ASIC
Australian Securities & Investments Commission

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Our Reference:
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Mr Percy Bell
Corporations and Schemese Unit
Financial System and Services Division
The Treasury
100 Market Street
Sydney NSW 2000

Dear Mr Bell

Treasury Consultation Paper: Proposed Industry Funding Model for the Australian Securities and Investments Commission - Submission by ASIC

I refer to the Treasury Consultation Paper released by the Assistant Treasurer on 28 August 2015.

I am pleased to attach to this letter, a submission in respect of the proposed Industry Funding Model from the Australian Securities and Investments Commission.

Regards

Brett Bassett
Regional Commissioner – Queensland
Senior Executive Leader – Small Business Compliance and Deterrence

Treasury consultation paper: Proposed industry funding model for the Australian Securities and Investments Commission

Submission by ASIC

October 2015

Background to ASIC's regulatory perimeter and existing funding arrangements

1 The Australian Securities and Investments Commission (ASIC) has a diverse range of regulatory functions, which have expanded significantly in recent years.

2 There are many activities within ASIC's regulatory function:

(a) As the *corporate regulator*, we ensure that companies, schemes and related entities meet their obligations under the *Corporations Act 2001*. We register and regulate companies at every point, from their incorporation through to their winding up, and ensure that company officers comply with their responsibilities.

(b) As the *consumer credit regulator*, we license and regulate people and businesses engaging in consumer credit activities (including banks, credit unions, finance companies, and mortgage and finance brokers).

(c) As the *markets regulator*, we assess how effectively financial markets are complying with their legal obligations to operate fair, orderly and transparent markets. We also advise the Minister about authorising new markets. On 1 August 2010, we assumed responsibility for the supervision of trading on Australia's domestic licensed equity, derivatives and futures markets.

(d) As the *financial services regulator*, we administer the Australian Financial Services (AFS) licensing regime and monitor financial services businesses to ensure that they operate efficiently, honestly and fairly. These businesses typically deal in superannuation, managed funds, deposit and payment products, shares and company securities, derivatives and insurance.

(e) Also as the *financial services regulator*—because of market failure caused by information asymmetries between consumers and suppliers of financial services—we promote financial literacy, to ensure investors feel confident when participating in the market and are able to make sensible and informed financial decisions.

(f) As the *corporate and financial services regulator*, we undertake a range of activities to facilitate business transactions in Australia. One of our key priorities is to lift the effectiveness of Australia's business registration and licensing regimes. This includes overseeing company registration and notifications, the AFS licensing and credit licensing regimes, business names registration and self-managed superannuation fund auditor and liquidator registration.

3 However, changes in ASIC's regulatory functions over the years have not been fully reflected in the manner in which ASIC collects revenue for the Government or in the way that the Government funds ASIC to perform its functions. We do not retain for our own use any of the revenue we collect,

