4 November 2022

Senior Adviser
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: ASICIFMReview@treasury.gov.au

Dear Sir/Madam

ASIC Industry Funding Model Review

The Australian Financial Markets Association (AFMA) welcomes the opportunity to make comments on the Government's review of the ASIC Industry Funding Model (IFM) (the Review).

Our submission responds to the questions raised in the review in the section immediately following this letter. We support the Review's summary of stakeholder feedback in Appendix B of the consultation paper.

We caution that the overriding principle that should be applied to industry funding is that it should produce overall results that are in the national interest. We have previously seen examples in the ASIC IFM where the pursuit of a fictitious perfection of recovery almost prevented market competition in Australia being established.

Similarly, at one time, an economic purist approach to charging for market messages, which while they do create some work for ASIC, caused significant damage to some already illiquid markets as their discouragement of quoting prices damaged price formation.

Ex-ante charging

We suggest that the lessons should be learnt from these episodes. In particular, the Review's dismissal of a move to an ex-ante model warrants immediate reconsideration.

A pursuit of the spurious accuracy of the ex-post charging arrangements is being prioritised over the damaging outcomes to the business environment (and thereby national interest) where firms are again unable to pass through charges in a predictable and timely manner. The fact that it is difficult for ASIC to calculate its costs in advance is an orthogonal issue if the Review looks at the issue from a national interest perspective.

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Under an ex-ante model while the false precision of the ex-post ASIC cost allocations would not be achieved, industry would still contribute a roughly appropriate amount, that over time would even out. This is all that cost recovery should ever seek to accomplish, and it can be done without undue damage to the business environment.

General comments

Following our response to the questions, in support of the Government's interest in efficient outcomes, while technically outside of the Terms of Reference of the Review, we provide some thoughts and discussion on some approaches that might be considered by Treasury more generally to ensure the Government and the regulated population is maximising the value and minimising any unnecessary costs in relation to ASIC.

Conclusion

We note again our support for the Review, which commenced 10 years after the enabling legislation passed Parliament in 2011. While we would have preferred wider Terms of Reference, in our view the Review has picked up substantial and important issues with the IFM arrangements and it is proving to be a constructive and worthwhile exercise.

While Treasury may be understandably keen for some time to pass before undertaking the endeavour again, we would suggest that it is a worthwhile periodic exercise on a medium-term time horizon (say five years).

Yours sincerely

Damian Jeffree

Senior Director of Policy

Section 1. Response to Review Questions

1. Appendix D provides a catalogue of sub sector definitions, metrics and formulas. If the status quo remains (that is, there are no substantial changes to the IFM framework), are any changes required to ensure the existing industry sub-sectors, levy formulas and entity metrics remain fit for purpose in the longer-term and/or can respond to changes within industry sub sectors?	In a cost recovery model, there is a balance to be struck between equity and simplicity. Certain subsector metrics in Treasury's model for ASIC are too simplified such that the allocation of costs is not reflective of where ASIC's regulatory effort is directed. Now that the IFM has been in operation for 5 years, we suggest validation is appropriate on ASIC's end. Our question would be does ASIC's data indicate that the levies being charged are proportionate to the time spent regulating/supervising each entity? For example, using the existing message and transactions metrics, some larger participants are paying a disproportionate amount of the Large Securities Exchange Participants subsector costs while ASIC's resources are often directed to smaller firms who have less robust compliance arrangements and governance frameworks. To have a fairer allocation, we propose the following changes for the two participant subsectors: • Increasing the fixed levy to cover ASIC's costs such as industry engagement, education, guidance, advice, IT support etc. as the whole industry benefits from these activities regardless of size. • Apply a graduated levy based on Surveillance, Supervision and Enforcement categories only, to take into account the relative sizes of each participant.

	As OTC data has improved since the start of the IFM regime e.g. OTC transaction reporting requirements, transaction-based metrics should be implemented for: **Retail OTCD Issuers** – this subsector's definition should incorporate an activity-based element, rather than only be based on having licence authorisations to issue and make markets in derivatives. The cost has increased significantly since the start of the IFM regime as ASIC has focused on poor outcomes for retail consumers e.g. in relation to CFDs, binary options etc, however it is firms who do not operate in the retail OTC industry whatsoever who are being levied for their work. **OTC traders definition** – The FTE metric is outdated and ASIC's expectations on how to apply it are unclear (e.g. advice in a 2018 Market Integrity Update article conflicts with that given by ASIC to AFMA in July this year). Treasury may wish to consider whether the definition of this subsector should be tied to the corporate advisors subsector. Levies should be shared by firms if they utilise ASIC's supervisory resources regardless of linkages to investment banks.
2. Do stakeholders understand ASIC's methodology for allocating costs of activities that impact multiple sub sectors? Is the current level of transparency relating to this approach appropriate?	

