



**Submission to Consultation on Proposed Industry
Funding Model for the Australian Securities and
Investments Commission**

9 October 2015

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1. Context and Background

ASIC proposed an industry funding model in its submissions to the 2014 Financial System Inquiry. The FSI Final Report recommended an industry funding model under the heading of 'Strengthening the Australian Securities and Investments Commission's Funding and Powers.' The FSI's recommendation was subject to there being careful implementation together with a significant strengthening of ASIC's accountability framework.

An industry funding model has been presented by ASIC, the FSI Final Report and some other stakeholders as a solution to perceived problems with the adequacy and predictability of ASIC's resourcing.

The FSI recommendation

The Final Report maintained that 'the absence of industry funding means ASIC costs are not transparent to regulated industry participants. It also exposes ASIC to an increased risk of funding cuts that are unrelated to changes in the cost of delivering on its mandate.'¹ According to ASIC, its 'regulated population has also increased in size and complexity yet funding has not increased accordingly.'²

The argument for industry funding has proceeded from an assumption that government can no longer be relied upon to adequately or predictably fund ASIC. Accepting this assumption sets a very bad precedent. In particular, it suggests that industry should bear the cost of the inability of successive governments to prioritise their expenditure appropriately.

If competing government expenditure priorities have adversely affected ASIC's capabilities and effectiveness, then this is an argument for a change in those priorities to ensure that this core function of government is properly funded. Such a change in expenditure priorities does not in itself require a change to an industry funding model. It does strengthen the case for longer term funding agreements between the government and ASIC (which AFMA has supported), as also recommended by the FSI Final Report. The government can and should resource its regulators adequately to perform the functions the government and the community expect of them.

Budget saving measure

It has become apparent that the main motivation for the proposed change to an industry funding model is to improve the government's fiscal position. The government has become increasingly unwilling to fund the administration of the regulation it imposes for the benefit of the community. This has also been the case with other regulators, such as AUSTRAC, where the government has moved to an 'industry contribution' model that pushes the cost of general regulatory functions, some of which have public good characteristics, on to an increasingly narrow sub-set of the regulated population in a manner that is inconsistent with the government's Charging Framework and Cost Recovery Guidelines. The government's approach to funding AUSTRAC cannot be explained other than as a budget saving measure.

¹ Australian Government, "Financial System Inquiry Final Report," November 2014, 250.

² ASIC, "15-236MR ASIC Welcomes Consultation on Industry Funding," August 28, 2015.

Lack of proper consultation

Disappointingly, it appears that the government has already decided to move to an industry funding model for ASIC, without any proper public consultation process about the advantages, but also the disadvantages, of such a model. The costs and benefits of industry funding were not adequately considered by the Financial System Inquiry. The current consultation is focused on the detail of a specific funding model rather than on the merit and objectives of industry funding.

A detailed funding model was discussed in the media well before it was opened to consultation with industry by Treasury. Comment from industry and other stakeholders has only been sought after the parameters of industry funding appear to have been decided, with little scope for stakeholders to shape the overall methodology. ASIC has effectively been allowed to become the author of its own funding model because of this lack of prior consultation.

Adverse impacts

It is inevitable that a large proportion of the amount to be funded by industry will be passed on to the consumers of the services provided by ASIC-regulated entities, or will be effectively taken out of the system through reductions in employment, transfer of business activity out of Australia or deterrence from setting up new business activity, with a loss of general taxation revenue. In our FSI submissions, AFMA urged the government to formulate and embrace a coherent strategy for the future development of the Australian financial services industry and its integration with Asia and the world economy. The proposals in the Consultation Paper are contra to such a strategy.

Lack of accountability and transparency mechanisms

The Consultation Paper also fails to provide any meaningful information about the robust accountability and transparency arrangements needed to ensure that an industry funding model operates appropriately and is subject to stringent controls. Much more substantive arrangements than a Cost Recovery Stakeholder Panel will be required to achieve this. AFMA's experience as a member of the Market Supervision Cost Recovery Stakeholder Panel to date is that the Panel has provided some degree of transparency about what the annual levy amounts will be and how the funds are apportioned to ASIC's supervisory activities, but the Panel has no actual decision making power and very little capacity to influence broader government decisions about cost recovery arrangements. Indeed, it has been made clear to the Panel that the government is not obliged to have any regard for the views of the Panel or any recommendations it may make.

The Consultation Paper makes the fiscal motivation explicit when it says that an industry funding model 'would also ensure that a greater share of general taxation could be allocated to Government activities that benefit society more broadly.'³ According to the

³ Australian Government, "Proposed Industry Funding Model for the Australian Securities and Investments Commission: Consultation Paper" (Canberra: Treasury, August 28, 2015), 4.

Minister for Finance, the government's user charging framework 'will lead to additional revenue to support Budget repair and other policy priorities.'⁴

These statements suggest that an industry funding model is being pursued primarily as a measure to ease the government's budget constraint. Statements such as these cannot help but arouse suspicion that the other arguments mounted for industry funding are a rationalisation for what is fundamentally a fiscal issue rather than issues of regulator efficiency, effectiveness, transparency and accountability. In the absence of offsetting reductions in the tax burden, the move to full industry funding is equivalent to an increase in the tax burden on industry, which is inconsistent with the government's stated policy objective of promoting Australia's international competitiveness and attractiveness as a regional and global financial centre.

