Stockbrokers
Association of Australia®

9 October, 2015

Corporations and Schemes Unit (CSU)
Financial System and Services Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: asicfunding@treasury.gov.au

Dear Sir/Madam

CONSULTATION PAPER – PROPOSED INDUSTRY FUNDING MODEL FOR THE AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION -SUBMISSION BY STOCKBROKERS ASSOCIATION OF AUSTRALIA

The Stockbrokers Association of Australia Limited ("the Stockbrokers Association") appreciates the opportunity to provide this Submission to Treasury in respect of the Consultation Paper ("the Consultation Paper") on the Proposed Industry Funding Model for the Australian Securities and Investments Commission ("the ASIC Funding Model") .

We would be happy to discuss any issues arising from our submissions on this issue. Should you require any further information, please contact Peter Stepek, Policy Executive, on (02) 8080 3200 or email pstepek@stockbrokers.org.au

Yours sincerely,

Andrew Green
Chief Executive

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EXECUTIVE SUMMARY

- Depending on their business model, whilst some stockbroking entities are facing a reasonably similar liability under the ASIC Funding Model compared to the existing ASIC Market Supervision Cost Recovery arrangements, there are many broking entities that will face a very significant increase in their cost burden.
- The stockbroking industry will find the increases that are proposed very hard to bear, in the context of consistently rising compliance costs imposed on the industry over the last 7 years, during a period when market and economic conditions have been poor and revenues falling.
- Whilst the proposed cost recovery may be consistent with moves in other jurisdictions, this does not change the fact that the ASIC Funding Model is likely to be very detrimental to the financial position of the stockbroking industry. There is the real potential for entities and jobs to be lost to other financial centres in the region, with whom Australia competes.
- A significant problem for stockbrokers with the existing ASIC Cost Recovery levy is the inability of stockbrokers to pass through the costs of the levy, due to the intense competition in the industry. The ASIC Funding Model does not address this problem, but continues it but with even greater impact due to the larger sums involved.
- There are sound policy reasons why the Government should not completely abandon its commitment to public funding of ASIC's budget. The Stockbrokers Association argues that a co-funding 50/50 arrangement with industry would be a more appropriate balance.
- The concept of a levy applied to transactions, such as employed in some other jurisdictions, has some shortcomings but on the other hand may solve some of the structural problems with the proposed arrangements. Further consideration of a transaction levy should be given.
- The proposed commencement date of 1 July 2016 does not allow much time to pursue further refinement or improvements to the proposed ASIC Funding Model. This may justify deferring that date to allow for further consideration to be given.
- There is no justification for the ASIC Funding Model to be phased in earlier for the financial services industry than for other industry sectors.
- There needs to be a meaningful mechanism for applying cost control over ASIC's budget. The proposals for consultation do not represent any improvement over the existing Stakeholder Panel, which has not been effective. There need to be incentives for ASIC and the Government to minimise ASIC expenditure, which is likely to grow considerably if ASIC is freed from public sector constraints.
- Fines raised by enforcement activity should be used to reduce the cost recovery burden of the relevant industry sector.
- Insufficient consideration has been given to adopting a holistic view of the impact of the range of cost recovery regimes being applied to industry sectors by different agencies, independently of each other.

I. PRELIMINARY COMMENTS

The Stockbrokers Association notes that the Proposed Industry Funding Model for the Australian Securities and Investments Commission stems from Recommendations in the Final Report of the Financial System Inquiry ("FSI").

In our Submission to Treasury in response to the Recommendations in the FSI Final Report[1], the Association noted that it appreciated the arguments in favour of ensuring that ASIC is funded by a model that is more stable and also is more capable of giving it the level of resources which it needs to do its job. The Association accepted that in order to perform its function, ASIC should not be subject to the vagaries of uncertain financing that often results from acute budget pressures at the Government level. We indicated our view that the potential for critical programs to suffer when Government funds are tight is not good for our markets.

Notwithstanding this, the Association has also argued that cost recovery in respect of market supervision should not be regarded as a given. There are many reasons which would justify not applying cost recovery to some or all of ASIC's budget, particularly the cost of supervision of Australia's markets.

The Association also stressed that there are a number of key aspects of any funding arrangement that needed to be carefully thought out. We highlighted that there were some serious flaws in the existing model for funding of ASIC's Market Supervision budget that were creating serious detriment to the industry. We submitted that these flaws needed to be remedied, and should not be reproduced in any model that applies to the ASIC budget generally.