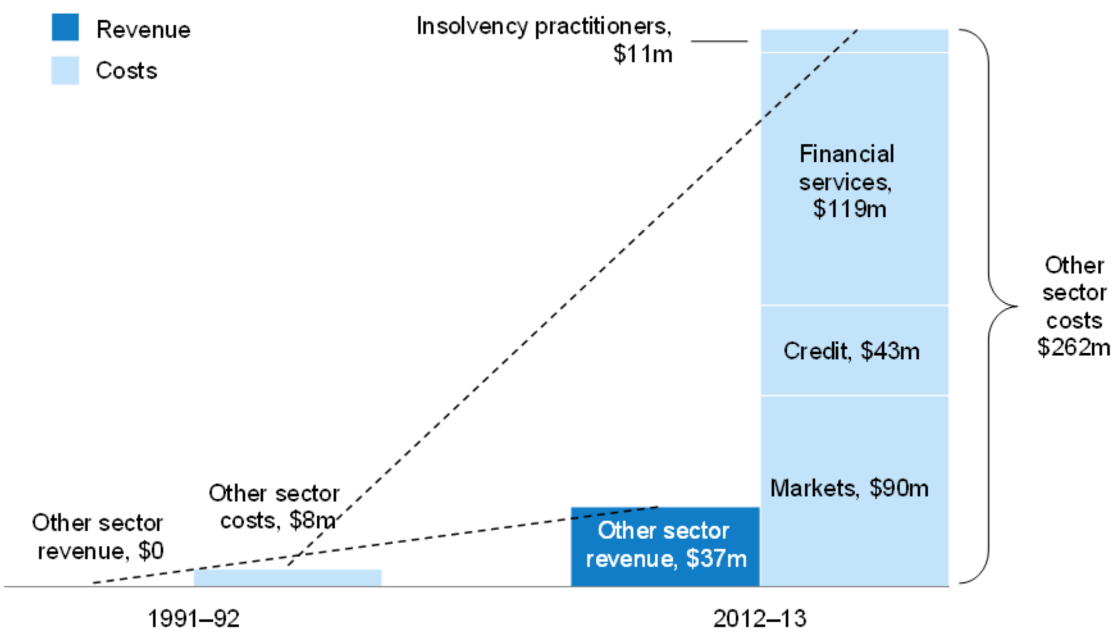
whether it be fees and charges or the proceeds of enforcement activities, apart from those that we seek to recover under s91 of the *Australian Securities and Investments Commission Act 2001* or costs awarded to us where we are successful in litigation.

4 In 1991–92, the then Australian Securities Commission's responsibilities were centred around registering and regulating companies and corporate law enforcement; its costs were largely aligned with the revenue it collected from company registration. Since then, the revenue collected from company registration has grown and significantly outstripped ASIC's current costs of providing this function.

5 Over the years, ASIC has evolved into a financial services and markets regulator. Figure 1 shows the proportion of ASIC's costs that are now spent regulating sectors other than companies (e.g. Australian financial services (AFS) licensees, financial markets and credit providers), compared to the Australian Securities Commission's responsibilities in 1991.

6 The revenue collected by the Government from the new sectors we now regulate is increasingly misaligned with ASIC's cost of regulation in these areas. For example, it costs ASIC about $108 million to regulate AFS licensees; however, ASIC collects for the Government only $3.7 million in registry fees from AFS licensees, approximately 3.5% of the cost of regulation.

Figure 1: Revenue and costs—all other sectors, 1991–2013 (nominal terms)[1]



Note: Figure 1 is an estimate only, and is not adjusted for inflation. Costs include depreciation. 'Other sectors' includes insolvency practitioners, AFS licensees, credit providers, exchange market operators, market participants and consumers. 'Financial services' includes financial advisers, insurers, responsible entities, superannuation fund trustees, deposit takers, investment banks, consumers and custodians.

[1] 1991–92 'other sector costs' are all sectors consolidated and includes $0.68 million for statutory bodies.

7 While regulation imposes compliance costs on industry, it also brings a number of benefits to a regulated population. Regulation can enhance the reputation of an industry, provide clear operating rules and standards, and reduce the risk of market problems. However, at present, the populations ASIC regulates are not charged in proportion with the benefits they receive from our regulation.

8 At present, there are also no economic incentives (price signals) in the market for the use of ASIC's resources. Price signals associated with the use of ASIC's resources would allow business to identify the cost of regulation required to achieve the desired regulatory outcome, such as improved efficiency or investor outcomes in a particular sector. Either ASIC or business must allocate resources to meet the Government's regulatory policy outcomes. By using correct price signals, industry can identify the cost of regulation and have an incentive to reduce the costs allocated to them. In turn, ASIC can direct its resources to those areas that pose greater risks to investor trust and confidence and fair, orderly and transparent markets. This would ensure that the desired policy outcomes are delivered in the most economically efficient way. However, these price signals are not currently in place.