AFMA does not accept as a general principle that industry funding should be pursued to address problems the government has in choosing between different expenditure priorities or problems with balancing the federal government's budget. These are issues of fiscal management that need to be addressed in the broader budget context and through the tax reform process. They should not be viewed as supporting what is a fundamental change in the nature of the relationship between ASIC, government, parliament and the regulated community.

Regulation is a public good

It is undesirable for government to be alleviated of the burden of funding the administrative cost of regulation that it imposes for the benefit of the community. It is important that government internalise the administrative cost of regulation via its budget process. Otherwise, regulation is under-priced from the perspective of government and may lead to an over-supply of regulation. This is a logical corollary of the argument that the beneficiaries of regulation should internalise its costs to ensure that the regulated outputs or products are not over-supplied. Economic efficiency demands a recognition of the mix of private and public benefits inherent in regulation of the type ASIC provides.

While industry benefits from a well-regulated corporate sector, financial system and markets, this is also true of society as a whole. Many of the benefits arising from regulation satisfy the technical definition of a public good: they are non-rivalrous and non-excludable in consumption. It is generally accepted that public goods should be funded by the taxpayer for efficiency and equity reasons. The FSI recognised this argument in principle and in relation to ASIC's financial education/literacy function. While the FSI did not see this as an obstacle to industry funding, it did not give a compelling explanation for why public goods should be funded by industry rather than taxpayers.⁵ Rather, there is an assumption that governments are unwilling to provide ASIC with adequate resources, which means that industry funding is being accepted as a second best solution.

The proposed industry funding model would lead to a weakening in the government's incentive to maintain effective scrutiny and oversight of ASIC's costs and effectiveness. Governments can be expected to more readily acquiesce to demands from ASIC for

⁴ Australian Government, "Agency Resourcing. Budget Paper No. 4 2015-16," May 12, 2015, 5.

⁵ Australian Government, "Financial System Inquiry Final Report," 253.

increased funding if it can be secured from industry without having to compete with other policy and expenditure priorities. As Maddock *et al* have noted:

Some regulators have proposed that their regulatory activities should be funded by a levy on the parties being regulated, by licence fees or similar industry charges. This should be resisted. It reduces the degree of budgetary scrutiny on the agency and undermines a key lever for regulatory accountability. Rather than having to fight for an allocation in the budget process, justifying spending to an expenditure review committee, a regulator funded by an industry levy is taxing the parties that it is regulating.⁶

Lack of certainty and burden on industry

The widely expressed view emerging from the FSI, that ASIC will be better resourced under an industry funding model, effectively makes explicit the assumption that ASIC will receive a more generous budget appropriation under a predominantly industry funded model than under the current predominantly taxpayer funded model. If this were not the case, then the shift to an industry funding model would not achieve the objective of improving ASIC's resourcing, as suggested by the Murray Report. If ASIC's resourcing is to be enhanced through industry funding, this does not suggest that ASIC will be under budgetary pressure to realise further efficiencies in its resource allocation, which is one of the rationalisations for moving to industry funding.

The Consultation Paper does not articulate how industry funding will produce better regulatory outcomes that are sufficient to warrant the imposition of significant additional cost burden on industry. There is no case made out that resourcing through industry funding equates to better regulation. AFMA strongly urges the Government to obtain further analysis and evidence from ASIC of the tangible improvements in regulation that will be delivered through industry funding – for consumers, but also for industry. This information should be made publicly available to allow for independent analysis and modelling. The failure to provide this type of cost-benefit information is a flaw in the consultation process, and adds to the impression that a decision to implement industry funding has already been made.

It should also be noted that full industry funding will add to the burden on industry from cost recovery levies that fund APRA and AUSTRAC. AFMA is concerned that there is insufficient regard to the quantum of this impost on industry and that industry levies are not sufficiently coordinated to take account of their impact on industry sectors and sub-sectors.

Feedback from our members indicates that both the quantum and lack of predictability in the burden of cost recovery levies is a material issue for business planning. In some cases, cost recovery has been influential in decisions about whether to continue particular business lines and decisions as to whether to enter or exit particular markets. Cost recovery arrangements are distorting business decisions, introducing inefficiencies that could otherwise be avoided.

⁶ Rodney Maddock, Joe Dimasi, and Stephen King, "Rationalising Rustic Regulators: How Should Australia's National Economic Regulators Be Reorganised?," July 11, 2014, 19–20.

2. Recommendations

The Consultation Paper states, and the government considers, that introducing an industry funding model for ASIC's regulatory activities would:

1. Ensure that costs are proportionately borne by those creating the need for regulation;
2. Establish price signals to drive economic efficiencies in the way resources are allocated in ASIC; and
3. Improve ASIC's transparency and accountability.

