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Corporations and Schemes Unit (CSU)
Financial System and Services Division
The Treasury
100 Market Street
Sydney NSW 2000

Email: asicfunding@treasury.gov.au

Dear Minister O'Dwyer

Proposed Industry Funding Model for the Australian Securities and Investments Commission

Governance Institute of Australia (Governance Institute) is the only independent professional association with a sole focus on whole-of-organisation governance. Our education, support and networking opportunities for directors, company secretaries, governance professionals and risk managers are second to none.

Our members have primary responsibility to develop and implement governance frameworks in public listed, unlisted and private companies. Our members, due to their involvement in governance and corporate administration, have a thorough working knowledge of the Corporations Act, and liaise with the Australian Securities and Investments Commission (ASIC) regularly in the course of their work. In listed companies, they have primary responsibility to deal with the Australian Securities Exchange (ASX) and interpret and implement the Listing Rules. Our members have a thorough working knowledge of the operations of the markets and the needs of investors.

Governance Institute welcomes the opportunity to comment on the consultation paper *Proposed Industry Funding Model for the Australian Securities and Investments Commission* and draws upon the experience of our members in providing our response.

General comments

Governance Institute strongly supports the roles and responsibilities of ASIC in maintaining and facilitating the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy; and promoting the confident and informed participation of investors and consumers in the financial system. Our members recognise that ASIC's role is central to maintaining trust and confidence in the market, which funds the broader Australian economy. We also recognise that a well-funded regulator is vital and that there must be proper accountability and transparency in relation to any funding it receives.

Our members agree with the recommendation by the Financial System Inquiry (FSI) to introduce a three-year public funding regime, and agree in principle with the FSI recommendation that this should be supported by an industry-funding model. Governance Institute recognises that the price of having an efficient market with integrity is to ensure that the regulator has sufficient funding, and is of the view that joint government and industry funding is the right model. We also note the precedents for an industry-funding model, such as AUSTRAC in Australia and the Financial Authority in the United Kingdom.

At a major public forum held by Governance Institute in August 2015, 'ASIC: What sort of corporate regulator does Australia need?', the Chair of the FSI, David Murray AO noted that:[1]

> For ASIC to be effective, you have to go to a public funding model. While the public funding model is not ideal, a three-year funding model has been proposed, supported by a user-pays regime. It is not possible to have a regime that is perfect. There will be cross-subsidies somewhere. Everyone will have a view that they're a good citizen but paying for someone else. But everyone is a beneficiary of good market enforcement.

Notwithstanding our in-principle support for an industry-funding model, our members are of the view that the lack of detail provided in the proposed model, as set out in the consultation paper, provides no certainty that there will be increased benefits to market participants or enhance market integrity overall. We also note that no alternative options were canvassed as to how an industry-funding model could operate. The lack of capacity to weigh alternative approaches and consider different models renders it difficult to arrive at an informed response. While it is possible that Treasury has considered alternative approaches, the absence of information as to why they have been discarded does not allow regulated entities to consider the proposed model within context.

The lack of substantiated benefits attached to the proposed model is also of concern. While the consultation paper makes reference to international industry-funding models in Chapter 3, it does not provide evidence or examples of whether these function successfully or have been shown to enhance market integrity. Nor does it specify the incorporation of any of the aspects of these models into the Australian proposal. For example, our members have significant concern with the industry-funding model as it applies to the Securities Exchange Commission (SEC) in the United States. In the SEC model, the regulator retains the fines. We do not support a model where the prosecutor determines where fines will be applied having regard to the financial capacity of the regulated entity, which has the potential for the regulator to take action on a revenue-raising basis, rather than a risk basis. We note that in Australia, the Australian Securities Exchange (ASX) fines brokers, but these funds do not go into ASX's consolidated revenue. They are used to support an education fund for brokers to improve practice in the industry, which is a preferable model.

A detailed explanation which correlates the approaches of industry funding from other jurisdictions would be more helpful in deliberating the proposal. The lack of clarity of purpose in Chapter 3 results in the overview of international funding models in the paper appearing for reasons of precedent rather than as a useful background for a considered construction of an Australian model.

Concerns with the proposed industry-funding model

Our members have taken a high-level approach in responding to the consultation paper and to that end have focused on dealing with the intended benefits as expressed in the proposed model. In this section, we set out our concerns relating to matters that the consultation paper and proposed model do not adequately address.

