FINANCIAL SECTOR SUPERVISION

Institutional framework

The financial sector legal framework in Australia covers banks, other deposit-taking institutions, investment banks, collective investment managers, securities and futures exchanges, clearing houses, securities and futures dealers and brokers, and insurance and superannuation entities. It relies on a range of legislation that is in the process of convergence. Australia has moved from an industry-based legal framework to one which is divided between prudential regulation of financial sector institutions on one side, and financial market integrity and investor protection on the other. Much of the existing legislation still reflects its industry focused heritage. As a result, separate legislation continues to exist dealing with areas such as life insurance and the securities markets. Australia's Constitution also requires that the States be involved in various aspects of the financial sector legal framework. In some areas, the States have referred their responsibility to the national government.

Prudential regulation, administered by the Australian Prudential Regulation Authority (APRA), is applied where financial risks cannot be adequately priced or managed in the market, and where concerns about financial safety are highest. For example, deposit-taking warrants prudential regulation because of the information asymmetry between depositors and institutions, and the fact that institutional failure has the potential to cause systemic instability. Stage one of the Government's financial system reforms, introduced on 1 July 1998, aims to apply prudential regulation (where it is considered necessary) to all financial institutions offering similar products.

The market integrity and investor protection aspects of the financial sector legal framework are intended to be brought fully under a single piece of comprehensive legislation that deals with both corporate regulation and financial markets, the Corporations Law. This process is occurring through the Corporate Law Economic Reform Program (CLERP) which, along with the role of the Australian Securities and Investments Commission (ASIC), is discussed above in 'Corporate governance framework'.

The Government's legislative framework provides scope for self-regulation by the main securities and derivatives markets — the Australian Stock Exchange (ASX) and the Sydney Futures Exchange (SFE) — subject to oversight by ASIC. These exchanges have Memoranda of Understanding with ASIC which elaborate on their respective roles as set out in the Corporations Law. The exchanges' internal business rules are subject to Ministerial disallowance.

Australia's financial sector regulatory framework is based around three central agencies:

- the Reserve Bank of Australia (RBA) is responsible for the objectives of monetary policy (as discussed in Part I of the report), overall financial system stability, and the regulation of the payments system.
  - payments system policy is carried out by the Payments System Board (PSB) within the RBA;
- APRA is responsible for the prudential supervision of deposit-taking institutions, life and general insurance companies, and superannuation funds; and
- ASIC is responsible for corporate regulation, market integrity, disclosure and other consumer protection issues.

Each agency has objectives specified in legislation and substantial operational autonomy, and is accountable to the Treasurer and Parliament. Coordination between the three agencies is facilitated by cross membership of the Boards, published Memoranda of Understanding, tripartite membership of the Council of Financial Regulators (a body established to enhance cooperation and collaboration between the three agencies), and finally, by close bilateral relations generally. Information-sharing arrangements are also in place.

Each agency produces annual reports containing information about the agency and its policies, and independently audited financial statements. The agencies also publish other information, for example, the RBA's monthly *Bulletin*, or APRA's quarterly *Bulletin* (which contain industry and other statistics, and copies of recent speeches and statements), research papers, consultative documents, and press releases on a range of matters of public interest.

Ongoing reform

There is a continuing legislative reform program to converge disparate elements of the financial markets provisions in the Corporations Law. While the recent financial system reforms have brought under a single framework a number of regulatory regimes organised along institutional lines, the purpose of CLERP is to implement an integrated framework for financial products that would provide consistent regulation of functionally similar markets and products.

The transfer of the currently State-regulated entities, such as credit unions, building societies and friendly societies, to Commonwealth jurisdiction (they will be prudentially regulated by APRA) is expected to be achieved by 1 July 1999.

A more extensive discussion of the developments in the financial system and its regulation can be found in the *Financial System Inquiry Final Report* (available at www.treasury.gov.au).

Transparency

Disclosure standard: IMF draft Code of Good Practices on Transparency in Monetary and Financial Policies

The second part of this draft Code, *Good Transparency Practices for Financial Policies by Financial Agencies*, identifies desirable transparency practices for financial agencies in the conduct of financial policies. Australia broadly conforms with these practices.

The roles, responsibilities and objectives of the financial agencies (APRA, ASIC, RBA and PSB) responsible for financial policies are clear and are specified in relevant legislation. Each agency has an open process for formulating and reporting financial policies and ensures the public availability of information on its policies. Mechanisms such as the provisions of the *Commonwealth Authorities and Companies Act 1997* help ensure the accountability and assurances of integrity of the financial agencies. Further details on Australia's observance of the individual aspects of the Code are contained in the second part of Attachment B to this report.

Disclosure standard: Core Principles for Effective Banking Supervision.

The Basle Committee on Banking Supervision released its *Core Principles for Effective Banking Supervision* in September 1997. These 25 principles have widespread acceptance as a basic reference tool for supervisory and other public authorities. The principles were designed to assist countries in developing adequate and robust prudential supervision of their financial sectors and to strengthen existing arrangements.

Australia has implemented the *Core Principles for Effective Banking Supervision* with the exceptions of principles 3 and 25 which relate to a formal 'fit and proper' test and the supervision of the local operations of foreign banks respectively, where Australia is only partly compliant.

Further details on Australia's adherence to these Principles are found in Attachment H to this report.

