



ASIC
Australian Securities &
Investments Commission

Market structure and competition

Mapping structural risk in ASIC's regulatory remit

Luke Meehan PhD

Snr Manager Economics and Risk

ACE2022

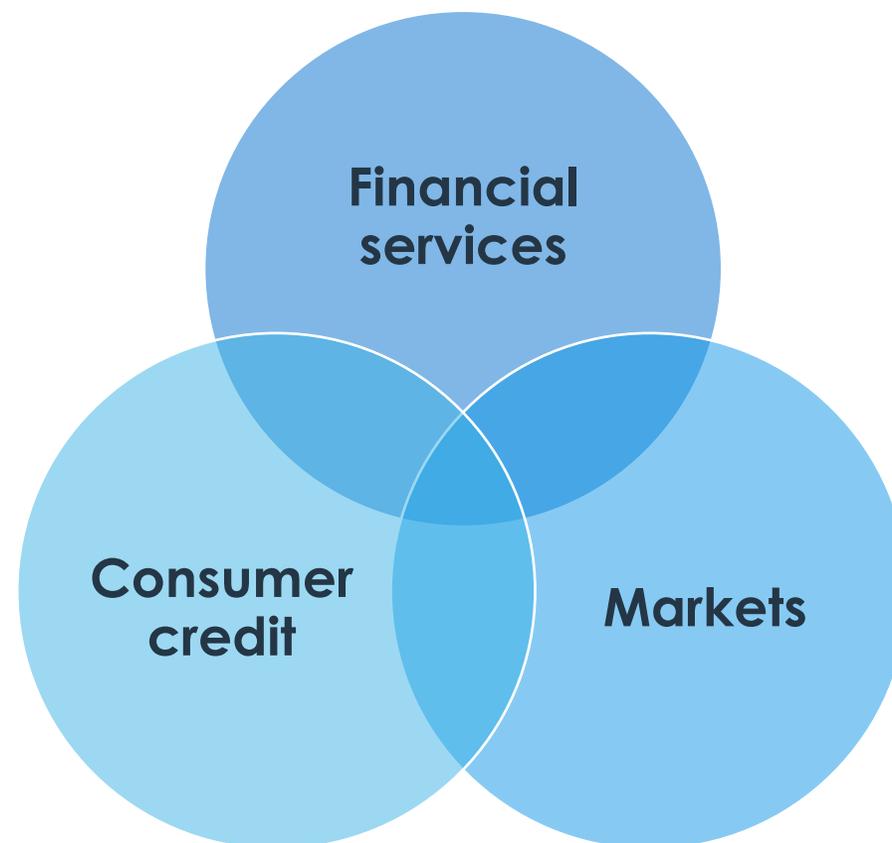
The Motivation



ASIC has a broad remit (~96 markets), a large and disparate regulated population and many types of consumers



It is challenging to make cross-market comparisons given each market's unique characteristics.



Project utility – internal to ASIC

Input to Strategic planning



Market health assessments provide a way for ASIC to objectively compare markets and [risks threat/harms], contributing to evidence-based prioritisation.

A Different Perspective



Market health assessments consider structural characteristics rather than operational characteristics.

A Reference for Teams



Finalised reports compile a wide range of useful statistics and data sources that can be a useful reference for teams going forward.

The role of market health assessments

The HARMs framework is designed to meet operational requirements



Minimal resourcing

Comparable across markets and across time



Highly targeted (focus on market definition)

Identifies knowledge gaps



IOIO
IOIO

Use only publicly available or internal data

Brief and accessible



The framework

Based on a Financial Risk Assessment model published by the UK Financial Conduct Authority

Received input from the ACCC and the Productivity Commission.

