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Investor Education Centre

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Bust them before do damage

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The mere mention of the word regulation makes the eyes glaze over. Nobody but a regulator gets excited at the thought of regulation, but it is a necessary evil. Without it we have anarchy. In some people's minds, the financial sector has already experienced anarchy and is in dire need of a regulatory overhaul.

Theoretically, if the sector had been well regulated, wrongdoers would have been identified before they had a chance to lose investors' money. Or at the very least, they would have been caught and punished after the event.

Perhaps our framework has failed because, according to Jane Diplock, the regulators have been under-resourced or not empowered enough. Or maybe it is because we have too many parties playing a role in regulation, so things slip through the cracks.

Regulation can work and we need look no further than Australia to see a successful regulatory framework in action. Australia has multiple regulators looking after specific aspects of the financial services sector, but the main regulators are APRA and ASIC. The Australian Prudential Regulation Authority is, as its name suggests, the prudential regulator. The Australian Securities and Investment Commission is the market conduct regulator.

The distinction between the two has been likened to a doctor and a policeman.

As the market conduct regulator, ASIC is like a policeman because it focuses on catching those who break the rules by stealing money and misrepresenting information. The best deterrent to crime is not so much the penalty but the likelihood of getting caught. So ASIC's greatest weapon is to investigate, catch and prosecute wrongdoers. Enough heads have rolled over the years for industry players to be scared of ASIC.

Then you have a prudential regulator like APRA who, like a doctor, is more concerned about maintaining health and if possible preventing failure. Rather than looking for criminals, they keep an eye on the patients (the industry players) making sure the industry is in good health and in the case of failure, they look to rehabilitate.

In New Zealand, we haven't seen much evidence of the policeman type regulator catching wrongdoers. And neither have we seen much evidence of the doctor type regulator who collects and monitors relevant information from all the operators to make sure the industry is healthy.

Fortunately, the Government is well aware of the public's disappointment and distrust of the financial sector regulatory framework and is doing quite a bit to sort it.

The Capital Markets Taskforce recommendations have been heeded and some are being implemented. New rules are being put in place to ensure that investment advisers, trustees, finance companies, fund managers, KiwiSaver providers and basically anyone who deals with investors' funds are up to the job. The phrase fit for purpose is an appropriate description of what the Government is seeking to ensure – that all those handling investors funds are properly educated, experienced, trustworthy and focused on the best interests of the investor at all times.

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Now at last, the word regulation can be greeted not with rolled eyes but with a sense of optimism for the future.

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