9 ASIC is largely funded by government appropriation. Variance in funding from year to year exacerbates the uncertainty inherent in the budget process and results in inefficiencies in the allocation of ASIC's resources to achieve regulatory outcomes. Since 2005, there have been significant differences between the forward projections of ASIC's budget expenditure and our realised expenditure. These differences have arisen from both general and targeted savings measures. For example, in the 2014–15 budget the Government announced a permanent 10% cut to ASIC's revenue appropriation to commence from that funding year.

10 The differences between the forward and realised expenditure limit our ability to forward plan in response to market and regulatory developments. Our ability to forward plan is also limited by the growing percentage of our operating budget that is provided by new policy proposal funding (i.e. ad-hoc funding provided by the Government for specific purposes and for limited time periods).

11 ASIC's current funding model was criticised by the Financial Stability Board (FSB) and the International Monetary Fund (IMF) in November 2012. The IMF expressed concerns about the government-funded models of securities regulation in Australia, the United States, Japan and Argentina. They were concerned about a lack of stable funding, an inability to commit resources to longer term projects and, as a result, weaknesses in proactive supervision.

12 A Senate Economics References Committee report[2] recommended that ASIC should be primarily funded through a user-pays model of industry levies. The Senate Committee expressed concern that the current funding model for ASIC does not promote efficient outcomes. The proposed user-pays model should be designed to reflect the cost associated with regulation and incentivise sectors to minimise the attention the regulator needs to devote to them.

13 The 2014 Financial System Inquiry agreed with the Senate Economic References Committee's conclusions and recommended in its final report that ASIC be moved to an industry funding model. The inquiry's objective was to ensure that ASIC has adequate funding and resources to deliver more effectively on its regulatory mandate.[3]

A new industry funding model

14 In light of the issues associated with the current funding model, we have worked closely with Treasury to assist in the development of the proposed industry funding model, based on a cost recovery approach for ASIC's regulatory functions. This model is consistent with the recommendations of the Financial System Inquiry and the IMF.

ASIC supports the proposed industry funding model

15 We strongly support an industry funding model based on the principle that those who drive the need for our regulation share in the costs of that regulation, rather than taxpayers in general. Recovering ASIC's regulatory costs through an industry funding model can:

(a) ensure costs are proportionately borne by those who create the need for regulation;

(b) achieve a more efficient allocation of ASIC's resources;

(c) promote better self-regulation within particular industry sectors;

(d) create greater transparency and accountability for ASIC; and

(e) strengthen ASIC's budget and operational independence.

[2] The Senate Economics References Committee, *Inquiry into the performance of the Australian Securities and Investments Commission*, final report, June 2014.

[3] The 1997 Financial System Inquiry (Wallis Inquiry) also recommended that ASIC should be funded by those benefiting from its activity, and collect from the financial entities it regulates enough revenue to fund itself (but not more): see Recommendation 104.

Why should industry bear the cost of regulation?

16 Regulation designed to enhance trust and confidence in the financial system and ensure that Australia's financial markets are fair, orderly and transparent fulfils an important public good.

17 However, although some of ASIC's regulated activities may exhibit greater degrees of public good characteristics, our view is that it would be more efficient and effective to recover 100% of the costs associated with ASIC's regulatory activities from industry, rather than by way of general taxation. This is for several reasons:

(a) Industry is expected to pass on some of the costs of ASIC's regulatory activities directly to consumers. This will ensure that only those consumers who use the products of regulated firms will share the costs of paying for ASIC's regulatory activities. As a consequence, general taxpayers, many of whom do not use or benefit directly from some of ASIC's regulatory activities, are not burdened with these costs.

(b) Industry participants drive the need for ASIC's regulatory activities, and therefore should pay the associated costs for this. This is consistent with the 'user-pays' principle in the Government's Cost Recovery Guidelines. By directly linking the fees and levies to the provision of specific regulatory activities to industry participants, the proposed industry funding model is designed to reflect the costs that industry imposes on society. This would provide an incentive for industry to self-regulate to improve public outcomes without the potential for ASIC regulatory action.

