



15 December 2017

Manager
Corporations and Schemes Unit
Financial System Division
The Treasury
Langton Crescent
Parkes ACT 2600

By email: asicfunding@treasury.gov.au

Dear Sir/Madam

Introduction of ASIC's Fees-for-Service Under the Industry Funding Model

The Australian Financial Markets Association (AFMA) welcomes the opportunity to make this submission commenting on the Introduction of ASIC's Fees-for-Service under the Industry Funding Model.

AFMA supports the general principle of fees being applied to demand-driven services provided by ASIC to the regulated population. In previous submissions, AFMA has noted that the case for applying fees to demand-driven services is stronger than for cost recovery of ASIC's general regulatory activities. This is because regulation in general has significant public good characteristics, whereas demand-driven services are more likely to confer private benefits on regulated entities.

While the case for cost recovery in relation to demand-driven services is stronger, it is still important that these fees reflect the efficient cost of supplying demand-driven services. This highlights the need for greater transparency and accountability in relation to the cost recovery model to ensure effective discipline on ASIC's costs and efficiency.

AFMA makes the following comments in relation to the specific consultation questions.

Q1. Do you have any comments on whether the Corporations (Fees) Regulations 2001 should continue to specify all ASIC fees regardless of whether they are determined on a cost-recovery basis or whether the cost-recovery fees should be specified in a

separate instrument so they can be more clearly differentiated from non-cost recovery fees?

It would be preferable for the relevant regulatory instruments to clearly distinguish between fees levied on a cost recovery and non-cost recovery basis. An important objective of the industry funding model is to ensure that ASIC's costs are transparent to the regulated community. It is also important that these costs are transparent to the government and parliament so that ASIC's budget appropriation reflects the efficient cost of discharging ASIC's regulatory responsibilities.

Q2. Do you have any feedback regarding the model objectives?

In previous consultations, AFMA has highlighted that the industry funding model objectives are often in conflict. The current consultation notes the trade-off between 'financial system innovation, while balancing financial stability objectives.' The more fundamental conflict, however, is between financial system competition and innovation and the cost of regulation, particularly to new entrants. This conflict is best addressed by minimising the cost of effective regulation through strong accountability and transparency arrangements to ensure ASIC's efficient use of resources. However, as noted below, the proposed transparency and accountability arrangements for the industry funding model have already been shown to be inadequate.

Q3. Is the proposed methodology for calculating fees-for-service appropriate? If not, why not?

Q4. Are there any other sectors where a tiered approach to setting fees would be appropriate?

Q5. Do you have any suggestions for how the proposed methodology could be modified? If so, please provide details?

The proposed methodology entails taking a weighted average hourly staff rate for the relevant regulatory teams and multiplying by the average number of hours required to process a form to calculate the applicable fee. However, there is no mechanism to ensure that the weighted average hourly staff rate or the number of hours taken reflect efficient costs.

The use of tiered fees mitigates this problem to some extent and may have broader applicability than proposed in the consultation, particularly for matters of varying complexity.

One particular proposed fee that we would like to highlight is Form Code M07 *Notice of changes to Security Exchange Guarantee Corporation (sic) operating rules [under] section 890G(1) of the Corporations Act*. The amount is to be increased from \$161 to \$38,651. The dominant purpose of SEGC is to operate the National Guarantee Fund (NGF). In our view the proposed fees in respect of a notice of changes to the Securities Exchanges Guarantee Corporation operating rules are inappropriate given that the NGF is a compensation fund to protect end-users of financial services and SEGC is not a for-profit business enterprise. We also note that other market operators who may wish to join the NGF and have NGF recognised as the market's approved compensation arrangements

under section 792A(e) maybe be deterred by these fees. A more nominal fee is appropriate in this case.

We note that Securities Exchanges Guarantee Corporation is incorrectly referred to in the Proposed Fee Schedule as Security Exchange Guarantee Corporation.

Q6. Are the proposed accountability measures for ASIC appropriate? If not, please provide details.

The consultation notes three main accountability mechanisms: the three-yearly reviews of the fee schedule; the annual cost recovery implementation statement (CRIS); and pre-existing ASIC communications to stakeholders (the Corporate Plan and Annual Report).

These measures fall short of the accountability measures required to effectively discipline ASIC's efficient costs given that industry funding substantially reduces the government's and parliament's fiscal incentive to monitor ASIC's efficiency.

AFMA note that the first CRIS under the industry funding model saw some significant and unexpected increases in the proposed levies for market participants relative to previous consultations, without any explanation in the CRIS. It was only as a result of inquiries by AFMA that it became apparent that these increases in levies were attributable to the cost recovery of ASIC enforcement actions that are potentially also the subject of judicial cost orders.

AFMA has since sought clarification from ASIC about the relationship between the recovery of the Enforcement Special Account and cost orders. It is AFMA's understanding that there is no intention to over- or double-recover enforcement costs through the industry funding model and cost orders, although this remains to be clarified. This episode highlights the inadequacy of the CRIS process as a transparency and accountability mechanism in providing certainty and predictability to the regulated population. The annual CRIS should contained more detailed explanation of how changes in fees and levies reflect ASIC's activities and the costs associated with those activities.

As noted in previous consultations, it is essential that the operation of the industry funding model is subjected to an independent, third-party review to ensure that the efficiencies and transparency claimed for the industry funding model are being realised. AFMA calls upon the government to formally commit to a regular, independent review process to ensure that the industry funding model is working as intended and to address any unintended consequences.

The adoption of industry funding requires careful attention to the internal and external governance of ASIC to ensure that appropriate scrutiny is brought to bear in an environment where increases in ASIC's budget appropriation are no longer funded out of general tax revenue.

Q7. Will the proposed fees-for-service model have an effect on competition and innovation? If so, please provide details, including possible ways to mitigate the effect.

The fee-for-service arrangements, in conjunction with the cost recovery of ASIC's general regulatory functions, can be expected to have a dilutory impact on competition and innovation by raising barriers to entry and potentially inducing exit from the industry, particularly on the part of marginally profitable foreign entities that enjoy considerable discretion over where to locate their business activities. Exit from the industry will raise the overall cost recovery burden on remaining firms. The move to industry funding of ASIC is at cross-purposes with the government's competition and innovation agenda for financial services.

The proposed fees-for-service may in some cases benefit incumbents who have already obtained regulatory approval and operating licenses under the previous fee schedule relative to new entrants that will be subject to substantially increased fees for service under the new fee schedule.

AFMA notes the effort to mitigate negative impacts on competition and innovation in relation to novel relief applications. The more fundamental issue is the cost of regulation in general, which the industry funding model attempts to shift more squarely on to industry, although the ultimate incidence of these costs is far from clear. In the case of new entrants and innovative business models, it is more difficult to pass these costs on to the end-users of financial services and so it is more likely that new entrants will need to absorb these costs.

This highlights the need to ensure that ASIC has strong incentives to minimise its efficient costs of regulation, but as already noted, the industry funding model does not have the strong transparency and accountability measures that would generate this discipline, while weakening the government's and parliament's incentives to scrutinise ASIC.

Accordingly, it is recommended that any independent, third-party review of the effectiveness of the industry funding model be given an explicit mandate to examine accountability and transparency arrangements for the industry funding model. The review should also examine whether there has been a decline in new business and innovation measured by the number of new license applications and other metrics.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Step Kirchner', written in a cursive style.

Dr Stephen Kirchner
Economist