or the clearing facility operator to transfer client positions from a failing firm to a viable one and seek appropriate remedies, if necessary (Principle 37, Recommendation 2).**

### **Large Exposures**

137. **The assessment expresses concern about potential exposures arising from bilateral transactions involving AFSL holders supervised neither by APRA nor by the operator of a clearing and settlement facility.** The assessment, therefore, recommends that ASIC should extend the large exposure requirements to all AFSL holders whose license conditions enable them to acquire large exposures relative to their capital base (Principle 37, Recommendation 1).

138. **Since only a very small proportion of OTC derivative transactions are conducted by AFSL holders that are supervised neither by APRA nor by the operator of a clearing and settlement facility, the authorities have assessed the risk posed as small.** They will, however, take the views expressed in the assessment into account.

139. **The G20 requirements for reporting OTC derivative transactions to trade repositories may assist in this regard.** The Australian government has released, for public consultation, draft legislation to implement the G20 reforms. Under the draft legislation, ASIC would be able to write rules imposing mandatory reporting obligations on persons, including AFSL holders that undertake specific OTC derivatives transactions. The mandatory reporting requirements may be relevant to this recommendation. After the first stage of implementation, it could usefully be assessed whether there are any remaining material gaps in the monitoring or regulation of large exposures.

**Summary**

140. **The authorities will continue to evaluate, and as appropriate, implement, the FSAP's recommendations.** The authorities look forward to continuing dialogue with the IMF to further our goal of enhancing Australia's regulatory and supervisory framework.