As we demonstrate below, the proposed funding model would not achieve these objectives in even a proximate manner. Consequently, AFMA makes the following recommendations:

- (a) Industry funding of ASIC should not be used as a budget repair mechanism, rather, it should only be adopted if it can be shown to improve the efficiency and quality of regulation, taking account of its impact on ASIC, industry participants and users.
- (b) Proposals to introduce industry funding should take account of the potentially damaging consequences for competition and innovation in the financial sector, but also on the level of business activity and employment in the sector, and the relative attractiveness of Australia as a place to do business.
- (c) To the extent that the uncertainty of ASIC resourcing is put forward as one of the main arguments in support of industry funding, the government can create certainty about ASIC's funding through other mechanisms, such as multi-year funding agreements, or shared funding arrangements where fees for applications-based services (user pays) are increased but the Government continues to fund the cost of regulation that is a public good.
- (d) The Consultation Paper does not articulate how an industry funding model will change the nature or quality of ASIC regulation. AFMA strongly urges the Government to obtain further analysis and evidence from ASIC of the tangible improvements in regulation that will be delivered through industry funding – for consumers, but also for industry. This information should be made publicly available to allow for independent analysis and modelling.
- (e) The Government should have a holistic view of the cumulative impact on Australian business of the multiple cost recovery levies for different regulators that currently exist and are proposed – i.e. APRA, AUSTRAC and ASIC. In our interactions with government agencies and officials to date, AFMA has found that no agency or department has an understanding of this issue, or appreciates the quantum of cumulative levies that are being imposed on business.

- (f) Following on from (e), it is a significant concern to AFMA members that each of the APRA, AUSTRAC and ASIC levies are calculated based on different methodologies, which add complexity and reduce transparency.
- (g) The existing transparency and accountability arrangements that apply to ASIC may be adequate in circumstances where funding is directly controlled and provided by the Government, but will be deficient as mechanisms to oversight an industry-funded regulator. Accordingly, if the Government decides to proceed with the industry funding proposal, AFMA recommends the implementation of new governance and oversight arrangements that could include:
- (i) The publication by ASIC of a service charter that guarantees the provision of high quality and timely regulatory services – this is particularly relevant for application-based services (i.e. licensing, relief from the law, lodgement of documents) but may also be relevant to supervisory and enforcement activities, which often entail substantial additional legal and advice costs for regulated entities even where the result is that no action is taken against the entity;
 - (ii) The establishment of additional independent oversight arrangements including review of the cost recovery model by the Productivity Commission, and a stronger outcomes based focus in the Regulator Performance Framework;
 - (iii) The establishment of an external Oversight Board to improve arrangements for the governance and management of ASIC under an industry funding model. This would likely require amendment of the ASIC Act to reform its governance arrangements and allocation of statutory responsibilities. The Oversight Board should report to the Treasurer on ASIC's performance against its statutory obligations and Statement of Expectations. The Board could assist ASIC Commissioners in developing an organisational culture, policies, codes and procedures to enable ASIC to meet its obligations in the most efficient and cost effective manner. The Board would not be involved in operational matters requiring interpretation of the law or in matters involving individual regulated entities. The Board should be independent of Treasury and the ASIC Commissioners;
 - (iv) Alternatively, the appointment of additional ASIC Commissioner(s) or other statutory officers charged with specific responsibility for ensuring prudent management of ASIC resources, with external and public accountability. While the Government's reluctance to create new regulation and red tape is understood, this needs to be balanced against the significant burden that will be imposed on industry and the importance of

protecting the interests of those who will be obliged to fund ASIC;

- (v) Establishment of an Inspector General of Regulation as a high powered but low cost accountability mechanism that could potentially be applied across the full range of financial system regulators (APRA, ASIC, AUSTRAC and ACCC) to support high quality administration of relevant laws. The Inspector General should have powers to compel documents and witnesses. In ASIC's case, this would balance the considerable powers it can exercise, especially under an industry funding model.

3. Non-Fiscal Arguments for Industry Funding

A number of additional rationalisations have been advanced for industry funding in the context of the FSI and by the government that reflect considerations other than the need to improve ASIC's resourcing without having to trade-off competing expenditure priorities. These arguments are as follows:

1. 'The absence of industry funding means ASIC costs are not transparent to regulated industry participants.'⁷
2. 'ASIC has limited accountability to industry and consumers in the activities it undertakes and why it undertakes them.'⁸
3. 'Regulatory costs can be allocated to those that create the need for regulation.'⁹
4. 'Establish price signals to drive economic efficiencies in the way resources are allocated in ASIC.'¹⁰

Each of these arguments is addressed below.

3.1 Transparency

The suggested improvement in transparency seems to rest on the government's undertaking that 'if the government introduces an industry funding model for ASIC's regulatory activities, additional accountability mechanisms would be introduced.'¹¹ The FSI and the Consultation Paper both make recommendations in relation to enhanced accountability arrangements, the adequacy of which are discussed elsewhere in this submission. However, even if these measures result in increased transparency, this transparency is of no benefit to the regulated community in the absence of effective mechanisms by which the regulated community can hold ASIC accountable for its costs and efficiency. The Consultation Paper does not propose effective additional accountability mechanisms that would allow the regulated community to bring such discipline to bear.

Moreover, to the extent that the degree of pass through of cost recovery fees and levies to final consumers is variable and not directly observable, industry funding will reduce transparency in relation to who ultimately bears the cost burden of regulation. This reduced transparency in relation to the incidence of regulatory costs may also lead to an over-supply of regulation.

⁷ Australian Government, "Financial System Inquiry Final Report," 250.

⁸ Australian Government, "Proposed Industry Funding Model for the Australian Securities and Investments Commission: Consultation Paper," 1.

⁹ *Ibid.*, 3.

¹⁰ *Ibid.*

¹¹ *Ibid.*, 4.

3.2 Accountability

Providing ASIC with the ability to impose a levy on industry participants to fund its activities would give significant new powers to ASIC. A concern for financial sector efficiency arises from this because industry participants do not have the forensic capability or the authority of a government to effectively review, critique and control ASIC's budget. Meanwhile, inefficient or misplaced regulation will harm the provision of financial services and international competitiveness.

