INTRODUCTION

ASICs proposal to move to an industry funding model as a solution to funding issues has been carefully considered by the Australian CFD and FX Forum. The argument by ASIC that costs are not transparent to industry participants, that the regulated population has increased in size and complexity without a corresponding increase in fees and the assumption government funding is unpredictable underlies ASIC's argument that an industry funding model is more suitable than the current structure.

The CFD and FX Forum has a number of objections to this proposal, which are outlined below. These include the counter-intuitive nature of the model, ASIC's flawed reasoning and assumptions, the barriers created by the model and the negative effect it will have on the industry and its' participants. The CFD and FX Forum structures this argument predominantly around the belief that surveillance and regulation are primarily for the benefit of the public and thus cost recovery should be limited under a model such as the one proposed by ASIC.

TRANSPARENCY AND ACCOUNTABILITY

ASIC argues that the creation of an industry funding model will increase transparency and accountability to industry participants. Unfortunately the consultation paper is lacking in substance as to the mechanics of this claim, nor does it provide any examples of how this will be achieved. The suggested improvements rely on the claim that IF the proposed funding model is implemented, accountability mechanisms will be introduced without detailing how this will happen. Further, ASICs argument that transparency will be achieved by these additional mechanisms is vague and rest on the assumption that these accountability mechanisms will result in increased transparency. These assumptions cannot be accepted by industry participants without significantly more detail than is currently available. ASIC cannot expect that industry will accept this model in good faith without this information.

As a result of the vagueness of these arguments, it is difficult to ascertain how ASIC will be motivated to curb spending or act in the best interests of industry when they are not accountable to participants and can argue that costs are continually increasing as a result of increased regulation. This can lead to an oversupply of regulation with ASIC having no fiscal motivation to limit spending. Without knowing how ASIC will provide feedback and be held accountable, one cannot assume that the measures implemented will be satisfactory.

It is also important to note that the CFD and FX Forum has, in consultation with ASIC, agreed to self-regulation as a means to ensure costs are lower and participants act in the best interests of the public. A move to an industry funding model will thwart the efforts of Forum members and result in a duplication of costs.

GOVERNMENT FUNDING

ASICs argument for a user-pays principle to ensure that a greater share of general taxation be allocated to activities that benefit society more broadly is noble, but flawed. The financial services industry as a whole is the backbone of the economy and critical to a productive and functional society. The CFD and FX Forum argues that ASIC is more concerned with the unpredictability of government funding and the increasing unwillingness of government to prioritise the regulation it imposes and therefore should lobby for a change in government priorities to ensure that this function of government is properly funded.

ASIC further makes the argument that recovering a larger share of regulatory activities from industry participants is consistent with foreign jurisdictions such as the UK and USA where costs are recovered from participants. This is a difficult comparison to understand given the relative size and maturity of these jurisdictions in comparison to Australia. The UK and USA are significantly larger in both value and volume of transactions, therefore the comparison is one of apples with oranges.

PURPOSE OF REGULATION

The CFD and FX Forum is of the opinion that if the benefit is for the public good, the cost should be tax-based as opposed to industry based.

ASIC outlines a number of regulatory activities that are not to be funded by this regulatory model, including financial literacy programs, general policy development and specific programs and seeks views from participants on whether these exclusions are appropriate.

The CFD and FX forum argues that ASICs scope of regulatory activities are collectively and primarily for the benefit of the public and the community as a whole and therefore it is undesirable for the industry to carry the burden of this activity The notion raised in the paper of industry passing on costs to consumers is flawed. Industry is not in the best position to put a price on what is a greater public benefit – this is what a taxpayer funded model should do. The assumption therefore that government is not responsible for this service is viewed as an incorrect one and needs to be addressed in a more suitable manner. Further to this, the acceptance of this assumption via the acceptance of an industry model in any form opens the door to further funding cuts in the future.

If funding from industry becomes the norm, there will be less incentive to scrutinise ASIC's costs and more incentive to allow ASIC to demand further increases in funding at the detriment of competition and consumers who will inevitably bear the cost of any increases.