≤ 6 weeks to complete

Prioritises accuracy, objectivity and replicability over completeness

~25 markets complete – will complete 40 before the cycle repeats

Market definition

Market definition is a balancing act between accuracy and usefulness

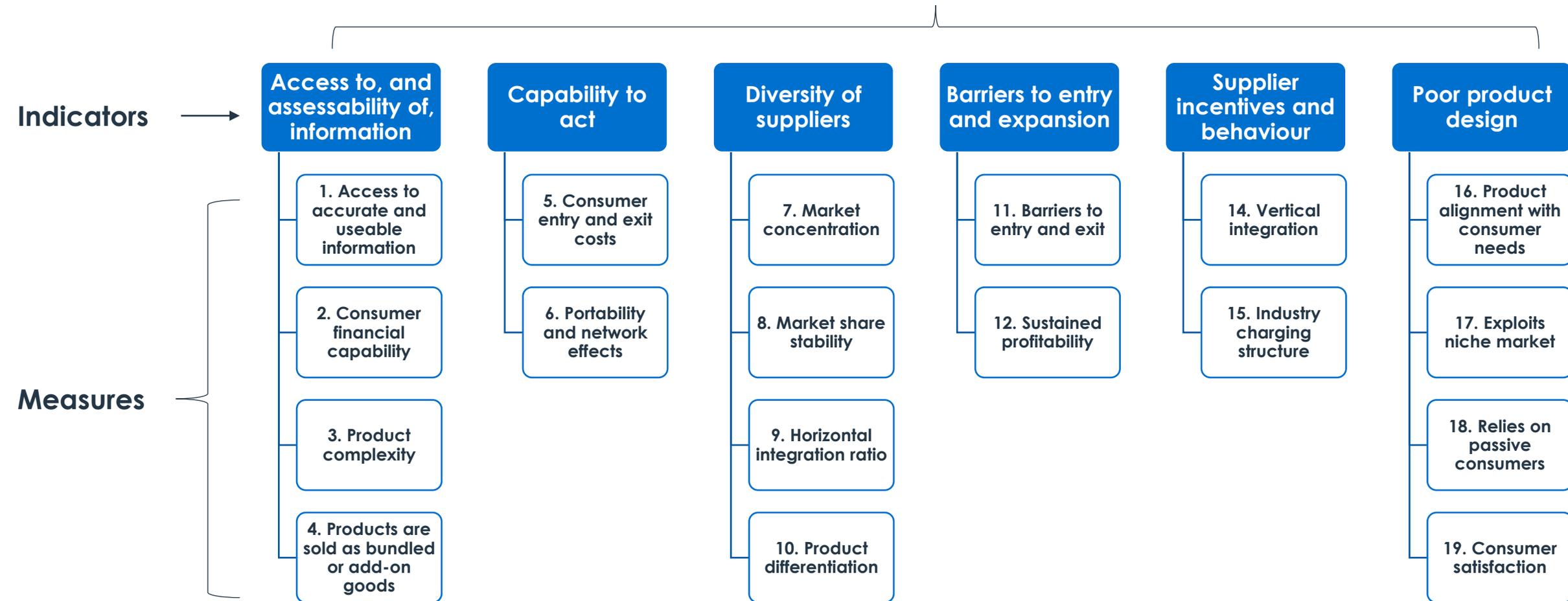
Where frictions originate in interconnected markets, we report the friction *and* identify its source.

A strong definition

- Isolates the source of problems in a complex supply chain
- Ensures comparability
- Helps with decision-making during the assessment
- Is challenging where financial products are imperfect substitutes
- Relies on data availability

Quantitative and Qualitative Indicators

Market



Demand-side Competition

Access to, and assessability of, information	1. Access to accurate and useable information	<ul style="list-style-type: none"> Is information that enables consumers to assess products readily available and digestible?
	2. Consumer financial capability	<ul style="list-style-type: none"> Does the product require a high level of financial capability? Niche market and scale concerns are captured elsewhere.
	3. Product complexity	<ul style="list-style-type: none"> Do products in this market have a large number of features? Is there a long delay before its benefits are realized? Is it difficult for consumers to understand their entitlements? Is the relevant product a credence good?
	4. Products are sold as bundled or add-on goods	<ul style="list-style-type: none"> Are products most commonly sold as a bundled or add-on product?
Capability to act	5. Consumer entry and exit costs	<ul style="list-style-type: none"> Are the fixed monetary costs of switching between providers over 10% of total annual fees (high), or below 5% (low)? Indirect and behavioural costs captured elsewhere.
	6. Portability and network effects	<ul style="list-style-type: none"> Are there substantial non-price barriers to consumers switching between products, including administrative, behavioural or compatibility barriers?