(c) The costs of regulatory activities will be different for entities in each stakeholder group and the proposed industry funding model has been designed so that the amount of levies charged better reflects the amount of effort ASIC allocates to regulating entities within each sector. The model also provides for changes in levies, as ASIC's regulatory work changes to accommodate different risks in varying sectors.

(d) If the costs of ASIC's regulatory activities continue to be recovered by way of general taxation, this would disguise the costs of its activities both to industry and the public more broadly. Cost recovery is different from general taxation in that there is an explicit link between ASIC's regulatory activity and the costs recovered.

(e) It is inherently difficult to identify what types of activities are pure public goods. This is recognised by the Government's Cost Recovery Guidelines, which suggest that the 'public good' argument may not be a relevant criterion for determining whether cost recovery is appropriate for specific regulatory activities.

Precedents exist for moving ASIC to industry funding

18 There are also a number of precedents that demonstrate that it is appropriate for ASIC to recover its regulatory costs via an industry funding model.

19 First, the user-pays principle has been expressly adopted by the Government's Cost Recovery Guidelines, which allow for cost recovery of regulatory activities. The Guidelines note that cost recovery can improve economic efficiency by ensuring those w create the need for regulation recognise the costs of administering regulatory activities.

20 Second, there is precedent for regulators similar to ASIC adopting a cost recovery approach. Regulatory cost recovery has been adopted by many of ASIC's domestic and international counterparts, even though it may be generally accepted that their regulatory activities also fulfil an important public good.

21 In Australia, a number of Commonwealth Government agencies are funded through cost recovery arrangements. For example, since it was established, Australian Prudential Regulation Authority (APRA) (which has similar supervisory, enforcement and policy activities that might ordinarily be considered a public good) has been funded from cost recovery arrangements through Commonwealth budget appropriations, largely recovered via levies imposed on those institutions it regulates.

22 Similarly, cost recovery has been adopted by some of ASIC's international counterparts, including the Financial Conduct Authority in the United Kingdom and the Financial Markets Authority in New Zealand.

ASIC supports enhanced transparency and accountability

Existing accountability measures

23 Transparency will increase the scope of our accountability but, as a Government agency, we would continue to have core accountability to Government and Parliament—for example, through our obligation to appear before and respond to parliamentary committees (e.g. Parliamentary Joint Committee), and because Government would still ultimately decide ASIC's budget each year.

24 Apart from the proposed transparency and accountability enhancements outlined in Treasury's consultation paper, there are also a number of other processes that have recently commenced or are underway to enhance financial and performance accountability for ASIC. They include:

(a) the Regulator Performance Framework established by the Department of Prime Minister and Cabinet. Key performance indicators (KPIs) have been developed to meet business expectations and currently include:

    (i) communication with those regulated is clear, targeted and effective;

    (ii) actions taken by regulators are proportionate to the risk being managed; and

    (iii) regulators are open and transparent in their dealings with regulated entities; and

(b) the addition of performance statements in annual reports, the production of an annual corporate plan, and strengthening the use of KPIs in portfolio budget statements.

25 Transparency in pricing ASIC's regulatory activities will help to enhance its accountability by ensuring resources are allocated to the areas they are most required. It will achieve this by exposing ASIC to greater scrutiny from our stakeholders, by encouraging industry participants to take a greater interest in the cost efficiency of our activities, and to inform the public how we are allocating our budget and resources in regulating the financial services sector and companies generally.

26 Apart from recently introduced accountability measures (see paragraph 24), ASIC is already subject to a range of transparency measures covering governance, efficiency, financial management, legal and regulatory decision making, and enforcement of the law. We are also accountable to our various stakeholders, including:

(a) the Australian Government and Parliament;

(b) industry and end users; and

(c) international bodies and our international peers.

27 ASIC regularly appears before the Parliamentary Joint Committee on Corporations and Financial Services and the Senate Standing Committees on Economics, as well as other Parliamentary committees. Last financial year we made approximately 15 of these appearances. ASIC also reports annually in our portfolio budget statement and through the tabling of our annual report. ASIC decisions are also subject to judicial and administrative review, providing a further level of accountability.