COUNTER-INTUITIVE NATURE OF THE MODEL

ASIC argues that costs will be allocated to those who create the need for regulation. The CFD and FX Forum argues that user-pay models cannot be easily achieved in the OTC Derivative industry, given the wide variety in size and activity of participants, and the number of unlicensed participants acting in the space. Further, the Consultation Paper makes no attempt to demonstrate or provide examples of how this objective will be achieved. ASICs fee structure is counter-intuitive; punishing larger, more stable providers for actions of the longer tail of smaller providers who require more monitoring and supervision. ASIC's model does not take into account the risk levels of individual businesses; instead treating all participants as having similar risks and therefore similar surveillance and monitoring requirements. In this regard, the CFD and FX Forum was initiated as a self-regulation mechanism, setting standards and benchmarks to ensure that regulatory requirements are met and therefore regulation by ASIC and costs are minimised. This endeavour has come at significant cost to its members. Adding additional costs punishes those providers meeting regulatory requirements who do not require the level of surveillance that is required by others.

In addition, it is noted that ASIC surveillance and monitoring of the industry is not limited to licenced entities, but extends to unlicensed entities operating in Australia such as those based in Cyprus. This inflates the cost of these activities, again punishing those who operate in the bounds of the law and who bear the costs of acquiring and maintaining licences and forces regulated companies to pay for enforcement action against unregulated entities where ASIC cannot recover costs.

The paper notes that 'cost recovery as a pricing mechanism is appropriate where there is an identifiable individual, organisation or group that receives the regulatory activity or creates the need for it'. In this regard there are numerous examples where an organisation has created a need for and received the regulatory activity, where ASIC cannot recover costs as these organisations are not licenced in the Australian market.

It should be further noted that fees proposed for Retail OTC Derivatives Issuers are significantly higher than for other financial service providers especially when taking into account providers NTA's and market capitalisations. As a comparison an OTC Derivative Provider compared to a Tier 3 Investment Bank will pay a similar amount with vastly different market capitalisations. The size of the OTC Derivative industry is small compared to financial services as a whole. The disproportionate costs will have a negative effect in the long run.

SELF REGULATION

The CFD and FX Forum has taken the initiative to self-regulate and hold its members to standards that either meet or are above regulatory requirement. These benchmarks are publically available, ensuring accountability of members. For example NTA and full segregation requirements are an opportunity cost that members willingly take on at their own expense. The model proposed by ASIC will result in further costs to members that leads to little incentive to self-regulate and act as a benchmark for the industry. A funding model such as this one can, paradoxically, have the opposite effect on industry regulation than is intended. In this regard, an increase in costs may result in industry initiatives such as the Forum being stifled as the mindset is not one of a joint effort to create a culture of regulatory compliance; rather that costs are extensive and industry participants are loathe to pay further. The lack of incentive to self-regulate may result in higher costs for monitoring and surveillance and further cost to industry.

BARRIER TO ENRY

ASIC notes that "It may also not be appropriate to cost recover or implement full cost recovery where it would have an adverse impact on competition, innovation or the financial viability of those who would pay the charges." The costs proposed under this model will likely have this negative impact. This is especially in the case of OTC Derivative providers who bear a significant proportion of costs under this model. This will create a barrier to entry for new players, limiting competition and ultimately resulting in a negative experience for consumers.

The OTC Derivative industry currently bears numerous costs to provide their financial services. These include the following:

- Licencing and other ASIC costs
- External Dispute Resolution
- Trade reporting costs

These costs are mandatory, with providers who hold a monopoly for example, FOS and DTCC who are the only providers available in the EDR and Trade Repository space. In the case of DTCC, the advantage is recognised as they are currently charging Australian providers more than those in other jurisdictions. Additional costs are prohibitive to business and cannot easily be passed on to consumers. Further, it is very difficult to clearly ascertain the costs to do business for new participants, again stifling competition.

QUESTIONS IN PAPER

The CFD and FX Forum has not addressed any of the questions in the consultation paper as it believes the questions are presumptions and based on an assumption that the model is definitely going to be implemented. We do not feel it is appropriate to answer these questions as we do not feel the model is appropriate. We believe further consultation and review of the costs and benefits of such an initiative is required. Furthermore, reform should be focussed on ASIC's performance and cost efficiency rather than simply passing on an inefficient and unfair cost structure to industry.

SUGGESTED ALTERNATIVES

- Comparative jurisdiction e.g. NZ where there is a 60:40 split
- Taxation reform; corporate tax based on size/turnover
- Cost plus taxation

Regards,

Diana Sayes

(on behalf of the CFD and FX Forum)