The Association in particular highlighted the areas where the existing ASIC Cost recovery model for market supervision was acting to undermine key Government Policy objectives.

Whilst the Association acknowledges that the ASIC Funding Model now extends the liability to fund ASIC to a broader range of entities, the concerns that we previously identified do not appear to have been addressed. The existing Market Supervision Cost recovery arrangements appear to remain largely unaltered, and have simply been added to by the additional menu of new fees and charges applying more broadly to a range of other ASIC functions.

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[1] See Submission dated 31 March 2015, pages 10 – 15, Recommendations 28 and 29

The result in our view is a funding model that will have an even greater detrimental impact on the Australian equities market than it has to date. Broking firms will have to shoulder a significantly increased cost burden, estimated in many cases to be over 400% more than the existing Market Supervision Cost Recovery amounts being paid.

In our submission, unless the flaws in the model can be addressed and/or the amounts reduced, then the ASIC Funding Model will have a serious impact on the financial position of many stockbroking firms. This will likely lead to further losses of jobs and market activity to other jurisdictions, and reduce returns to investors.

What creates an additional concern for the stockbroking industry is the potential that other sectors will be in a position to pass their additional cost recovery burden onto brokers. In particular, the potential exists for exchange market operators to pass on the additional cost recovery obligations on to their users, i.e. Market participants.

Whilst the ASIC Funding Model represents a good attempt to share the burden of cost recovery more broadly across industry in general, this will be undone if the exchanges pass their additional costs onto brokers, who are themselves unable to pass any costs through. The end result will be that brokers will be forced to wear both sets of costs.

We set out our analysis in more detail in the following sections of this Submission.

II. ANALYSIS OF ASIC FUNDING MODEL

1. Significant Increases in levy amounts

Stockbroking firms are currently responsible for a heavy burden of costs under the Market Supervision Cost Recovery levy. Approximately 80-odd Market Participants currently bear 87.4% of the costs of ASIC market supervision (approximately $16 million). This has been in place since 2012, and has been very hard to bear. It has done great damage to the financial position of the industry.

The existing Market Supervision levy appears to remain largely unchanged under the new proposals. Depending on business models, for some broking firms the amount firms will be required to pay under the ASIC Funding Model will remain broadly similar.

However, on top of the market supervision component, the additional fees to be imposed under the ASIC Funding Model for other items will result in a significant increase in the amount that many stockbroking firms will be liable to pay over and above the existing Market Supervision Cost Recovery levy.

This will be particularly the case for firms with retail client advisers. The Association has been advised by member firms that they have conducted initial costings of the new amounts payable under the ASIC Funding Model. There has been consistent feedback from a number of firms that they are facing an increase of around 400% compared to the existing Market Supervision Cost Recovery levy. For example an existing liability to pay $40K will become a liability to pay $150K. One significant reason for these increases is the retail adviser fees.

The SAA acknowledges that ASIC Funding Model has made a good attempt to identify a basis for extending cost recovery to a wide range of entities not currently subject to ASIC cost recovery. Nevertheless, the fact remains that the stockbroking sector will find the increases that are proposed very hard to bear, in the context of the ongoing additional regulatory costs that have been imposed on industry over the last 7 years, the inability of broking firms to pass on these costs, and continued pressure on revenue due to poor economic and trading conditions.

The Government needs to be aware that, unless some changes are made to the model either with respect to the design of the levy so that brokers will be able to pass the costs through, or as to the total amount to be recovered from the stockbroking sector, substantial damage will be done to the industry.

We will discuss this further below.

2. Levies not able to be passed through

In previous submissions on cost recovery, the Association has consistently highlighted that due to the intense competition in the stockbroking sector, brokers have had no choice but to carry the cost of the market supervision levy themselves. Members have consistently advised us that any firm that raised brokerage to cover cost recovery levies would lose customers to those that did not. Brokerage rates have not risen in years, and the only direction that brokerage has followed has been downwards.

This situation is unlikely to change. There is no reason to imagine that brokers will find it any easier to pass through the new additional fees that will be payable under the ASIC Funding Model. The result will therefore be that brokers will be having to carry an even larger cost burden on their books. This will erode further the financial position of the industry. Stockbroking businesses are fragile. The inexorable increase in government costs is bound to force firms to merge or close.