3. Is it more important to have a simpler model that can be more readily understood by entities and administered by ASIC which may result in increased cross-subsidisation, or a more equitable model (similar to the status quo) that closely links the recovery of costs to the groups of entities causing the need for those costs?	AFMA supports a more equitable model (similar to status quo) over a simpler model with increased cross-subsidisation.
4. Is cross-subsidising costs for entities within a sub sector or sector more appropriate than cross-subsidising costs across all of ASIC's regulated population? If so, why?	Cross subsidisation should in general be limited or avoided. It is less inappropriate (although still undesirable) when only within a sector or subsector.
5. Are there other opportunities to simplify the design, structure and legislative framework for levies? If so, what opportunities and what benefits would they provide?	The present design makes it difficult to map the costs incurred by ASIC on to final products and services being provided in a way that ensures that prices to consumers accurately reflect these costs. The ASIC cost recovery arrangements are levied on suppliers rather than consumers based on proxy measures of regulatory intensity, such as the size of the regulated entity's earnings, assets headcounts and transactions. These proxy measures do not necessarily accurately reflect regulatory risks and costs and may instead be based more on administrative convenience or perceived capacity to pay. It is usually thought to be efficient to levy suppliers on the basis that they will pass the cost burden on to consumers in the form of higher prices. Cost recovery arrangements typically assume some pass through of costs from suppliers to consumers. However, this pass through is difficult to

	achieve for brokers because of the ex-post charging model. To the extent that the cost burden does not fall on the beneficiaries of regulation then resource allocation is not necessarily improved.
6. Does the design, structure and legislative framework of the levy component of the IFM have sufficient flexibility to respond to changes in markets, sectors and products ASIC has oversight of? If not, what aspects require more flexibility and what changes could be made?	We believe that the government process for establishing and reviewing recoverable costs should fit within a coordinated economic policy framework that takes into account the economy-wide impact of multiple revenue charges across the financial services sector. That said, we believe it is sufficiently flexible.
7. How can costs associated with enforcement activity be recovered most equitably? What changes could be made to the current approach, and what benefits would they provide?	Enforcement activity costs are driven by those that break the law. Those that do not break the law are not driving enforcement costs. While it may not be possible or desirable for good policy reasons to levy all these costs on those that break laws, the public good nature of enforcement would support some or all of the fine income received from these parties supporting enforcement.
8. Are there opportunities to improve the transparency and reporting of enforcement costs? If so, what changes could be made and what benefits would they provide?	o Greater transparency is sought on ASIC's methodology for how the costs of activities are used to calculate and determine the estimated and final levy metric rates. o Greater transparency is sought on what the drivers in the movements are between the final and estimated metric rates as well as the prior period metric rates for each sub-sector.

9. Is the approach of attributing costs of illegal unlicensed conduct to the most 'relevant' sub sector the most appropriate recovery method? Alternatively, how should these costs be recovered, and why?	The cost of enforcing the law in respect of unlicensed activities is part of the general overhead for the running of ASIC and should be allocated as a general administration cost across the levies or absorbed by the government. Charging a 'relevant' sub-sector goes against the principle that those who create the need for regulation should pay for the regulation. Clearly regulated entities are not responsible for the activities of unlicensed persons and the effort of the regulator in this regard is a public good.
10. Are there alternative ways to recover the costs of ASIC's activity relating to emerging sectors and legal unlicensed conduct from current industry sub sectors, and why?	Same answer as above – The cost of enforcing the law in respect of unlicensed activities is part of the general overhead for the running of ASIC and should be allocated as a general administration cost across the levies.
11. How can costs associated with capital expenditure be recovered most equitably and transparently? What changes could be made to the current approach, and what benefits would they provide?	Costs associated with capital expenditure should be part of the general overhead for the running of ASIC which should be allocated as a general administration cost across the levies generally. AFMA believes the capex should be recovered across the life of the asset, rather than in year 1.
12. How can costs associated with education and policy advice be recovered most equitably and transparently? What changes could be made to the current approach, and what benefits would they provide?	Costs associated with education and policy advice should be considered part of the general overhead for the running of ASIC which should be allocated as a general administration cost across the levies generally.

