Stockbrokers and Investment Advisers Association
Serving the interests of investors

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Via upload

Committee Members
Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Senators

INQUIRY INTO ASIC INVESTIGATION AND ENFORCEMENT

The Stockbrokers and Investment Advisers Association (SIAA) (formerly the Stockbrokers and Financial Advisers Association) is the professional body for the stockbroking and investment advice industry. Our members are Market Participants and Advisory firms that provide securities and investment advice, execution services and equity capital-raising for Australian investors, both retail and wholesale, and for businesses. Practitioner Members are suitably qualified professionals who are employed in the securities and derivatives industry.

The history of the stockbroking profession in Australia can be found here.

SIAA members represent the full range of advice providers from full-service and online brokers to execution-only participants and provide wealth advice and portfolio management services. As holders of an Australian Financial Services Licence and as Market Participants, our members are regulated by ASIC.

Thank you for the opportunity to provide feedback on the inquiry into ASIC's investigation and enforcement. We have restricted our comments to the resourcing allocated to ASIC investigations and enforcement action.

Executive summary

- ASIC's investigation and enforcement activities are currently funded by industry according to the ASIC industry funding model. The design, structure and legislative framework of the levy component of the ASIC industry funding model does not have the flexibility to respond to changes in the markets, sectors and products ASIC has oversight of and has resulted in unsustainable increases in levies, particularly for the personal advice subsector.
- One of the biggest flaws in the ASIC industry funding model is that levies imposed on the

financial advice sub-sector are calculated according to the number of financial advisers on the Financial Adviser Register (FAR), yet that number has decreased significantly.

- The pressures applied to ASIC resulting from the findings and recommendations of the Hayne Royal Commission have led to a cost 'blow out' that has impacted disproportionately on firms providing personal advice to retail clients. They have had to pay for litigation and other enforcement action against large financial institutions that no longer neither provide personal financial advice nor pay the personal advice levy.
- SIAA has long argued that there should not be one single 'bucket' for advisers providing personal advice to retail clients. We consider that stockbrokers advising retail clients do not warrant being charged the same fee as advisers in other financial sectors.
- It is important that leviable entities know the sub sectors that are being charged for enforcement matters, particularly when those matters are the subject of substantial litigation. There is a lack of transparency on how costs are allocated.
- Since the initial consultation on the ASIC industry funding model, SIAA 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.

Detailed comments - resourcing of investigation and enforcement action

ASIC's investigation and enforcement activities are currently funded by industry according to the ASIC industry funding model. SIAA has concerns about the impact that the current model of funding ASIC investigation and enforcement is having on our members.

The ASIC industry funding model is currently subject to a review by Treasury. A link to SIAA's submission on the review of the industry funding model dated 7 November 2022 is here.

Historical concerns

SIAA has had a consistent approach to the ASIC industry funding model and has long advocated for changes to it to reduce the impact of the model's unintended consequences upon the industry and consumers. Our members raised concerns some time ago that the rate of increase of ASIC funding would simply continue unchecked.

SIAA's original view was that the government should not completely abandon its commitment to public funding of ASIC's budget and we argued for a co-funding 50/50 arrangement with industry as a more appropriate balance. We pointed out that such a co-funding model would provide a meaningful mechanism for applying cost control over ASIC's budget process. We voiced our strong concerns about the effectiveness of proposed consultation mechanisms as a way of exerting any influence over what we saw as a strong risk that ASIC's budget would grow exponentially in the future and stated that cost control of ASIC's expenditure required the government's involvement. We also questioned the extent to which the government itself, with the best will in the world, would be able to resist ASIC's demands for funding increases in the context of market events and pressures that would arise. We were not confident that there were adequate measures in place to restrain the growth of the ASIC budget in future and argued that strong independent oversight and more transparency of ASIC resource allocation was needed.