Another result of the lack of pass through is that investors will make very little contribution to the costs of funding ASIC. In relation to ordinary retail investors and fund managers holding the pooled investment of every day Australians, this would at least mean that there is no erosion of investment returns. However in relation to offshore investors in the Australian markets, those investors would bear very little of the burden of funding the market regulator. In our submission, it is appropriate that investors, as the beneficiaries of ASIC's investor protection functions, make a fair contribution to the cost of those functions.

3. Likely impact of the funding model

Following on from the above section, the Association highlights that the result of loading ever increasing costs onto the industry will be to make stockbroking and retail advice a marginal business.

The Government needs to be aware that there is a real potential for firms to wind up operations in this jurisdiction and move offshore to lower cost jurisdictions. This will weaken Australia's markets and our ability to compete with other markets in our region.

Given that the some of the biggest fee increases will be experienced by retail firms, there is a **major risk of closure** of a number of those firms. Bigger firms are likely to be in a better position to bear the additional costs, so there is a real potential that the only providers of retail advice in the market will be large financial institutions. This will limit the choice of retail investors as to who they can seek out for advice. It is also likely to **adversely impact on innovation**, given that smaller firms are often more agile and innovative due to their size.

In our view, pursuing cost recovery is very likely to reduce competition, directly contradicting the stated Government policy objective of increasing competition. It will also reduce innovation, again contrary to the Turnbull Government's stated focus on innovation.

4. Cap on cost recovery

The Stockbrokers Association has **consistently questioned the rationale for pursuing full cost recovery** of ASIC's budget.

We understand that this was a recommendation of the FSI Final Report, and that there was support for this recommendation from a number of quarters. We also understand that cost recovery is Government policy, although there are qualifications to that policy.

Since the initial consultation on the *Corporations (Fees) Amendment Bill 2011*, the SAA has consistently argued that there are strong reasons why the Government should not walk away completely from its obligations to adequately fund the regulator from public revenue.

The integrity of Australia's securities and other financial product markets, and its financial markets overall, is a matter of significance to all Australians. Australia enjoys a high standing and reputation for market integrity, and this has stood the country in good stead over the years.

The benefits of well-supervised markets do not accrue just for the benefit of market participants who trade those markets, nor does it just benefit investors who buy and sell shares. **Benefits flow** to Australian business entities generally, to their employees, and **ultimately to the nation as a whole.**

If there is full industry funding, there is no incentive for the Government or ASIC to reduce costs and pursue efficiency measures.

Without resiling from our fundamental position, the Association argues that the Government should limit industry funding of ASIC's budget to **50% of the budget** (that is, the amount proposed to be subject to cost recovery, not including the excluded amounts referred to at page 6 of the Consultation Paper), with the other half continuing to be funded from public revenue.

5. Transaction fee

If Government is intent on pursuing cost recovery for ASIC's budget, one mechanism that should be considered is a transaction based levy. A transaction levy has a number of shortcomings, however it would overcome the difficulties with pass through that the stockbroking sector (and perhaps other sectors) face. Some members consider that a transaction levy such as that employed in Hong Kong, which is based on the $value of the transaction, has appeal.

One of the shortcomings of a transaction levy is the cost of designing systems to calculate and collect the levies. Implementation costs could be high, and it might be

more cost effective for exchanges to collect the fee on behalf of market participants, thereby limiting the number of entities required to undertake system development.

Transaction fees also suffer from the drawback that they would be unlikely to be product neutral. A fee on equity transactions but not on other transactions such as fixed income, managed funds or derivatives, could influence investment decisions for the wrong reasons.

Not all of the components of the ASIC Funding Model would suit a transaction fee, but the biggest components for many firms, namely the Market Supervision turnover and message components, could be raised by way of a transaction based levy rather than being imposed on the market participant directly.

A transaction fee would also suffer from being a "friction" cost on investment funds, which would reduce returns over time. However, this would inevitably be the result of any pass-through of cost recovery amounts to the end investor.

Despite the above shortcomings, a transaction fee may be preferable to a cost recovery burden that would significantly damage the broking sector.

6. Lack of framework for cost control by ASIC

In the Stockbrokers Association Submission to Treasury on the FSI Final Report, the Association argued that any move towards placing ASIC on a full autonomous funding model should not occur without the introduction of adequate supervision over the level of spending. The industries who will bear the cost of funding those agencies must have some say on the amounts they are being called upon to pay. There is an inherent lack of fairness in being asked to pay for a budget over which one has no control.

In the absence of a suitable framework for cost control, there is **no incentive for Government or ASIC to minimise expenditure** if the costs are being fully met by industry funding.