Disclosure standard: Collection and reporting of international banking statistics to the Bank for International Settlements (BIS)

The Report of the G22 Working Group on Transparency and Accountability recommended the reporting of international banking statistics to the BIS, as the BIS regularly collects and publishes cross-border banking statistics. Australia does not currently provide these statistics to the BIS. Some international investment and other relevant data are collected from banks by the Australian Bureau of Statistics (ABS), but confidentiality constraints prevent the ABS from releasing these data in a useable form. APRA has approached the relevant banks to get this data copied to it with the intention of contributing to the BIS collection. The banks have agreed to do this, and Australia will be providing some data to the BIS shortly.

Disclosure standard: Regulatory principles developed by the International Association of Insurance Supervisors (IAIS).

In September 1997, IAIS adopted two sets of supervisory principles: the *Insurance Supervisory Principles*; and the *Principles Applicable to the*

Supervision of International Insurers and Insurance Groups and their Cross-Border Establishments.

As a member of IAIS, Australia undertook the first self-assessment of its supervisory framework for insurers authorised to write insurance business in Australia, against the *IAIS Insurance Supervisory Principles*, in February 1998. It was found that Australia's supervisory regime for insurers was largely in conformance with these Principles, although there were some areas where Australia's supervisory framework did not fully conform. These were mainly with regard to general (non-life) insurers (e.g. APRA's limited powers to set standards with respect to the assets or liabilities of authorised general (non-life) insurers, and solvency requirements for general (non-life) insurers which only partially reflected the size, complexity and business risk of individual companies). These issues are currently being examined to determine what needs to be done to bring Australia's regulatory framework into line with IAIS Principles.

IAIS has set up a variety of committees to develop more detailed standards for areas covered by the *Insurance Supervisory Principles*. APRA is represented on both the Technical Committee and Solvency Sub-Committee.

Disclosure Standard: International Disclosure Standards for Cross-border Offerings and Initial Listings by Foreign Issuers developed by the IOSCO.

The International Organization of Securities Commissions (IOSCO) is an international forum for securities regulators. Its membership includes ASIC, Australia's relevant regulator. In September 1998, IOSCO issued disclosure standards for cross-border offerings and initial listings by foreign issuers and recommended that its members accept the standards. Australia supports and was involved in the development of these standards.

The purpose of the IOSCO disclosure standards is to facilitate cross-border offerings and listings by multinational issuers, by enhancing comparability of information, while ensuring a high level of investor protection.

An important factor in achieving this goal is the development of a generally accepted body of non-financial statement disclosure standards that could be addressed in a single disclosure document.

This document could then be used by foreign issuers in cross-border offerings and initial listings, subject to the host country granting approval through its disclosure document approval process. IOSCO has developed such a body of non-financial disclosure standards.

The standards apply to listings and public offers of securities, as well as sales of equity securities for cash. Therefore unless otherwise indicated, the standards are intended to be used for prospectuses and registration statements as well as offering and initial listing documents.

Foreign issuers must be given relief from strict compliance with Australian prospectus laws if they are to use a foreign prospectus. The forum of relief is set out in an ASIC policy statement, which provides views on how it will interpret and enforce parts of the law. ASIC enforces and interprets the law in a way which gives effect to the IOSCO standards in respect of certain foreign issuers. Such issuers are those making particular rights issues; issues pursuant to options and convertible notes; and foreign takeovers and schemes of arrangement. The policy statement only provides limited relief in the case of initial offerings, which are restricted to 20 or fewer offers per year.

The IOSCO standards cater for two acceptable approaches to disclosure standards. The first is a checklist approach and the second is a 'materiality' test approach.

The checklist approach identifies specific line items in the following areas:

- the offer and listing;
- key information concerning the company;
- offer statistics and expected timetable;
- identity of directors, senior management, advisers and employees;
- financial information;
- operating and financial review prospects;
- major shareholders and related party transactions; and
- additional information.

The 'materiality' test, on the other hand, takes into account that there may be matters known to an issuer that could have a material effect on a decision to invest, but may be missed by specific line item disclosure requirements. The materiality requirement places the onus on an issuer

to make a decision as to the relevance and necessity of certain information and bear the responsibility for making full disclosure.

Australian law requires the issuer of a prospectus to provide all the information that would be material to an investor's needs to make an informed investment decision. Information that investors require for an informed assessment may include:

(a) assets and liabilities, financial position, profits and losses, and the prospects of the corporation; and

(b) the rights attaching to the securities.

Where a country adopts a materiality approach, this principle overrides the country's specific line item disclosure for non-financial statement information in documents used for listings or public offerings of securities. Some countries may even choose to use a hybrid approach, with some specific line items combined with the requirement of materially informed investors. The Australian view is that the adequate supply of material information to investors is the preferred approach, because it leads to fuller disclosure.

Because the disclosure test under Australian law is similar to the test used in many overseas jurisdictions, issuers making an international offering should not find it cumbersome to consider at the outset what additional disclosures are necessary for Australia. They can then include those disclosures in the foreign offer document, yielding compliance if the document is to be lodged and circulated in Australia.

Disclosure Standard: IOSCO Statement of Objectives and Principles of Securities Regulation.

The IOSCO document relating to the objectives and principles of securities regulation sets out 30 principles of securities regulation that give effect to three objectives upon which effective securities regulation is based: the protection of investors; ensuring that markets are fair, efficient, and transparent; and the reduction of systemic risk.

Australia is a member of IOSCO and was involved in the development of the statement. Further details on Australia's adherence to this standard are at Attachment I.