ASIC's primary accountability is to government. The government already has accountability arrangements in place for ASIC similar to those that apply to other regulators. However, as already noted, industry funding could be expected to weaken the government's fiscal incentive to maintain effective scrutiny of ASIC's costs and effectiveness. Additional accountability arrangements will only be useful if governments have a fiscal incentive to use them.

The FSI and the Consultation Paper implicitly recognised this problem in noting that additional accountability arrangements would be appropriate in the context of a move to industry funding. However, none of the proposed arrangements create a mechanism through which the regulated community can effectively achieve the necessary discipline on ASIC's budget.

Since ASIC has the ability to deliver adverse regulatory outcomes to the regulated community, often on the basis of the exercise of discretionary powers, the regulated community has little incentive to make representations to either ASIC or the government about ASIC's efficiency or effectiveness. Industry funding creates a conflict of interest for ASIC by putting it in the position of both regulating entities as well as deciding how much those entities will contribute under the funding model. As Rodney Maddock *et al* have argued:

Requiring the regulated businesses to fund the regulator might seem appealing in that the parties 'using' the regulation are paying for it. But the structure means that regulated parties have very little incentive to complain about excessive charging or laxness by the regulator. They may indeed feel intimidated. It sets up a 'customer-provider' relationship between the regulator and the parties it is regulating, while at the same time reducing the accountability of the regulator to its actual principal – the parliament. Put simply, it creates the wrong incentives.¹²

With the government responsible for determining ASIC's budget appropriation, ASIC's primary accountability will remain to parliament. Enhanced transparency and accountability are mainly of benefit in so far as they assist the government and the parliament in holding ASIC accountable for its budget appropriation regardless of whether ASIC is largely taxpayer or industry-funded. Such arrangements do not require industry funding for their effectiveness and may be weakened by them. Indeed, such

¹² Maddock, Dimasi, and King, "Rationalising Rustic Regulators: How Should Australia's National Economic Regulators Be Reorganised?"

arrangements are only being proposed in this context because it is believed that industry funding makes them necessary. AFMA agree that industry funding should be accompanied by enhanced transparency and accountability mechanisms as discussed elsewhere in this submission. But there is a circularity to the argument that increased transparency and accountability will result from industry funding because industry funding will lead to the introduction of additional transparency and accountability mechanisms.

3.3 Allocating Costs to those Creating the Need for Regulation

The Consultation Paper invokes the Australian Government Charging Framework and Cost Recovery Guidelines in arguing that:

‘cost recovery as a pricing mechanism is appropriate where there is an identifiable individual, organization or group that receives the regulatory activity or creates the need for it. This ensures that regulatory costs can be allocated to those that create the need for regulation...Industry funding would ensure that ASIC’s regulatory costs were borne by those that drive the need for regulation (and their customers, if costs are passed through). This aligns with the user-pays principle.’¹³

The Australian Government Charging Framework maintains that this approach is intended to ‘promote equity, whereby the recipients who create the need for a government activity, rather than the general public, bear its costs.’¹⁴

The rationale given in the Consultation Paper for cost recovery is the expectation that it would ‘ensure that those creating the need for regulation bear its cost.’ The proposed funding model clearly would not achieve this outcome, even in a proximate manner. Rather, it would introduce a new inequity into the system.

Indeed, the usefulness and plausibility of the Consultation Paper suffers from the fact that it makes no attempt to demonstrate how the proposed funding model would in practice achieve this objective. It merely provides a two sentence statement that this will be outcome.

For the proposed model to have a credible basis, there must be a proper analysis of what actions cause the need for regulation, who undertakes these actions and how the costs are attributed to these entities. In practice, we think this will be an intractable problem because the conceptual basis is wrong and the required information is not available. The proposed model would only work in a limited range of circumstances.

Under the proposed model, entities and persons that do not hold an AFSL, for example, proprietary traders not required to hold a financial markets license, ordinary traders/investors, and overseas hedge funds would not be levied.

¹³ Australian Government, “Proposed Industry Funding Model for the Australian Securities and Investments Commission: Consultation Paper,” 3–4.

¹⁴ Australian Government, “Australian Government Charging Framework: Resource Management Guide No. 302” (Department of Finance, July 2015), 4.

Entities that operate a low risk business model from a regulatory perspective would be required to pay the same level of fees as high risk operators and bear the compliance costs for regulation caused by the need to curtail the impact of high risk operators.

ASIC's main regulatory function is to enforce the provisions of the Corporations Act. The Act addresses a wide range of government regulatory intentions, but is mainly concerned with the effective functioning and integrity of corporate entities, retail and wholesale financial markets. For the most part, this regulation is designed to protect consumers, borrowers, and investors.

Even where ASIC supplies demand-driven services, this demand is ultimately derived from these broader regulatory functions. The need for regulation arises from consumer demand for the products and services produced by regulated entities.

Regulation is a cost rather than a benefit to regulated entities. Regulated entities benefit indirectly from a well-regulated corporate sector and financial system, but this benefit also accrues to society as a whole. It is non-rivalrous and non-excludable in consumption, satisfying the technical definition of a public good, which is more appropriately taxpayer-funded. As noted in the Consultation Paper, investor education and financial literacy programs also have the characteristics of a public good insofar as ASIC makes this information freely available.