The consultation paper notes that the overriding purpose of the proposed model is to ensure that the costs of ASIC's regulatory activities are borne by those who create the need for regulation, and that those costs are borne in proportion to the different risk profiles of each industry participant and the intensity of supervisory activities required on the part of ASIC. The

[1] Governance Institute of Australia, 'ASIC: What sort of corporate regulator does Australia need?' forum, Sydney, 26 August 2015

aim is that this approach will ensure the levy payable by entities matches the cost of their regulation.

The consultation paper proposes 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 transparency and accountability.

We respond to these three matters below.

1 Ensure that costs are proportionately borne by those creating the need for regulation

Our members are of the view that the question of whether costs are proportionately borne by those creating the need for regulation through the proposed method of having the formula of payment driven by market capitalisation appears to be an arbitrary method that:

- ignores the broader impact of the public benefit to the whole community of the listed company. Companies employ staff, foster innovation and contribute to society at all levels
- takes a 'one-size-fits-all approach', ignoring the variances that occur in companies and does not distinguish between the business activities of individual schemes and any risk allocation in relation to those activities. Therefore, the levy proposal is not proportionately borne by those who need the most regulation
- does not take into account that higher market capitalisation companies are generally better resourced and cannot be assumed to demand frequent regulator attention, whereas often smaller cap companies are models that may be likely to take up more regulatory focus, time and attention. ASIC's supervisory activities may be lessened rather than intensified when companies that are better resourced have the capacity to put in place strong internal governance, risk and compliance programs that are assessed regularly, with training provided to employees to ensure compliance. Notwithstanding this, large, publicly listed companies will pay a larger annual levy.

Other issues of concern include that the consultation paper:

- makes no mention of phoenix activity, which does not occur in the listed market. Yet such activity requires significant allocation of supervisory resources on the part of ASIC. The proposed model does not factor in the inequity in a proposal based on market capitalisation in relation to regulatory attention required in the unlisted arena
- where an entity provides multiple regulated services and, accordingly, falls into more than one industry sector or sub-sector, that entity will pay the annual levy that applies to each category of services it provides. There are no discounts being proposed for entities that operate across multiple sectors. Nor is there any consideration of the benefits that may accrue from supervising an entity in its entirety, which could provide risk assessment of an 'ecosystem'
- reduces incentives for companies to manage their costs tightly
- states that larger entities generally pose a higher risk to the Australian economy. However, there is no relativity to risk. There appears to be no risk analysis attributable to particular types of companies. A user–pays system has the potential to increase improvements in risk culture, but the methodology in the consultation paper does not support this end

- may be a regressive and unfair way of taxing companies. In particular, given the $15 billion cap proposed, this will eventuate in the companies in the middle bracket paying a proportionately higher levy.

Overall, the proposed model is predicated on a ‘capacity-to-pay’ approach, which differs from the stated aim of costs being proportionately borne by those creating the need for regulatory supervision.

2 Establish price signals to drive economic efficiencies in the way resources are allocated in ASIC

Our members are of the view that the proposal that price signals will drive economic efficiencies in the way resources are allocated in ASIC is not an obvious outcome.

The paper also suggests that pricing signals would influence the behaviour of regulated entities such that they would be self-regulating, which would reduce the need for ASIC oversight. It is not clear how this would be achieved.

The price signals have the potential to:

- create an overtly business culture at ASIC
- create greater cost increases. Our members question the similarity to APRA as an industry-funded example and whether APRA’s costs have increased relative to ASIC’s over a 10-year period, and note no comparative information is provided in the consultation paper
- offer a disincentive for government to increase the pool of funds available to ASIC.

3 Improve transparency and accountability

Our members are of the view that there is no substantiation in the consultation paper that introducing the proposed industry-funding model for ASIC’s regulatory activities will improve transparency and accountability. Indeed, we point to the potential for an industry-funding model to:

- be less efficient in terms of risk blow-out over time
- create greater complexity through the management of the system. Proposed panels of industry representatives and committees will add to compliance issues and reporting, thereby creating more red tape and shifting further costs onto industry
- create less accountability for those that bear the costs.

On the matter of the proposed impact on competition and innovation, we question whether it is clear if this is possible, given the limited details provided in the consultation paper. We also note that government will have no financial incentive to restrain ASIC expenditure, which may result in further costs to industry. With an increasing need for Australia to attract foreign investment, it is challenging to see how the proposal as set out in the consultation paper will meet these future needs.

Further considerations

Tax deductibility

The consultation paper is silent on the matter of whether the levies and fees proposed under the model set out in the consultation paper will be tax deductible. Governance Institute is of the view that any industry-funding model needs to clarify that such levies and fees would be tax deductible, given they will constitute standard costs of business.

