



Narrow Road Capital – ASIC Funding Submission

Abuser Pays Not User Pays

The consultation paper on industry funding for ASIC is fundamentally flawed in one crucial aspect. It argues for a “user pays” system. The authors have failed to distinguish between a situation (for instance a toll road), where users have alternative options (e.g. take public transport or another route) and a compulsory regulatory system where industry participants are compelled to “use” ASIC. The obvious alternative is an “abuser pays” system, where those who act improperly in the financial services sector pay for the cost of regulation for all participants.

Background to the need for regulation

The majority of financial services providers are honest practitioners. However, a minority are dishonest and seek to enrich themselves with little or no regard for client outcomes. The impact of these “bad actors” is disproportionate with a recent survey from Roy Morgan finding that only 24% of Australians give financial planners high or very high ratings for ethics and honesty. The scandals at Macquarie and CBA financial planning groups, following on from Storm Financial, are major contributors to these appalling results.

As a result of bad actors, governments over many decades have rightly introduced regulation of financial services. Most participants do not need regulation to operate honestly, they understand that trust and a good reputation are essential for long term business survival. Bad actors focus on short term gains, which often involves conflicted advice. They choose to sell lower quality products or services (which generate higher revenues for themselves) rather than those that best suit their clients. If there were no bad actors there would be no need for regulation.

An abuser pays system is fairer and incentivises good behaviour

The introduction of an abuser pays system pushes the cost of industry regulation onto those that create the need for regulation. It removes some of the direct cost burden of compliance activities from honest businesses. In doing this, it incentivises good behaviour and punishes bad behaviour. It is not sufficient for bad actors to be required to pay back wrongful gains and compensate those hurt. There must also be a punitive element to send a clear signal to all market participants that such misconduct will not be profitable or tolerated in any way.

An example of how an abuser pays system would work

In recent years the widespread misconduct at Macquarie and CBA financial planning groups has been exposed. Evidence has been presented that documents were forged, clients were lied to, investments were made without consent or regard for their suitability, whistle blowers were ignored and efforts were made to cover up the wrong doing. As a result, many clients lost a substantial portion of their life savings and are having to go through extended legal processes just to receive basic compensation. As yet, no criminal charges have been laid or fines issued.

Given the severity of the misconduct, enforceable undertakings that include fines of 10% of annual profit for Macquarie and CBA should be considered the minimum appropriate response. This would raise approximately \$1 billion which is sufficient to cover expected costs for financial services regulatory activities for four years. Should misconduct be found to have occurred in the bank bill swap rates market fines of a similar scale should apply. This would bring Australia into line with the US and UK, where fines of this order are regularly issued for misconduct.

End of Submission

Written by Jonathan Rochford for Narrow Road Capital. Narrow Road Capital appreciates the opportunity to make a submission, feedback is welcome and can be sent to info@narrowroadcapital.com