We highlighted the following negative consequences of the model:

- While the cost of ASIC Market Supervision under the model represented a moderate increase compared to the previous scheme, stockbroking firms would face a very significant increase in the amount of fees they would be required to pay as a result of the other levies under the model. The cost impact would be particularly large in relation to retail stockbroking firms, mainly due to the retail adviser fee. Firms employing a large number of retail advisers would face a massive cost increase.
- The model contained a number of significant financial incentives for stockbrokers to cease providing personal advice to retail clients, or to stop dealing with retail clients at all. One option for those trying to reduce the impact of the model would be to cease providing personal financial advice to clients, and limit advice to general advice only. Another would be to limit the client-base to wholesale or sophisticated clients only. In both cases, the fee reduction under the model would be significant. To the extent that members were able to pass through any of the costs, the model would make the cost of advice more expensive. We argued that this was something the government needed to fully appreciate, in view of its often-stated objective of increasing the extent to which retail investors are able to access financial advice that is affordable and is suited to their needs.
- There was a significant disparity in resource allocation between those providing personal advice and those providing general advice – with those firms providing general advice paying substantially lower fees under the model. We queried the resource allocation at the time, given that the issue of advisers purporting to provide general advice but in actual fact providing personal advice was flagged as a significant issue by ASIC.
- We argued that there should not be one single 'bucket' for advisers providing personal advice to retail clients. We recommended that stockbrokers advising retail clients did not warrant being charged the same fee as advisers in other financial sectors such as financial planning and set out the important reasons supporting this view. The reasons we articulated have stood the test of time.
- The model provided for fines and other amounts recovered from enforcement action to be paid into consolidated revenue, thus representing a windfall gain for government, rather than being used to offset the industry costs for the relevant sector.

The arguments we made to government were prescient to say the least and, unfortunately, many of the unintended consequences that we foreshadowed have come to pass. These are discussed in greater detail below.

Current issues

Unsustainable increases in levies

Increases to the ASIC levy for personal advice have not been sustainable.

The ASIC industry funding model was consistently raised by financial advisers and advice licensees as a key matter affecting the cost of advice and the viability of their business during consultations for the Quality of Advice Review[1].

We understand that Treasury was originally of the view that the cost of industry funding would have a minimal impact on industry and that industry would be able to pass these costs through to clients. However, the increases in the levy did not have a minimal impact. Providing retail clients with advice incurs a fixed cost burden which our members report has become unsustainable generally and certainly untenable in regional areas. Prior to the introduction of the freeze, our members were telling us that it was difficult for them to budget for ASIC industry funding levies due to the significant increase in levies, volatility in levies between years and variance between estimated and actual levies.

The estimate for the 2020/21 financial advice levy was a staggering increase of 246% over the 2018/19 estimate and resulted in the industry calling for the industry funding model to be reviewed. This in turn forced the government to freeze the levy and undertake a review of the model.

A review of the financial advice levy bears out our arguments.

Year	Estimate	Final	% increase from estimate	% increase from previous year
2018/19	$1500 plus **$907** per adviser	$1500 plus **$1142** per adviser	**26%**	**22%**
2019/20	$1500 plus **$1571** per adviser	$1500 plus **$2426** per adviser	**54%**	**112%**
2020/21	$1500 plus **$3138** per adviser	**Frozen** to 2018/19 level of $1500 plus **$1142** per adviser	N/A	N/A
2021/22	N/A	**Frozen** to 2018/19 level of $1500 plus $1142 per adviser	N/A	N/A

The levy relief for the personal advice sub sector resulted in $34.2 million and an estimated $35.3 million not being recovered from the sub sector for 2020-21 and 2021-22 respectively. This is proof that the model is not working for the sub sector. If the freeze had not been implemented, personal advice licensees would have been required to pay even higher levies than previously.

The precipitous decline in adviser numbers

One of the biggest flaws in the ASIC industry funding model is that levies imposed on the financial advice sub-sector are calculated according to the number of financial advisers on the FAR. This model may work well when the number of financial advisers on the FAR and the amounts to be levied remain stable. However, the decline in the number of financial advisers has been precipitous. The large banks have exited wealth management (including financial planning), and now have zero advisers providing personal advice on the FAR. Adviser numbers on the FAR have fallen from 25, 484 in 2017 to **15,863 as of 23 February 2023.** Financial adviser numbers are expected to continue to fall and we consider that any levy model must take this into account.

[1] Quality of Advice Review (2022) Final Report, page 46.

Levy amounts don't accurately reflect the firms generating the enforcement and supervisory work

The model design does not meet the overarching principle for government charging that those who cause the need for regulation should pay for it, and has led to outcomes such as:

- groups of entities (a sub sector or multiple sub sectors) paying for enforcement action taken by ASIC against individual entities
- smaller entities paying for enforcement action taken by ASIC against larger entities, which the industry considers to be disproportionate and lacking in fairness
- entities paying for enforcement costs relating to entities who have left the sector, due to the time lag between misconduct and enforcement action and the often-lengthy process of enforcement meaning matters may take multiple years to resolve.