13. What changes could be made to the reporting of indirect costs to improve stakeholder understanding of these costs?	
14. Do regulated entities find estimated levies useful, and how is this information used by entities? 14.1. Noting the trade-off between timing and accuracy, when is it most beneficial for entities to receive estimated levy amounts? 14.2. Would alternative information, such as a range for estimated levies, be more useful?	AFMA supports moving to an ex-ante charging regime. This will avoid the unnecessary variances associated with the difficult challenge of estimating these charges in advance. o AFMA supports the ongoing provision of the CRIS, and we find it useful. However, further clarity is required in the CRIS to state whether there have been any changes to the metric definitions for each sub-sector from the prior period. o Publishing the metric definitions at the same time as the CRIS or stating in the CRIS whether there are changes to the metric definitions will create greater efficiencies in the Levy return preparation process as well as providing entities with a timely view of the financial impacts of the levy on its P&L and cash flow. o It would be beneficial if a more accurate estimate of the levies is received at a later date, provided entities are still allowed the current length of time allowed between receiving the estimated levies and metric requirements and the return lodgement due date. o The current form of the estimated levies is preferred, a range of the estimated levies would not be more useful.

15. Is it more important to have less volatile/more stable levy amounts year-on-year, or more granular and equitable apportionment of costs each year?	While still not desirable, AFMA would argue that the volatility in charging will be less of an issue for participants if this volatility occurs in an ex-ante model. The ex-ante model will enable timely pass-through of the ASIC charges. At present the volatility is a particular issue as it comes long after the activity has occurred and in many cases as a result is absorbed by the participant.
16. Are there other ways to manage or reduce volatility in levy amounts year-on-year, including other approaches to spreading costs? If so, why, and what benefits would it provide?	
Fees-for-service	
17. In relation to the design, structure and legislative framework for fees-for-service: 17.1. Are any changes required to ensure it remains fit for purpose in the longer-term and/or can respond to changes in industry? 17.2. Are there opportunities to simplify the design, structure, and legislative framework for fees-for-service?	

18. Are there any costs currently recovered through fees-for-service that would be more appropriate to recover through industry levies? If so, why?	AFMA views preparing exemptions and legislative instruments as better recovered through industry levies. These are often required to address less than ideal outcomes in ASIC regulations. Charging individual firms that are adversely affected by non-ideal regulations, particularly where these changes are often of wider industry benefit would appear to create an undesirable and unnecessary barrier to improving the regulatory settings.
19. If fee amounts are to be changed, should this be amended via a one-off increase or staged to spread the impact over multiple years?	
20. Is it appropriate for ASIC to have the power to determine which of its regulatory activities/services it can charge a fee for?	
21. Is it appropriate for ASIC to have the power to set fee amounts, or should this power remain with the Government? 21.1. If ASIC were provided the power to set fee amounts, should there be any limitations on what fees it can adjust, or by how much? For example, setting caps on specific fees in primary law or regulations, or setting principles to guide ASIC's setting of fee amounts?	To manage conflicts in a more appropriate governance framework this power should remain with Government.
22. What transparency and accountability mechanisms would be appropriate if ASIC were setting fee amounts?	AFMA does not support ASIC setting fee amounts in isolation.

23. Do fees for licence and registration cancellations provide a disincentive to cancel licenses and registrations? If so, would a lower fee or no fee remove this disincentive?	
24. Would it be more appropriate for the costs associated with licence and registration cancellations to be recovered through industry levies (noting that there are wider benefits to ensuring entities and individuals that are no longer undertaking a particular licensed activity do not continue to hold a licence for that activity)?	
25. Is it appropriate for ASIC's work on individual relief applications to be recovered via fees, with the costs associated with ASIC's work on relief provided to a class of entities to be recovered through industry levies?	
Reporting, transparency and consultation	
26. How do regulated entities and other stakeholders engage with ASIC's transparency and consultation mechanisms relating to the IFM? What aspects are most useful? 26.1. What do stakeholders seek from mechanisms to engage with the IFM? Is it more important for these mechanisms to provide transparency, or to allow for stakeholder consultation and feedback?	AFMA has engaged with these processes and from time to time important changes have been made. However, generally these are not particularly responsive processes. These processes should be run by an independent or neutral third party. We have found the Treasury IFM Review helpful in this regard. We suggest that the issues the Treasury IFM Review are considering might have been

