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Retail Market Conduct Taskforce Consultation Report

The Australian Financial Markets Association (AFMA) welcomes the opportunity to make comment on the Retail Market Conduct Taskforce Consultation Report.

AFMA supports IOSCO's intention to better understand the evolution of retail trading over recent years and respond proportionately.

While it is true that certain elements of the evolution of retail trading warrant analysis and a proportionate response, AFMA is concerned that the report in reflecting the regulatory focus of its IOSCO member survey contributors presents an unwarranted and perhaps unbalanced perspective on the evolution of the market. It does not give appropriate weight to the benefits that have also accumulated alongside matters of regulatory interest and ignores the clear benefits to retail investors and the economy.

From a regulator perspective increased retail investor activities means increased opportunity for things to go wrong and create investor harm, but from the bigger picture retail investor participation, within sensible bounds and with the already regulated protections, is fundamentally a good thing that will benefit investors even in our imperfect world where not everything goes to plan.

Greater direct involvement in investment through the financial markets supports economically beneficial activity that will support businesses raising capital and over the long term should contribute to economic and improvements in individual financial circumstances.

The industry has made investment much cheaper for retail investors. This is also a significant benefit, and as fees typically represented a higher proportion of invested capital for smaller investors this change is particularly welcome.

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Self-directed retail investment has also become easier through improved applications and interfaces and relevant information has become more accessible, which should help better inform investor choices.

We provide some responses to the Report's questions below.

Yours sincerely

Damian Jeffree
Senior Director of Policy

Q1: In their risk analysis, should regulators specifically consider/target specific demographic profiles/groups for additional or enhanced investor protection measures? If so, should greater attention be focused on younger age groups or older age groups? Is there a tipping point in behaviours beyond which regulators should become concerned?

Where particular matters are negatively affecting particular demographics then it is certainly logical to target information campaigns at those demographics, but regulators should not approach individual investors acting legally as though they were regulated entities. To do so would be an overly paternalistic approach they may not be in accord with the freedoms appropriate in many jurisdictions. Many jurisdictions already have sensible limits on the types of exposures available to retail investors including limiting leverage on certain exposures and this type of approach combined with education is likely to achieve an appropriate balance in the access of retail to investment markets.

We note the concern with different age cohorts. Age is being used in the paper as a proxy for the level of understanding of the investor, however, it is not well-suited for this purpose. Many nominally less experienced investors are well informed and vice versa. The focus should be on informed investors.

Q2: Does the consultation report capture accurately the important retail trends and the reasons for increased retail trading? Are there any missing concerns or issues and other potential risk magnifiers? What may be the current and potential long-term implications of increased retail participation in markets in your view?

The report is accurate in capturing the major trends but the analysis, as we have suggested above, is excessively negative for what is for the most part an essentially positive trend.

As we have noted above the main long-term implications of increased retail investment are better financial outcomes for those investors and an important increase in economically productive capital supply for the economy.

Q3: What may be the potential implications of self-directed trading and gamification from a retail risk and conduct perspective? Should high risk aspects of these activities be regulated or prohibited, for example, certain risky gamification techniques?

A major factor that is not acknowledged by the paper in the increase in self-directed investing in the Australian context is that regulation has increased the cost of financial advice and made it inaccessible for many investors. This is being reviewed locally in a consultation being undertaken with the aim of lowering the cost of advice[1]. If the regulatory framework did not create so much unwarranted risk and cost for advice providers and was more supportive of limited advice it would be possible to shift many

[1] https://treasury.gov.au/review/quality-advice-review

people into the lower risk advised space. It is incumbent on IOSCO to consider what regulators can do to ease the path to advice for retail investors.

The assertions of the paper in relation to some matters may not be soundly based. For example the paper states “there is a risk that compliance with “best execution” rules might not be respected by firms”, while trivially this is true in that it is always a risk, we see no evidence of an increase in these rules not being respected, and indeed best execution can sometimes be more readily met and evidenced by self-directed electronic execution platforms.

AFMA is cautious about regulatory interventions in relation to ‘gamification’. Enhanced user interfaces can also be used to benefit investors as they can used to make learning about investment and risk more integrated into the user experience. Improvements to technology should be seen as a neutral force that can have positive and less positive applications.

It is true that there are parallels between investing and gaming in that money is put at risk in both. The primary difference being that money is more likely, over the long-term, to be lost in gaming and to be gained in investing.

While investment interfaces should not hawk products, it would be odd if regulations meant that only the activity that is likely to lose money, actual gaming, was free to provide consumers with an engaging user interface experience.

> Q4: How should regulators consider whether to monitor crypto-asset trading by retail investors? Are there ways that the apparent data gaps with regard to retail investor crypto- asset trading could be filled or other protections for retail investors or ways in which regulators could begin to monitor crypto-asset trading? Are different approaches likely to be more or less effective in jurisdictions with different regulatory, statistical and other governmental and private sector approaches to data gathering?

AFMA supports making ‘crypto-assets’ subject to the same suite of investor protections as applies to financial products, particularly as ‘crypto-assets’ can be a high-risk area for investors.

> Q5: How should regulators approach these trends (e.g., both trading for crypto-assets or brokerages using hidden revenue raising mechanisms) and when should they seek to intervene?