It is apparent that those firms in the financial advice sub sector are subsidising the costs of firms who are no longer in the sub sector or who have reduced their exposure to the sub sector and are the subject of ASIC enforcement and supervision action in relation to personal advice issues arising from the Hayne Royal Commission. This is compounded by the fact that the number of financial advisers which form the denominator when determining the levy for the sub sector has fallen significantly since the model was introduced. The pressures applied to ASIC resulting from the findings and recommendations of the Hayne Royal Commission have led to a cost 'blow out' that has impacted disproportionately on firms providing personal advice to retail clients. They have had to pay for litigation and other enforcement action against large financial institutions that neither provide personal financial advice nor pay the personal advice levy.

Essentially, the personal advice sub sector is funding large scale litigation against the large financial services firms. Unlike litigation funders, leviable firms receive no credit for litigation wins. We note that recovered legal costs are applied back to relevant sub sectors. However, ASIC only successfully recovers a fraction of its total enforcement costs. A big issue for the sub sector is when ASIC loses cases and becomes liable to pay not only its own legal costs but the legal costs of the successful party —the advice sub sector bears those costs. One could argue that because a loss in court means that the entity in question was not in breach of the law, charging personal advice licensees for the costs of this action runs counter to the principle that sub sector members pay for the wrongdoing of their fellow members.

Stockbrokers are included in the personal advice subsector

SIAA has long argued that there should not be one single 'bucket' for advisers providing personal advice to retail clients. We consider that stockbrokers advising retail clients do not warrant being charged the same fee as advisers in other financial sectors.

In support of this, we note the following matters:

- Stockbrokers are subject to a high level of regulation under the Market Integrity Rules, while other financial advisers are not. The Market Integrity Rules establish a web of obligations that put brokers to the highest standards in the financial sector, including requirements relating to governance, prohibited conduct, client relations and best execution.
- As a reflection of the higher standards, the complaint levels against stockbrokers are consistently low historically and are falling over time. Recent complaints data from AFCA

shows that for the period 2021/2022 out of the total number of 72, 358 complaints, only 298 complaints were made against stockbrokers. This represents a percentage of 0.41% and needs to be considered in the context of 2.3 million trades a day on ASX. In 2021/22 only six complaints were found in favour of the client and 40 were found in favour of the firm. For the previous financial year, complaints against stockbrokers amounted to 490 or 0.69% of total complaints. The number of complaints against our members is declining but they continue to be liable for increasing levies.

- The higher standards imposed on stockbrokers has required a significantly higher spend on compliance systems compared to other parts of the financial sector, including:
  - compliance systems for monitoring the firm's trading activity and also the activity of the firm's clients
  - systems for complying with obligations to report suspicions of insider trading or market manipulation by clients or other persons
  - systems for monitoring best execution for clients.

No credit is given to stockbrokers under the current ASIC funding model for performing this role or for the high cost of the systems they implement to comply with the higher levels of obligations applying to them. Rather, they are required to contribute the same amount as other parties in the financial advice sector.

SIAA recommends that the financial adviser levy for stockbroking firms be reduced to take into account these risk-based factors. A risk metric needs to be applied to the ASIC industry funding levy so that it more accurately reflects the firms that are generating the enforcement and supervisory work.

There is poor transparency on how costs are allocated

Licensees that provide personal advice to retail clients account for 14 per cent of enforcement costs since the commencement of the ASIC industry funding model (average over 4 years from 2017-18 to 2020-21). However, there is little transparency or understanding about what enforcement matters are being charged to the sector. Stakeholders are also unclear about the reasons behind the decisions. We consider that the current level of transparency is unacceptable.

It is important that leviable entities know the sub sectors that are being charged for enforcement matters, particularly when those matters are the subject of substantial litigation. By way of example, ASIC is currently appealing the decision of the Federal Court in the Commonwealth Bank and Colonial First State conflicted remuneration decision. This matter relates to conduct that occurred from 1 July 2013 to 30 June 2019, involving approximately 390,000 individuals and allegedly $22 million in conflicted remuneration and was a referral from the Hayne Royal Commission. Are personal advice licensees paying for this litigation and if so, is it fair that they are?

Another issue that demonstrates this point is that of unlicensed advisers. Enforcement costs for unlicensed advisers are currently charged to the personal advice sub sector. For example, we understand that ASIC is charging the costs of the Melissa Caddick enforcement action to the personal advice sub sector, despite the fact that:

- Melissa Caddick was holding herself out as a financial adviser but may also have been operating an unlicensed investment scheme,

- Melissa Caddick may have been providing unlicensed advice to wholesale clients as well as retail clients.