It is important to recognise that regulated entities bear a significant cost in identifying and curtailing the actions of those whose behavior is the target of regulation. For example, financial services licensees are required to have systems in place to identify suspicious activities, which assists ASIC in taking action against those who break the law.¹⁵ Regulated entities are often part of the solution, but under an industry funding model, they are treated as if they are the problem.

The economic rationale for levying industry depends on the assumption that industry can pass these costs on to consumers. However, both the attribution of regulator costs to regulated institutions and activities and the subsequent pass through to consumers is necessarily very imperfect. The degree of pass through to consumers is not directly observable. Regulatory risk and intensity are only crudely proxied by the proposed industry funding model. As noted above, there is a significant public benefit to regulation that is very difficult to embody in industry as opposed to taxpayer funding models. Past experience with cost recovery arrangements has been to ignore this public good aspect of regulation in designing cost recovery models, with levies applied more on the basis of administrative convenience and perceived capacity to pay than regulatory risk or intensity. Much of the regulatory risk addressed by ASIC arises from fringe players in the

¹⁵ Under ASIC Market Integrity Rule 5.11.1, a market participant must notify ASIC if it has reasonable grounds to suspect that a person has placed an order or entered into a transaction while in possession of inside information, or which has the effect of creating or maintaining an artificial price or a false or misleading appearance in the market or price for trading in financial products. A market participant must have a clear, well-understood and documented process for complying with its obligations under Rule 5.11.1. A recent example of suspicious matter reporting is documented in 'Alleged insider trading case cracked through LinkedIn,' *Sydney Morning Herald*, 12 May 2014.

corporate sector, credit and financial markets. However, the proposed industry funding model levies entities on the basis of crude risk proxies that often mistakenly assume that bigger is riskier. This is not conducive to either equity or economic efficiency.

An examination of calendar years 2013 and 2014 demonstrates that ASIC's aggregate enforcement outcomes are overwhelmingly directed to small business. Small business accounts for 68% of total enforcement outcomes (Figure 1) and 90% of criminal matters (Figure 2) over this two year period.

Figure 1

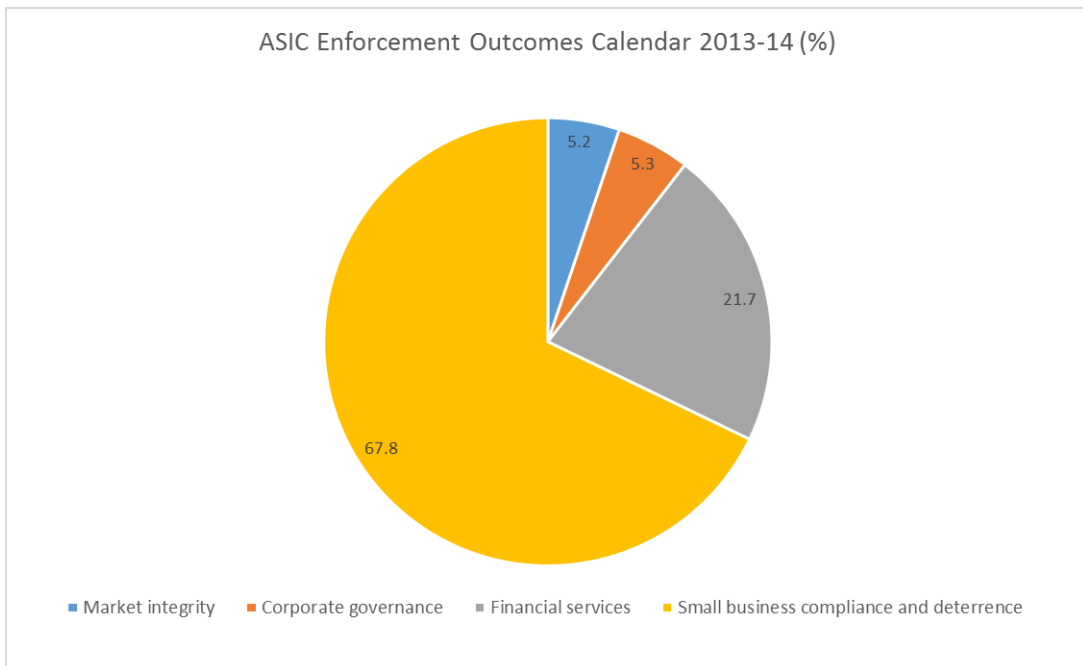
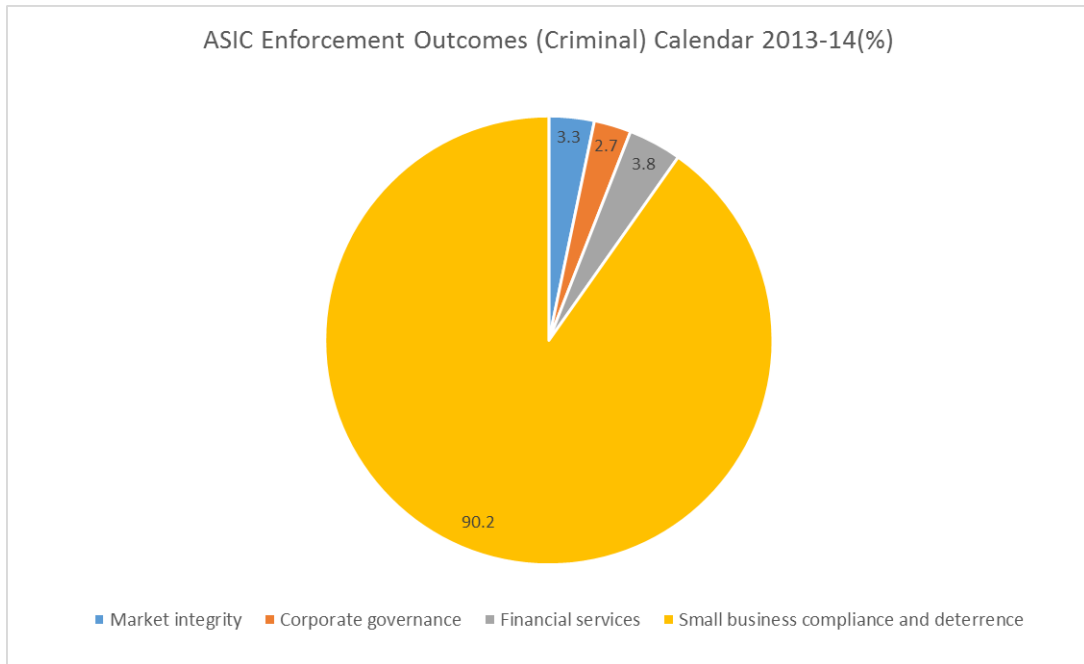