Supply-side Competition

Diversity of suppliers	7. Market concentration	<ul style="list-style-type: none"> Assessed using the Herfindahl-Hirschman Index (HHI) and C4 measures of market concentration, which considers the number and size of firms within a market. HHI > 2000 is high, HHI between 2000 and 1000 is moderate, HHI < 1000 is low.
	8. Market share stability	<ul style="list-style-type: none"> Are the 3-year changes in market concentration measures changing, indicating changes to competitive health?
	9. Horizontal integration	<ul style="list-style-type: none"> Do a large proportion of market players own competing firms? Measured as the volume of revenue derived within a market by licensees of other players – High over 66%, Low under 33%
	10. Product differentiation	<ul style="list-style-type: none"> Does the market feature product innovations or added choice that benefit consumers? Analysts focus on the quality of choice, not the quantity.

Supply-side Competition (Continued)

Barriers to entry and expansion	11. Barriers to entry and exit	<ul style="list-style-type: none"> Degree of barriers to the entry and exit of firms and products. Barriers may be regulatory, network access, capital costs, economy of scale or other.
	12. Sustained profitability	<ul style="list-style-type: none"> High degrees of profitability may be an indicator of competition failures. Sustained profit margins over three or more years – Above 20% or below 3% is high, between 15% and 20% is moderate, between 15% and 3% at least once is low.
Supplier incentives and behaviour	13. Vertical integration	<ul style="list-style-type: none"> Do a large proportion of market players own firms at other levels of the supply chain? This proportion is measured as the revenue of vertically integrated firms against the revenue of the whole market (high risk is above 66%, low risk below 33%)
	14. Industry charging structure	<ul style="list-style-type: none"> Remuneration structures, with low risk being direct or up-front fees and high-risk being commissions, loans, profit sharing or dollar value based payments.

Product Design

Poor product design	15. Product alignment with consumer needs	<ul style="list-style-type: none"> • This measure aims to identify markets where poor design or distribution of a product is likely to lead to consumer detriment. • Subjective estimation by analyst, with careful cross-market comparison.
	16. Exploits niche market	<ul style="list-style-type: none"> • Consumers with low incomes, in remote locations, or from culturally and linguistically diverse backgrounds may be more vulnerable to exploitation. • High risk is over 50% of sector revenue derived from such consumers, low below 25%.
	17. Relies on passive consumers	<ul style="list-style-type: none"> • Is the market dependent on passive consumers for its business model?
	18. Consumer satisfaction	<ul style="list-style-type: none"> • Surveyed consumer satisfaction and/or the level of complaints may indicate consumer outcomes. Focusing on changes in this controls for differences between markets.



Outputs

**A measure of
structural
vulnerability**

**A standardised
estimate of size
(size at risk)**

A range of descriptive statistics, data gaps, and topic for future research are also reported



A measure of structural vulnerability

1. Demand side, supply side and product design measures are scored as **low**, **medium** or **high** risk.
2. Their weighted* sum determines a risk rating for each indicator.
3. The weighted sum of all measures determines the overall risk score for each market.

**Weights were constructed based on the assessed contribution of each measure to a potential market failure, and are regularly reviewed and updated.*

A standardised estimate of size (size at risk)

Uses the sum of z-scores for size-related overlay indicators, including revenue, consumers, producers and an exposure variable.