28 In addition to the many formal channels by which we are held accountable, we have put in place measures to be accountable to industry and the broader public. These measures focus on improving transparency and communication in the way we choose our strategic priorities and the day-to-day decisions we make. Some examples of these measures include:

(a) taking advice from various external panels, such as our Consumer Advisory Panel, External Advisory Panel, Directors Advisory Panel and the Market Supervision Advisory Panel;

(b) our stakeholder survey, which regularly measures ASIC stakeholders' perceptions of the environment in which ASIC operates, and ASIC's performance; and

(c) our Service Charter, which covers the most common interactions between ASIC and our stakeholders and sets performance targets for each type of interaction.

Proposed transparency and accountability measures

29 If Government is minded to move ASIC to an industry funding model, a range of additional accountability and transparency measures will be put in place to enhance the existing measures.

30 We support and will actively engage with industry and Treasury on the following enhanced measures, as outlined in Treasury's consultation paper:

(a) continued Government appropriation and setting of ASIC's funding parameters through existing budget processes, including the requirement for ASIC to receive additional funding for urgent and unforeseen policy requirements outside of the budget process;

(b) consultation and review process for the proposed industry funding model;

(c) consultation on fees every three years;

(d) requirement for ASIC to produce a cost recovery implementation statement; and

(e) the formation of a Cost Recovery Stakeholder panel.

31 In addition to the above, we will consider producing a new publication that amalgamates our existing public reports that demonstrate ASIC's performance. This document may include information from or about the following areas of regulatory activity:

(a) disruption activities or outcomes that do not involve formal proceedings;

(b) individual relief applications made to ASIC to increase the quality of information available about the decisions we make;

(c) surveillance and compliance activities;

(d) enforcement actions; and

(e) our compulsory information-gathering powers.

32 While we support enhanced transparency and accountability measures, we also need to ensure ASIC's ongoing independence as a regulator.

33 For that reason, care is needed to ensure that enhanced accountability and transparency does not lead to an increased risk (real or perceived) of lack of independence. We are confident that we have the processes in place to deal with these issues at present, but wish to ensure that any additional accountability or transparency measures do not compromise our position.

ASIC supports recovery of the full costs of its regulation

34 We support the recovery of all of its regulatory activities and does not support excluding certain activities from the proposed industry funding model.

35 In particular, we have made some comments below, on specific activities relating to the Enforcement Special Account (ESA) and financial literacy.

Enforcement Special Account

36 The ESA is a pool of money from Government that allows ASIC to take major enforcement action, usually against big and well-resourced corporations.

37 Excluding the ESA from industry funding means that smaller entities are paying their share of enforcement costs while those larger enforcement matters, which involve larger companies, continue to be funded by Government and in turn the general taxpayer.

Financial literacy

38 ASIC's financial literacy work is about helping people to help themselves. It addressed a key market failure in financial services caused by information asymmetries between consumers of financial services and their suppliers.

39 Our research shows consumers like ASIC providing financial literacy education and advice, because it is from a trusted and impartial source. For example, ASIC's MoneySmart website, which is central to our financial literacy work, attracts about 500,000 visits each month.

40 Financial service providers directly benefit from our financial literacy work because it lifts consumers' confidence and participation in the financial system, and because better informed consumers improve competition and market discipline for the benefit of industry as a whole.

41 Improving financial literacy also means consumers and investors are less likely to buy unsuitable financial products or accept inappropriate advice, ultimately leading to poor providers going out of business and better consumer outcomes.

42 We also see financial literacy—including consumer and investor education—as a regulatory tool in the same way that surveillance and enforcement are regulatory tools. We often deploy education to complement other regulatory work—for example, educating people about what to look for when considering financial advice, consumer leases or hybrid securities. As risky financial products and services appear in the regulatory landscape, our Financial Literacy team take steps to develop specific information and tools to highlight to consumers the risks of using these products and services.

43 Currently, ASIC's financial literacy work is already cost recovered via the APRA financial industry levies.