PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS and FINANCIAL SERVICES

OVERSIGHT OF THE AUSTRALIAN SECURITIES and INVESTMENTS COMMISSION and THE TAKEOVERS PANEL

OPENING STATEMENT FROM SEAN HUGHES

FRIDAY, 5 SEPTEMBER 2014

MELBOURNE

Chairman, Deputy Chair and Members, thank you for your invitation to appear before the Committee today. I am honoured and pleased to be here. I have previously indicated to the Secretary that I am appearing in a private capacity, however I want first to set some context to my appearance.

Background and qualifications

In October 2010, I was appointed as the inaugural Chief Executive (Designate) of the Financial Markets Authority of New Zealand (FMANZ). FMANZ was established by the Financial Markets Authority Act 2011 of the New Zealand Parliament and came into existence on 1 May 2011. I held office as CEO until 31 December 2013 when I returned to Australia.

While in New Zealand, I also held adjunct roles as co-Chair of the Council of Financial Regulators (comprising FMANZ, the Reserve Bank, the Treasury and the Ministry of Business, Innovation and Employment) and Chair of the National Strategy for Financial Literacy Advisory Group.

Prior to my role as CEO of FMANZ, I held two successive senior executive leadership roles at the Australian Securities and Investments Commission (ASIC) between 2008 and 2010 in the enforcement and corporate governance areas. I was previously employed by ASIC from 1999 until 2003 in senior executive roles in enforcement and compliance relating to financial services reform and regulation.

Outside my public sector regulatory roles, I have also been employed by ANZ as Group General Manager, Compliance (2003 – 2007) and then by National Australia Bank as Senior Legal Counsel for the Australian Bank (2007 – 2008). I have held partnership and senior legal roles at commercial law firms in Australia, Hong Kong, London and New Zealand.

I am currently a non-executive member of the Comcare and Seacare Authority Audit Committee and hold graduate and postgraduate qualifications in law and corporate governance from universities and institutes in Australia, New Zealand and England. I have recently been appointed to an executive management role in the superannuation / funds management sector.

Reform in New Zealand's financial markets

Prior to FMANZ's establishment in 2011, regulatory responsibility for financial markets regulation in New Zealand was allocated across a number of agencies including: the Reserve Bank, the Securities Commission, the Government Actuary, the Ministry of Economic Development, the Commerce

Commission and the Serious Fraud Office. Concerns were expressed by both market participants and observers about the fragmented nature of these arrangements and the perceived lack of proactive investigation and enforcement of breaches of legislation. In addition, the existing regulatory toolkit (as contained in the Securities Act 1978) was considered to be antiquated and the Government had foreshadowed a review of that regime.

However, following the report of the Capital Markets Development Taskforce in 2009, the Government decided to fast-track both its reform of the regulatory framework and the modernisation of the legislative regime. In no small part, the catalyst for this rapid response was the disproportionate impact of the global financial crisis in New Zealand. Confidence in New Zealand's markets was sorely tested at this time. As one indicator of that, in 1987, 26% of household assets were invested in New Zealand's equity markets. As at the end of 2010, that share had plummeted to just 7%.

In particular, around 60 second–tier finance companies collapsed or arranged moratoria between 2006 and 2011, putting at risk NZ$8.5 billion (A$7.56 billion) of investors' money, predominantly retirees and small business owners. In the wake of these events, investigations into allegations of false and misleading statements in offer documents, as well as other corporate deficiencies, were commenced by a number of the then-existing regulatory agencies.

Jane Diplock, the former Chair of the Securities Commission, had suggested that these finance company collapses occurred in "a regulatory desert". Given the dictates of its legislative remit, the Commission's role was limited to ensuring risks were properly disclosed in offer documents, allowing investors to make their own judgements as to whether the returns being offered were worth those risks.

Regulators can do no more than operate within their legal boundaries and, if these are too limited, ask for more powers. The New Zealand Government heeded that call with the formation of FMANZ. The enabling legislation was passed with unanimous support from both sides of the House.

The Government's key focus was to restore investor confidence in New Zealand's capital markets. Investor confidence was seen as crucial if New Zealand was to develop the kinds of vibrant capital markets needed to lift that country's economic performance. We were also mindful of New Zealand's international reputation as a capital market, and the regulatory structures needed to reflect that. In March 2011, a Morningstar global study of investor experience in 22 countries rated New Zealand last with a D-minus. The report said New Zealand scored worst because of its low rating in key areas of disclosure as well as regulation and taxation. Morningstar acknowledged New Zealand was moving to improve its performance with the creation of FMANZ and the major review of securities laws then taking place.

The fallout from the global crisis, and the finance company collapses, together with the recommendations of the Capital Markets Development Taskforce, made clear the need for a more integrated approach to regulating the financial sector, and strengthening key regulatory agencies' enforcement powers.

As the inaugural CEO of FMANZ and as a former ASIC senior executive, it was personally encouraging that New Zealand decided to implement a twin peaks model similar to the Australian ASIC/APRA design, with FMANZ standing alongside the Reserve Bank as the prudential regulator. This spelt the end of the previous fragmented regime with a multiplicity of regulatory bodies, although some significant exceptions from the Australian model do remain:

- The corporate registry function is held separately within the public sector, not housed by any one regulator;
- There is no public sector prudential regulator for the New Zealand retirement savings model (KiwiSaver). FMANZ performs a broader role than ASIC does in relation to the superannuation sector, and also regulates independent fund trustees to oversee the performance of fund managers.