	already addressed had the annual ASIC processes been run by an independent party.
27. Are the existing transparency and consultation mechanisms in relation to the IFM appropriate? 27.1. Would changes to existing mechanisms or alternative mechanisms be beneficial? If so, what changes could be adopted and what benefits would they provide?	We think these could be improved to be more independent and responsive. The benefits would include greater responsiveness and avoidance of conflicts, and potentially a clearer focus on outcomes that are in the national interest.
28. How is the CRIS used by regulated entities and other stakeholders, and do stakeholders find the information in the CRIS useful? 28.1. Could improvements be made to the CRIS, including the form/format and nature of information provided? If so, what improvements and what benefits would they provide? 28.2. At what time is it most beneficial for the CRIS to be published?	The options on page 38 (summarised below) are sensible and would enhance licensees' understanding of costs/variances/regulatory effort: 1. Reframe the purpose of the CRIS to focus more on transparency 2. Introduce other consultation mechanisms 3. Publish the CRIS at a consistent time each year 4. Publish information and material variances earlier in the year Further to 1. above, the CRIS would benefit from containing more detail on how ASIC's costs were incurred especially for general categories such as policy, education and guidance – what projects were undertaken in a year to give rise to those costs? This would give licensees greater visibility of the benefits from ASIC's work. We suggest that given industry funding is in place industry should be empowered by standing processes to play a greater role in bringing

	challenge to ASIC expenditures. We expect that some services could be done more efficiently and costs reduced. Industry should be granted a seat at the funding table to bring its knowledge of risk and optimizing risk management to bear.
29. Noting that changes to the IFM are for the most part decisions for the Government, is annual consultation by ASIC via the CRIS useful? Would less frequent but more substantive consultation be preferable?	AFMA would support less frequent but more substantive consultations. Minor refinements can be addressed with less formal (and less expensive) processes.
30. Are changes required to the criteria determining material variance? If so, what should be changed – the percentage and/or dollar value amount, or be based on the number of entities impacted? 30.1. When should information regarding material variations be published? 31. What other information would be useful to regulated entities or other stakeholders to understand how ASIC sets its regulatory priorities and/or to understand the relationship between ASIC's costs and the amounts recovered from industry? What benefits would additional information provide?	There is the potential for industry to provide some services provided by ASIC at lower cost, and in a way that is more consistent with international practice. We suggest that these services be moved out into industry where possible in order to lower the costs that need to be recovered from industry.

Section 2. General comments

1. Issues with Cost Recovery Arrangements

Proxy measures create inherent inaccuracy in cost recovery calculations

In practice, it is difficult to map the costs incurred by regulators on to final goods and services in a way that ensures that prices to consumers accurately reflect these costs. Cost recovery arrangements are typically levied on suppliers, rather than consumers, based on proxy measures of regulatory intensity such as the size of the regulated entity's earnings or assets. These proxy measures do not necessarily accurately reflect regulatory risks and costs and may instead be based more on administrative convenience or perceived capacity to pay.

Levied costs are often not fully passed on to the relevant end users

It is usually thought to be efficient to levy suppliers on the basis that they will pass the cost burden on to consumers in the form of higher prices. However, this pass through may only be partial depending on the relative price sensitivity of supply and demand. If consumers are more price sensitive than suppliers, then more of the cost burden will fall on suppliers. To the extent that the cost burden does not fall on the beneficiaries of regulation, then resource allocation is not necessarily improved. Because the statutory or notional burden of cost recovery may differ from the actual economic burden after pass through, there is often a lack of transparency about the burden of cost recovery. This may result in 'fiscal illusion,' whereby the true economic burden of regulation is under-estimated by both suppliers and consumers, resulting in an over-supply of regulation.

Where cost recovery resembles a financial transaction tax it is inherently inefficient

Cost recovery is inefficient when it acts as a tax on the regulated activity (e.g. financial transactions) rather than a correction for under-pricing of regulator costs. In this case, cost recovery resembles a financial transaction tax and may lead to an under-allocation rather than an over-allocation of resources to that activity, which can be just as inefficient. This would seem to be a significant risk in Australia to the extent that cost recovery arrangements do not map well on to the regulated activity, and the proxy measures used to apply cost recovery are based on transactions or assets rather than measures of regulatory risk or intensity.