Figure 2

Market integrity accounts for only 5.2% of total enforcement outcomes and 3.3% of criminal matters. These enforcement outcomes demonstrate that the proposed funding model is poorly calibrated to actual regulatory risks arising from those industry sectors creating the most need for regulation and enforcement action. This mis-calibration is not conducive to economic efficiency or equity.

By contrast, a predominantly taxpayer funded model is an efficient and equitable way of levying the main beneficiaries of regulation, namely consumers. Financial products and services are for the most normal or superior goods, meaning consumption of them rises with income. A progressive income tax system efficiently and equitably levies the main beneficiaries of the general regulatory functions performed by ASIC. Taxpayer funding also does not impose additional compliance and collection costs on industry over and above those already embedded in the tax system.

3.4 Price Signals Driving Economic Efficiencies

The Consultation Paper maintains that ‘industry funding would drive economic efficiencies in the way that resources are allocated. Industry funding for ASIC’s regulatory activities would establish clear price signals that would influence the behavior of regulated entities that create the need for government oversight.’¹⁶

The Consultation Paper gives only one hypothetical example of this price signalling effect. It suggests that regulated entities will only seek license authorisations for current as opposed to prospective business activities, reducing the supervisory burden on ASIC. This is not a compelling example. ASIC already has the scope to allocate resources based on

¹⁶ Australian Government, “Proposed Industry Funding Model for the Australian Securities and Investments Commission: Consultation Paper,” 4.

the actual rather than prospective activities by licensees. Moreover, this example highlights the concern that such fees may serve as a barrier to entry and innovation.

In its first round submission to the FSI, ASIC claimed that a user pays funding model will generate price signals that will encourage self-regulation or co-regulation where the pre-conditions for such models exist as an alternative to regulation by ASIC. However, these pre-conditions are arguably absent for much of ASIC's regulatory activities. For the most part, ASIC-regulated entities do not have the choice of self or co-regulation as an alternative to current arrangements. Indeed, ASIC would have a strong incentive to disallow or lobby against such self-regulatory models if it were industry funded. ASIC's argument in this regard is akin to APRA arguing that cost recovery would generate price signals that would lead to self-regulated, unlicensed banks, which are an impossibility under Australian law.

ASIC also maintained that a lack of pricing may lead to over-use of its services compared to other more costly alternatives, for example, private legal advice. Yet ASIC can charge user fees for these specific, demand-driven services without having to adopt a cost recovery model for its other regulatory activities, for which there is a much stronger case for taxpayer funding.

Where ASIC's regulatory activities have identifiable beneficiaries, it is efficient to seek to recover the costs of regulation to ensure that market prices internalise the cost of regulation. The existing cost recovery arrangements flowing from the introduction of equity market competition and supervision are an example of the more selective application of the government's Cost Recovery Guidelines, although even in this case, market supervision arrangements have a mix of public and private benefits that should be recognised.

4. ASIC's Activities

The Consultation Paper proposes to exclude the following activities from the industry funding model:

- ASIC's registry activities, which are currently the subject of a tender process
- The Enforcement Special Account
- The Unclaimed Moneys programs
- Financial literacy programs
- The insurance aggregator for North Queensland residential property
- The Assetless Administration Fund

Consultation Question 1: Do you agree that the exclusion of these activities is appropriate? If not, why not?

AFMA supports the exclusion of the above activities from the industry funding model, however, the rationale for their exclusion arguably applies more broadly.

The Consultation Paper notes that ‘it is usually not appropriate to cost recover some government activities, such as general policy development and ministerial support.’¹⁷ Yet the paper indicates that policy advice to government is to be included in the industry funding model.

AFMA submits that, with the exception of existing cost recovery arrangements, surveillance, enforcement, guidance, policy advice, stakeholder engagement and education should be outside the scope of the industry funding model. Licensing and professional registration should be within scope, along with ASIC’s registry business depending on the outcome of the prospective sale process.