- Consideration was given to whether FMANZ should acquire enforcement powers in relation to consumer credit, but ultimately these were left with the Commerce Commission (albeit there are some shared accountabilities).
- New Zealand has not gone as far as Australia in FMANZ's oversight of the secondary markets operator (NZX), which maintains its own self-regulatory capacity, subject to FMANZ oversight.
- Investigation and enforcement of serious criminal activity in the financial sector is shared between FMANZ and the Serious Fraud Office.

FMANZ in operation

FMANZ's main objective is to promote and facilitate fair, efficient and transparent markets. This balance between a traditional regulatory policing role and one of markets facilitation was a deliberate measure to ensure that every regulatory decision was made in the context of what was best for the market and the economy.

FMA's establishment in 2011 provided a new legislative landscape for New Zealand's financial markets. The regulator acquired much greater powers of surveillance, regulation and enforcement than its predecessors. We had a far wider scope in terms of the people and entities we oversaw, ranging from registered securities exchanges, superannuation schemes, issuers and brokers to financial advisers. In October 2011 we added trustees and statutory supervisors to that list, and then acquired oversight of auditors of issuers from July 2012.

However, this was not the end of the Government's reform agenda for the financial markets. In 2013, the Financial Markets Conduct Act came into force (with a 2 year transitional timetable). At a high-level, the reforms included:

- changes to disclosure - replacing the requirement for issuers to prepare a prospectus and investment statement with a single short form product disclosure statement tailored to retail investors;
- a modified liability framework for securities law breaches including criminal penalties for the first time for reckless and intentional breaches of directors' duties, doubling existing criminal penalties as well as civil penalties for misleading information in disclosure documents and advertisements; and
- a further significant increase in the scope of regulated entities, to include fund managers, independent trustees of superannuation schemes, derivatives dealers and peer-to-peer lenders.

There was also a significant uplift in resources (more than double than that of FMANZ's predecessors). FMANZ's funding model differs from ASIC in that the New Zealand model is a mixture of cost recovery fees and Crown funding. This cost recovery includes fees charged to licensed financial advisers and other regulated entities. Moving away from a pure appropriations-funding model enabled a significant uplift in FMANZ's resources from inception. After a 3 year transitional capability and infrastructure build budget, FMA is forecast to return to a normalised annual budget in 2014/15 of approximately NZ$26 million (A$23.12 million) net of other income and separate litigation appropriation funding[1]. Staff numbers also grew significantly in my term from approximately 70 based almost exclusively in Wellington, to a twin-hub model in Auckland and Wellington of approximately 150.

[1] http://www.fma.govt.nz/about-us/corporate-publications/statement-of-intent/statement-of-intent-2014-2018/ and http://www.fma.govt.nz/about-us/corporate-publications/statement-of-intent/statement-of-performance-expectations-2014-2015/

We also thought it was important to signal to the market what our intended focus on enforcement and other activities was going to be. Within the first 6 months of operation, FMANZ published its Enforcement policy[2] and then its Compliance focus in 2013[3].

FMANZ inherited a significant number of investigations and enquiries from its predecessor agencies. It was important to move quickly to address investor concerns, address public criticism of previous regulators, identify any recoverable losses for investors and hold those accountable to the full scrutiny of the Courts. As a result of FMANZ's activities, over 30 directors were convicted of securities offences during my term, while FMANZ was also successful in a range of other matters involving disclosure deficiencies, secondary markets misconduct, financial adviser breaches and unlicensed activities.

Regulatory Philosophy post-GFC

The period since the global crisis has seen further soul-searching across both developed and emerging markets as to how best to equip markets, regulators and investors to withstand cyclical and unforeseen shocks. It is now obvious that there is no one size fits all approach, nor is there a nirvana model for regulation.

What is clear is that the activities and effectiveness of regulators are conditioned by their resourcing, culture, priorities and powers, as well as by the cohesion within which they work with other agencies (both nationally and across borders) to address systemic risk.

I am pleased to say that FMANZ was an early adopter of the risk-based approach to early targeting and identification of threats and risks to our statutory objective: namely to promote and facilitate fair, efficient and transparent markets. The establishment of a strategic intelligence function with a dedicated resource base was an early and effective initiative.

In closing, I wanted to quote briefly from a presentation I gave during my term at FMANZ:

"Efficient capital markets are a marriage of well-performing and mature product issuers and advisers, and informed, confident, risk-savvy investors. FMA's objective is to promote both. The reality is that the path along the cliff top is risky. And not everyone is careful. Companies do fail, and investors do get hurt. Creditors are left unpaid. Employees are exposed and vulnerable. That's the nature of capital markets. Through good market regulation and oversight, we might be able to reduce the chances of this happening, but we cannot prevent it, nor will we. That is not the role of a regulator in a developed market economy, and nor should it be. I reject any assertion that regulators are there to guarantee survival. There will always be an element of risk in securities market participation and this will never change despite all the regulation, close supervision, powers or resources in the world. Risk-taking, in the right circumstances and with the right resources and controls, is appropriate and I encourage it as an enabler of capital growth.

I am not, however, an advocate for the efficient markets theory of minimalist regulation. When a company plummets over that cliff because its directors and management have been asleep at the wheel - or worse, because they've bailed out the door and let their investors take the plunge alone - then we will look to see what action the FMA can take. We will take action."

I look forward to responding to the Committee's questions.

[2] http://www.fma.govt.nz/laws-we-enforce/enforcement/fma-enforcement-policy/

[3] http://www.fma.govt.nz/media/1513558/fma_s_compliance_focus_for_2013.pdf