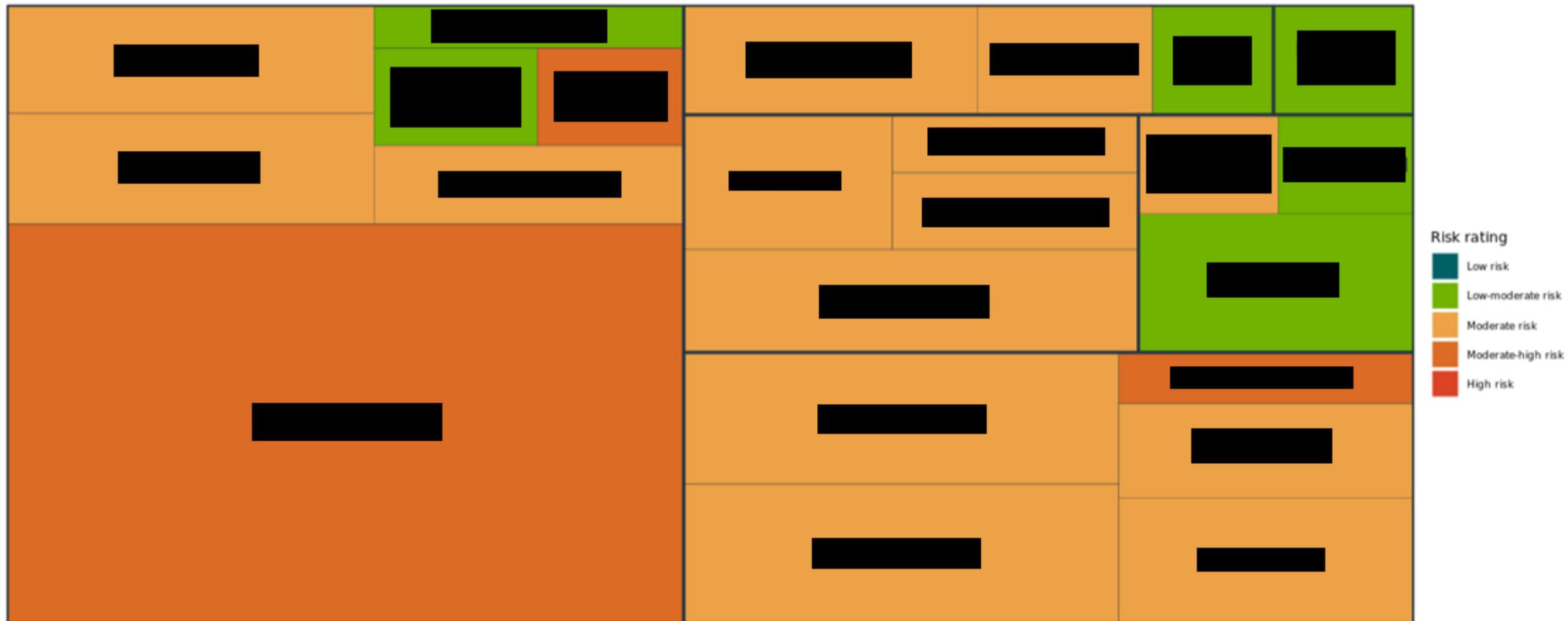
$$\textit{size-at-risk} = z_{\textit{revenue}} + z_{\textit{consumers}} + z_{\textit{producers}} + z_{\textit{exposure}}$$

$$\textit{where } z_m = \frac{m - \mu}{\sigma}$$



Findings are reported in an interactive dashboard, which is used as an input to ASIC's business and strategic planning processes.

Heatmap



Example findings - insurance

Commission expenses/gross written premium



1. Underwriting result as a percentage of net earned premium. Source: [APRA \(2022\)](#)

Findings

Poor accessibility and availability of information is a key source of structural problems in retail settings, often due to excessive search costs.

Although vertical integration has decreased in recent years, the level of vertical integration in some markets remains high.

Challenges

Market definition

Indicators that don't change monotonically (more/less not always better)

Frictions originating in downstream/upstream markets

Behavioural factors are hard to measure





ASIC
Australian Securities &
Investments Commission

Discussion