The Association noted that the existing ASIC Cost Market Supervision Cost Recovery arrangements have highlighted the lack of transparency over project spending, and the inability of market participants to have any real input on that spending.

The existing mechanisms for consultation regarding the ASIC Market Supervision Cost Recovery levy have not provided a meaningful degree of cost control. Whilst the Association accepts that ASIC has made a good effort to provide information to the Stakeholder Panel established for the purposes of the Market Supervision Cost recovery

arrangements, it is our view that the Panel has not afforded any meaningful ability to influence the ASIC budget or expenditure by ASIC on projects being cost recovered.

The Association has consistently and strongly articulated the position at the Stakeholder Panel, that changes to the Market Supervision Cost Recovery levy were needed, citing the details of the detrimental impact that the levy was having on the industry, and calling for the design of the levy to be changed. The Association was not the only organisation mounting such arguments, however the inability of these arguments to gain any traction does not give us any confidence that stakeholder consultation will afford any meaningful ability to influence the process.

We reiterate the Association's concerns about the other aspects of Recommendation 28, namely, that ASIC be released from public sector constraints on pay and recruitment. Whilst it makes sense that ASIC be in a position to offer more attractive remuneration in order to obtain the necessary skills for it to do its job, the Association remains concerned that the clear implication is that **ASIC's total budget will only rise significantly** as it seeks to ensure that it is "better resourced" in future.

Based on our previous experience, we do not see how "consultation" will provide industry with any meaningful framework to influence such budget increases or issues relating to ASIC Funding in general. More work needs to be done to address this issue.

7. Application of Enforcement fines

The Model does not deal with the question of fines and other amounts raised from enforcement activity.

If ASIC is fully funded, then any such amounts, given that they are paid into consolidated revenue, would represent a windfall gain for government.

The Stockbrokers Association has consistently argued that amounts raised from enforcement activity should be directed back either to industry development (education and other such programs raising industry standards) or to funding the industry costs for the relevant sector, which would reduce the amount needing to be recouped by way of cost recovery.

This is further justified because those paying fines will pay a price for their poor behavior, and those who invest in compliance would derive a benefit from reduced contributions. This would represent an incentive to invest in sound culture, compliance and risk management.

The ASIC Funding Model should include a mechanism whereby amounts raised from enforcement fines are reinvested in the relevant industry sector.

8. Lack of holistic approach to cost Recovery

The Association has consistently highlighted that Cost Recovery is being pursued by agencies independently of each other and without any apparent consideration of the **combined impact of all of the cost recovery measures** on individual entities or on industry sectors.

The stockbroking sector is subject to multiple other cost recovery regimes, including the AUSTRAC cost recovery arrangements and Financial Ombudsman Service (FOS) annual fees. For members that are part of a group that is APRA–regulated, APRA cost recovery arrangements are also in place.

The Association has argued that the considerations of funding ASIC should not be considered in isolation. There needs to be a holistic picture of the cumulative burden of cost recovery already in place in relation to the financial sector, particularly the stockbroking industry, and the distortive or weakening impact that may flow from continued application of cost recovery to that industry or group.

It is not evident to us that any consideration is being given to this question.

III. SPECIFIC QUESTIONS IN CONSULTATION PAPER

1. Do you agree that the exclusion of these activities from cost recovery is appropriate? If not, why not?

The Association agrees with the exclusion of the items set out Page 6 from ASIC Cost Recovery

15. Are the proposed consultation arrangements on the levy mechanisms and funding appropriate?

We refer to our earlier comments at Section 6 of this Submission regarding our experiences with the effectiveness of the existing Cost Recovery Stakeholder Panel. It follows that we have reservations about the likely future effectiveness of any similar measures based on consultation alone.

19. Are the proposed arrangements for phasing in cost recovery levies appropriate? If not, what alternative approach would you suggest and why?

Whilst the Market Supervision Cost recovery arrangements are already in place and are able to continue to apply, we do not understand why the Funding Model generally should be phased in for the financial services industry earlier than other industry sectors. It there is justification for a later commencement for other sectors, then that rationale should equally extend to all industry sectors.

The proposed target of 1 July 2016 may be achievable if the ASIC Funding Model is adopted in the form proposed in the Consultation Paper. However, it does not allow for much time to conduct any further analysis or reconsideration of any elements of the proposed model, including the consideration of any of the issues raised in this Submission or other submissions that may be received.