Applications for relief

Regulated entities can calculate, based on the proposed model, that there will a dramatic increase in the cost for novel applications for relief. Governance Institute has concerns that smaller companies are likely to be priced out of applying for relief on this basis. We note that roundtable discussion with ASIC clarified that this concern is likely to be misplaced, given that ASIC's research reveals that smaller companies do not apply for novel relief. Furthermore, in these discussions, ASIC provided significant detail concerning the additional work it undertakes to review novel applications for relief. However, none of this explanatory context is contained in the consultation paper. This relates to our earlier concern as to the lack of detail concerning the benefits that may accrue to an industry-funded model based on examples from other jurisdictions. Without such context, it is difficult to assess the proposed model, as respondents are not fully informed.

Service levels

Governance Institute is concerned that there could be a dissonance between ASIC's definition of service levels and the definition accorded to this term by market participants. The proposed model speaks to enhanced service levels, which for ASIC refers to the metrics provided in its annual report on performance against its service charter. These metrics include (but are not limited to):

- registering a company or business name — aim to complete company and business name registrations within one business day
- registering a company or business name — aim to complete applications for company registrations within two business days and business name registrations within seven business days
- updating company or business name information and status — for applications lodged online, enter critical information and status changes to company or business name registers within one business day; and for paper applications lodged by mail, enter critical information and status changes to company or business name registers within five business days
- lodge or search for company and business name information online — aim for 100 per cent availability to search for company and business name register information online between 8.30am and 7.00pm AEST Monday to Friday, excluding public holidays, and to lodge registration and registry information changes online between 8.30am and 7.00pm AEST Monday to Friday, excluding public holidays
- customer enquiries — answer telephone enquiries on the spot; reply to enquiries sent to asic.gov.au/question within three business days.

While these registry processes are important, regulated entities have a different conception of service level. Contact with ASIC frequently involves more complicated scenarios than those set out above. When an industry-funded model is contemplated, a timely response to more complicated scenarios is key to the levies and fees being seen to drive economic efficiencies within ASIC for the benefit of the market overall and improvements in transparency and accountability. Yet the consultation paper is silent on how such service levels may be enhanced.

Alternative industry-funding model

As mentioned earlier, the consultation paper contains no reference to alternative models of industry funding, such as small charges attached to each transaction with the regulator, that does not differentiate as to size or legal structure of entity. For example, one option is that every transaction attracts a charge as little as 10 cents or 20 cents.

Governance Institute is not recommending such a model, but pointing to the lack of alternatives for consideration so that market participants can assess whether the proposed model is the most efficacious one. We are of the view that Treasury needs to explain why no alternatives have been proposed.

Any alternative model would, of course, require oversight by Treasury and would need to be regularly reviewed.

Separate recommendations

In addition, Governance Institute recommends that the following issues also be taken into consideration in the development of a proposal for an industry funding model:

- particular regard should be given to ACNC-regulated companies that are also companies limited by guarantee which sees them subject to regulation by ASIC in certain areas, with the emphasis on their requirements not being overly onerous
- a requirement of a certain level of service (in the form of service level agreements) should be expected from the industry-funding model in terms of timely responses and turnarounds, even on complicated matters and
- that the date of the determination of the market capitalisation should not be the same date as the ASX determination date, so as not to place an onerous burden on companies in the payment of fees.

Recommendation

Governance Institute strongly supports ASIC being properly funded to meet its responsibilities. However, our members think that the proposed model as set out in the consultation paper lacks detail; provides no evidence of the benefits that are deemed to accrue from the model; does not offer evidence or examples of whether the model in other jurisdictions has improved market integrity; contains flaws in explaining the mechanics of how the levy system will actually work; and offers no alternative models, including explanations as to why they may have been discarded or if they have been considered.

While we support an industry-funding model in principle, Governance Institute is of the view that further consultation is required, with the detail provided on the areas we have highlighted above so that an informed decision can be taken.

Governance Institute recommends that:

- the consultation paper be seen as the first stage in a consultation process
- Treasury proceed to develop and issue a discussion paper, which:
    - provides evidence of the benefits that are deemed to accrue from the model
    - offers evidence or examples of whether the model in other jurisdictions has improved market integrity
    - provides alternative models, including explanations as to why they may have been discarded or if they have been considered
    - sets out in more detail why the proposed model is seen to be the most efficacious for the Australian market.

Yours sincerely

Steven Burrell
Chief Executive