While the registry business is outside the scope of the industry funding model, AFMA submit that the government will need to pay careful attention to ensuring that a private registry operator is not able to exploit a monopoly position in a way that inhibits access to business information that is required by regulation and which benefits the community by being made readily accessible. The government should give consideration to an access pricing regime for any private registry operator to ensure that the community is not over-charged for access to this information. It is noteworthy that access to such information is freely provided by government in jurisdictions such as the United States.

With these considerations in mind, one possible alternative funding model for ASIC is for revenue derived from demand-driven services to be hypothecated to ASIC’s budget appropriation, along with existing cost recovery levies, with any shortfall being made up by taxpayer funding. This mixed funding model recognises the mix of public and private benefit inherent in much of ASIC’s regulatory activities and maintains the government’s direct budgetary stake in the continued efficiency and effectiveness of ASIC.

Question 3: Do you support cost recovery arrangements for ASIC’s regulatory activities being consolidated within a single ASIC industry funding model? If not, why not?

If the government decides to proceed with the industry funding model as proposed, it would make sense to roll existing cost recovery arrangements into a single levy.

Question 5: The Government currently recovers most of the costs of operating the MoneySmart website through APRA’s supervisory levies. Should these costs no longer be recovered from industry? Why or why not?

AFMA support the exclusion of financial literacy programs from the industry funding model. These programs are intended to benefit consumers by supplying them with freely available information. Their exclusion from industry funding would be consistent with the Government’s Cost Recovery Guidelines.

5. International Funding Models

Question 8: Are there any approaches to industry funding adopted by other regulators that you believe should be applied to an industry funding model for ASIC? If so, please describe and provide reasons why.

¹⁷ Ibid., 6.

Canada's *User Fees Act 2004* provides a model for a rigorous statutory assessment process for cost recovery arrangements that could usefully be applied in Australia. In particular, Australia could benefit from the Canadian approach by incorporating the government's Cost Recovery Guidelines in legislation and bringing them within the scope of administrative review arrangements. The Productivity Commission could be given the task of either formulating or evaluating cost recovery proposals and methodologies. The legislation could make the Productivity Commission's recommendations binding on the government. This would prevent ASIC from being effectively the author of its own funding model.

The Canadian Act provides for an independent review panel to scrutinise cost recovery proposals when requested by stakeholders. In Australia, this function could also be performed by an automatic referral of methodology reviews and/or fee consultations to the Productivity Commission.

The Canadian model also ties user fees to service standards and provides for fee relief where these service standards are not met. This approach would be consistent with the government's stated intention to use industry funding arrangements to drive efficiencies within ASIC.

The Hong Kong Securities and Futures Commission's (SFC) practice of calibrating levies based on economic and market conditions is also worth noting and considering in terms of its relevance to an ASIC funding model.

The SFC waived its annual licensing fees from 1 April 2009 to 31 March 2010 and again from 1 April 2012 to 31 March 2014. In March 2014, fees were waived for another two-year period. The fee waiver applies to all licensed corporations, registered institutions, responsible officers and representatives, benefiting more than 39,000 intermediaries. As noted by the SFC's CEO Ashley Alder:

'Market participants have been operating in a stressed environment amid uncertainty over the global economy. We hope that the two year fee waiver will help relieve the cost pressures facing the securities and futures industry.'¹⁸

The Consultation Paper notes that 45% of global securities regulators are either government-funded or have a mixed funding model rather than full industry funding.

Comparisons with overseas funding models and the fees charged under these models need to be treated with considerable caution. Large jurisdictions like the US and UK have greater scale to absorb the costs that are associated with industry funding. Globally active financial market participants typically do not have a discretionary exposure to US and UK markets, but they do have much greater discretion in relation to exposure to Australian regulation and industry funding. Fees that may not deter a business from establishing in the US or UK may have a much greater impact in a relatively small market like Australia.

¹⁸ 'SFC waives annual licensing fee for over 39,000 licensees,' SFC press release, 17 March 2014. <http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=14PR33>

6. Proposed Industry Funding Model

The proposed industry funding model consists of annual supervisory levies that apportion to regulated sectors those costs that cannot be attributed to specific entities, together with fee for service arrangements for specific on-demand services to individual entities.

Ex-ante fees are proposed for the following regulatory activities: licensing and professional registration, applications for relief and formal guidance review of documents lodged by entities under the Corporations Act. Existing fee arrangements do not reflect ASIC's costs and the proposed fee arrangements aim to match fees to costs. Some existing lodgment fees that do not apply to individual entities are to be rolled into the annual levies.

AFMA support the general principle that fees reflecting efficient costs should be applied to demand-driven services. However, this highlights the need for independent review mechanisms to scrutinise costs and ensure that available efficiencies are fully realised.

AFMA does not generally support fees being applied to relief applications, particularly where the need for relief arises from uncertainty in the application of the law or policy. In these instances, it is government and not industry that creates the need for regulation. Government should bear the cost of creating regulatory uncertainty as a discipline on regulatory processes.

The Financial System Inquiry recognised that 'depending on how they are designed, fees and levies have the potential to increase barriers to entry and potentially limit competition.'¹⁹ This concern is also raised in the Consultation Paper. ASIC is already a significant cost for smaller, new entrants in the market infrastructure space under existing funding arrangements. The new funding model, coming on top of existing regulatory cost burdens, could be expected to deter new entry and prompt exit from the industry on the part of marginally profitable participants. New entrants in particular have little or no capacity to pass through costs to end-users. This can be expected to hinder innovation and to lead to a concentration of risk in larger incumbent firms. This is inconsistent with the government's stated intention to promote financial innovation, particularly in relation to fintech businesses.