We consider that advisers on the FAR are doing the right thing and shouldn't be responsible for paying the enforcement costs of someone who isn't. We also consider that enforcement of the licensing provisions benefits the entire financial services industry.

Another allocation issue that stakeholders have difficulty understanding is why 60% of the costs of the Westpac case (that involved the provision of general advice about superannuation by call centre employees of a large bank) were charged to the personal advice sub sector.

The current model has no flexibility

It is clear that the design, structure and legislative framework of the levy component of the ASIC industry funding model does not have the flexibility to respond to changes in the markets, sectors and products ASIC has oversight of. As stated above, a more equitable model would ensure that costs caused by entities that are no longer in the sub sector or who have significantly reduced their exposure to the sub sector, are not charged to entities who have not caused them. This would bring the model into line with the principle that costs should be recovered from those causing the need for regulation.

We consider that sectors that are not regulated and not paying levies should not be regulated on the basis of industry funding model funding. Funding for the regulation of emerging sectors should be sourced from government. By way of example, we do not consider that it is appropriate or fair that our members pay for the regulation of crypto assets. They are not financial products.

Levies are just one cost caused by the increasing regulatory burden

Our members are experiencing a significant increase in regulatory burden as a consequence of government policy and regulation and the ASIC industry funding levy is just one cost caused by this increasing regulatory burden. We consider that the costs to industry of compliance in many cases to be underestimated. For example, compliance with the new reportable situations regime has substantially increased the complexity and amount of reporting and resulted in increased compliance costs.

In addition to the legal and compliance costs of implementing legal reforms our members are subject to:

- ASX fees
- AFCA membership fees
- National Guarantee fund levies
- increasing costs of Professional Indemnity insurance

Our members will also be subject to levies imposed under the proposed compensation scheme of last resort.

It is highly unlikely that ASIC's costs will be reducing as it will need to deal with additional regulatory matters, including:

- The operation of the Single Disciplinary Body (no cases have been brought before the panel to date)

- The administration of the National Adviser exam
- The new reportable situations regime.

Accordingly, we can expect ASIC's costs (and the levy amounts imposed by leviable entities) to increase as well.

The risks of full cost recovery

Since the initial consultation on the model, SIAA 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.

Financial services are a quickly moving industry and is subject increasingly to disruption and challenge. ASIC is required to stay on top of changing market practices and external factors impacting the industry. Its resources are increasingly directed at understanding and assessing emerging industry sectors, business models, markets and assets outside of the traditional markets. Crypto assets are such an example. We consider that this work has wide-ranging benefits.

This is an example of the kinds of costs that we consider should be paid for, at least in part, by government.

If there is full industry funding, there is no incentive for the government or ASIC to reduce costs and pursue efficiency measures. The significant increases in the levy year on year is evidence of this.

There has never been a more important time to ensure access to affordable financial advice for Australians, given the significant number of Australians entering retirement with superannuation that must be well managed to ensure a comfortable retirement[2] and the intergenerational transfer of wealth that has been documented by the Productivity Commission[3], yet the costs of providing that advice continue to increase. SIAA members do not wish to see Australians hindered from accessing financial advice because it is unaffordable.

If government has no appetite to contribute to ASIC's costs, the only other way to bring equity and stability back into the model is for government to place a cap on ASIC's budget. Clearly, any changes to the levy structure will push the costs onto other sub sectors. While ever the model is a 'nil sum' game, a reduction of a levy for one sector will result in an increase for another.

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[2] Australian Government, The Treasury, *Retirement Income Review: Final Report*, November 2020: 'The two main assets held by people when they retire are their home and their superannuation.', p 55. According to the Treasurer in 2019, the median superannuation balance at retirement is projected to increase from $188,000 in 2016-17 to $475,000 by 2050 in real terms: The Hon Josh Frydenberg MP, 'Superannuation review enables us to plan for changing demographics', *The Australian*, 28 September 2019

[3] Australian Government, Productivity Commission, *Wealth transfers and their economic effects*, November 2021: The Productivity Commission's wealth transfer report provides estimates of $3.5 trillion or an average of about $175 billion per year passing through the generations in the next two decades.

Conclusion

If you require additional information or wish to discuss this submission in greater detail please do not hesitate to contact SIAA's policy manager, Michelle Huckel, at michelle.huckel@stockbrokers.org.au.

Yours faithfully

Judith Fox
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