AFMA holds that all the exact same risks that apply and must be managed in relation to financial products also apply and must be managed in relation to De-Fi.

As per our comments above these products should be classified as financial products to bring the existing suite of protections into play for the sector. As the types of risks posed by De-fi and financial products are broadly the same (noting some De-fi products are very high risk), they should have the same suite of regulatory protections.

> Q6: Should regulators proactively monitor social media and online statements for retail investor protection and if so, when and how? Should social media be subject to additional regulatory obligations regarding securities trading and/or crypto-asset trading? How could such monitoring be implemented, and obligations enforced proportionate to the harm/potential harm? Are there any legal (e.g., data protection) or technical obstacles? What sort of risk assessment should regulators do to determine where to allocate their resources?

In the Australian context the existing regulations apply equally to social media influencers. ASIC has stepped up enforcement of these regulations and this appears to be having the desired effect.

> Q7: Are the main fraud types covered correctly (e.g., crypto-asset scams, boiler room scams, clone investment firms, and misleading information and promotional material)? What are the fraud patterns that cause/have potential to cause most retail investor harm? Are there other types of frauds or scams that regulators should consider?

AFMA rejects the general characterisation of the increased retail investor activity: "The current market environment might have created a fertile ground for fraudulent and scam activity". This negative assessment should be further investigated and may well reflect the orientation of the survey respondents whose work focuses on managing these types of activities.

We suggest IOSCO survey more than just its member regulators in the first instance in order to achieve a more balanced view on the state of play in markets.

In the Australian jurisdiction at least, we find that existing regulation is more than capable of dealing with the issues identified. Beyond the 'crypto' label there is fundamentally nothing new in the fraud types mentioned. The new elements are the technology being used (including cryptographic), the increase in participation and in some cases the openness of the misconduct.

> Q8: How has COVID-19 impacted retail conduct and frauds? How should regulators best respond to fraud and misconduct in the current environment, also in consideration of the impact of COVID-19 on retail market conduct?

Stepping up consumer education and enforcing existing regulations are both supported by AFMA as appropriate responses.

> Q9: Does the Consultation Report capture well the existing cross-border challenges? Are there any missing concerns or issues that are not highlighted? Are there any other novel ways of addressing cross-border challenges affecting retail investors? As an international body, what could be IOSCO's role in addressing the cross-border challenges highlighted in this consultation report?

The range of challenges surveyed appears well-captured.

AFMA does not support requirements by regulators to licence foreign providers with limited involvement in a jurisdiction or where services are provided by foreign firms in jurisdictions with broadly similar regulatory requirements.

IOSCO should assist regulators establish shared frameworks so that broad equivalence can be more readily established.

> Q10: What may be the concerns or issues that regulators should ask for disclosure of (at both firm and product level), keeping in mind the balance between quantity of disclosure and the ability of retail investors to absorb such disclosure? Should markets continue to seek to put in place special arrangements that could encourage companies during stressed market events to provide disclosures and updates that help retail investors better evaluate current and expected impacts of such events? If so, what may be the practical options to achieve this, including who should provide this information? Are there specific technological measures or non-technological measures (e.g. changing the timing, presentation of the information) you would suggest to enhance the ability of retail investors to process the disclosure?

While keeping investors well informed is an important policy objective, AFMA cautions that it must not be done at the cost of making the listed capital markets unattractive and high risk for firms. Listed markets are a public good and provide much needed transparency for investors. An accretion of regulatory costs and risks associated with public listing is supporting a trend towards migration of firms to private ownership. Regulators are not well placed to access the economic impact of these changes and should defer to the jurisdictional policy body before adding more challenges for listed firms.

> Q11: Where product intervention powers exist, what factors should regulators consider to determine when it should be used and at what stage to ensure suitability and to mitigate investor harm? For example, should regulators monitor leverage levels in retail trading and/or seek the power to limit leverage? If so, is it possible to describe the kind of situation in which such powers could justifiably be used?

Product intervention powers should be used sparingly and should not be a regular feature of regulatory activity as to do so would create an undesirable unpredictability. ASIC's

Regulation Guide 272 notes they can be of benefit to help regulators respond quickly where this is necessary to avoid 'significant consumer detriment in the market'.

> Q12: Are the developments in retail investor behaviour sufficiently significant and persistent to justify reviews by regulators of their current approaches to retail investor protection? If so, is that true globally or only in some markets? If some, what are the characteristics of the markets for which that is most true?

AFMA supports the concerns around crypto-assets and De-fi remaining out of scope for regulators when they present the same types of risks as financial products.

> Q13: Are the above regulatory tools appropriate, proportionate, and effective? Are there other regulatory tools regulators might consider? What new technologies may help regulators as they continue to address misconduct and fraud (including online/via social media)?

We agree a one-size-fits-all approach is not appropriate. Policy makers in each jurisdiction should determine the appropriate regulatory mechanisms for their circumstances.

> Q14: Since the date of the IOSCO survey exercise in August 2021, have there been any other measurable changes in retail investor trends that should be taken into consideration?

We note that the market conditions have changed markedly since the survey was undertaken. Some parts of the market have turned from bull to bear, and retail investor activity is gradually decreasing to more normal historic levels.