To mitigate these impacts, consideration should be given to charging some fees on an ex-post rather than an ex-ante basis to reduce barriers to entry, especially on the part of new licensees. Consideration should also be given to providing temporary fee relief for new entrants. The Cost Recovery Guidelines provide for partial cost recovery where full cost recovery would be inconsistent with other policy objectives. Given that the government seeks to promote competition and innovation in financial services, partial cost recovery would seem justified for new licensees, particularly market infrastructure providers. If partial cost recovery is applied on this basis, it is important that government pick-up any shortfall in funding rather than imposing a larger burden on other industry participants.

Another potential unintended impact of the proposed model is to provide incentives for regulated entities to move outside the regulatory perimeter, for example, through de-listing or failing to list, reducing disclosure to the market and increasing risk.

¹⁹ Australian Government, "Financial System Inquiry Final Report," 253.

7. Fee Determination and Review Processes

The Consultation Paper suggests three yearly consultations on ASIC's fees and five yearly reviews of the industry funding model's methodology. The government is also proposing the following accountability mechanisms:

- ASIC will report on its performance relative to objectives in its Annual Report (this should go without saying).
- ASIC will produce an annual Cost Recovery Impact Statement (CRIS) with industry given the opportunity to comment on the draft CRIS.
- The government will introduce a Cost Recovery Stakeholder Panel with representation from Treasury, ASIC and effected industry sectors. The existing ASIC Market Supervision Cost Recovery Stakeholder Panel will be subsumed into the new panel.

Question 17: Do you have any further suggestions for enhancements to be made to ASIC's accountability structure or industry funding model? If so, please provide details.

AFMA considers the proposed accountability arrangements inadequate in providing effective scrutiny and accountability of ASIC's cost and effectiveness, which is one of the stated aims of industry funding.

AFMA has considerable experience with similar processes in relation to existing cost recovery arrangements and has not found them to be effective in disciplining regulator costs or meeting stakeholder concerns. AFMA's experience of the Market Supervision Cost Recovery Stakeholder Panel to date is that the Panel has no actual decision making power and very little capacity to influence decisions about cost recovery arrangements. Indeed, it has been made clear to the Panel that the government is not obliged to have any regard for the views of the Panel or any recommendations it may make.

AFMA submits that the proposed five yearly reviews of the cost recovery model should be subject to an independent review process. The Productivity Commission would be an appropriate body to either formulate or review the cost recovery methodology. The frequency of these reviews should be increased to three years and precede the three yearly consultations on fees so that the fee reviews reflect the recommendations of the independent Productivity Commission formulation or review of the cost recovery methodology. As things stand, ASIC is effectively the author of its own funding model, with no effective independent review mechanisms in place to the extent that government is not appropriately incentivised to perform this function.

Because industry funding significantly weakens the government's fiscal incentive to maintain effective oversight of ASIC, AFMA submit that a full industry funding model demands a much higher degree of accountability and more demanding governance arrangements than currently provided or that have accompanied other industry funding models. In particular, the industry funding model needs to be tied explicitly to the

Capability Review's consideration of governance arrangements and accountability mechanisms.

AFMA is of the view that the Financial Regulator Assessment Board recommended by the Financial System Inquiry is inadequate to this task. The existing Regulator Performance Framework (RPF) is also too limited in scope and too reliant on self-assessment to constitute an effective accountability mechanism. The RPF should be given a stronger outcomes-based focus with a greater reliance on external assessment and review. The existing ASIC Service Charter could be expanded and brought within the scope of the RPF and other accountability mechanisms, with service standards tied to levies and fees in such a way as to provide fee relief where service standards are not met.

8. Phase-in Arrangements and Levy Administration

Question 21: Are the proposed administration arrangements suitable? If not, why not?

The proposed phase-in arrangements propose an earlier timetable for financial service industries (AFS Licensees, Market Infrastructure Providers and Australian Credit Licensees) relative to remaining industries. The rationale for treating financial and non-financial services industries differently in relation to the phase-in timetable is unclear.

AFMA submit that the same phase-in arrangement proposed for non-financial service industries also be applied to financial service industries.

Question 22: Is it appropriate not to levy entities entering the market part way through the year? If not, how do you propose that these entities be treated?

AFMA support the proposed arrangements for new entrants.

9. Funding Model for Market Infrastructure Providers

Question 52: Are the proposed levy arrangements for MIPs appropriate? Why or why not?

Question 53: Will the proposed levy arrangements for MIPs be competitively neutral? If not, why not?

Question 54: Will the proposed levy arrangements for MIPs support innovation? If not, why not?

AFMA considers that the proposed fee schedule for MIPs will act as a significant barrier to new entry and innovation. It could also lead to exit from the Australian market for MIPs with marginal profitability. This is particularly the case where Australian markets could be serviced from offshore.

To mitigate these impacts, consideration should be given to charging fees on an ex-post basis to reduce barriers to entry, especially on the part of new licensees. Consideration should also be given to providing temporary fee relief for new entrants. The Cost Recovery

Guidelines provide for partial cost recovery where full cost recovery would be inconsistent with other policy objectives. Where partial cost recovery is provided for on this basis, it is important that the resulting funding shortfall is borne by the taxpayer and not other industry participants. Given that the government seeks to promote competition and innovation in financial services, partial cost recovery would seem justified for new licensees.