Beneficiary pays principle is difficult in practice

Cost recovery is also motivated by the 'beneficiary pays' principle. Those who benefit most from regulation should bear its cost for reasons of both economic efficiency and equity. However, identifying the direct beneficiaries of regulation is not always straightforward. This in turn makes it difficult to devise cost recovery arrangements that effectively levy the beneficiary.

Where there is a benefit that accrues to society as a whole rather than individual consumers, there is a strong efficiency and equity case for funding the regulator out of general tax revenue to ensure costs are borne by all the beneficiaries of regulation.

In the case of financial institutions and financial services, ASIC regulation exists mainly to protect consumers in their roles as buyers of financial products and services.

More efficient tax sources are already available

Taxpayer funding has the benefit of not imposing additional compliance and collection burdens over and above those already built into the tax system. Some existing tax bases are far more efficient than the cost recovery sources which tend to be inefficient in terms of both their impact on their activity and their costs of collection.

A holistic approach to cost recovery design is preferred

Instead of a piecemeal activity-by-activity approach to new cost recovery measures they should be developed by financial experts with appropriate modelling and quantitative skills to correctly measure inputs, outputs and costs and to provide an assessment of their impact on productivity.

2. Cost Recovery and Regulator Incentives

It is important that cost recovery arrangements are designed to ensure that regulators are given appropriate incentives to minimise costs. It is widely accepted that cost recovery should be based only on 'efficient' costs.

As Maddock et al [1]have noted:

> Some regulators have proposed that their regulatory activities should be funded by a levy on the parties being regulated, by licence fees or similar industry charges. This should be resisted. It reduces the degree of budgetary scrutiny on the agency and undermines a key lever for regulatory accountability. Rather than having to fight for an allocation in the budget process, justifying spending to an expenditure review committee, a regulator funded by an industry levy is taxing the parties that it is regulating.

The Financial Regulator Assessment Authority could encompass as an addition to existing accountability mechanisms, helping to ensure cost recovery reflects efficient costs.

In AFMA's experience, governments over the years have provided much greater scrutiny to measures that may affect tax revenue flows than it does to measures that may have a financial impact on other parties.

We suggest that industry be given more information around ASIC costs (for which it will be charged) and a structured opportunity for input to assist in finding efficiencies. This is appropriate generally given the value of the expertise industry can bring, but also particularly where industry must bear the costs it is appropriate they be given the chance to help minimise these costs.

3. Canadian Model

Canada provides a useful model for a rigorous and systematic approach to cost recovery. Canada's cost recovery framework is enshrined in legislation, the User Fees Act 2004, rather than taking the form of guidelines as in Australia.

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[1] Rodney Maddock, Joe Dimasi and Stephen King, 'Rationalising rustic regulators: How should Australia's national economic regulators be reorganised?' Monash Policy Forum, 11 July 2014. p. 19-20

Under the Act, fees must be accompanied by measurable and relevant service standards, developed in consultation with paying and non-paying stakeholders and reported to Parliament each year, together with a summary of stakeholder feedback from consultation.

Canada makes use of a rigorous four stage process that precedes the imposition of cost recovery arrangements.

- Phase 1: An iterative process under which the Department proposing a fee presents its rationale and analysis (covering elements referenced in the User Fees Act) to clients, who provide feedback, including in relation to recommendations for service improvement. Documentation should include pricing factor analysis and any methodologies that lead to the proposed fee level. This analysis is expected to include an assessment of the mix of public and private benefit.
- Phase 2: The Department publicises the fee proposal in the light of the consultation proceedings from Phase 1. An independent panel review may be established to review any client complaints, and its recommendations are considered by the Department.
- Phase 3: The Minister tables the fee proposal in both Houses of Parliament, for approval or amendment. The proposal must be presented in line with a template that, among other aspects, requires:
    - explanation of the cost elements of the fee;
    - comparisons with other countries;
    - a summary of the findings of the impact analysis of the fee;
    - explanation of the communication strategy and how complaints have been addressed;
    - explanation of the performance standards against which performance of the regulating authority can be measured, and whether these standards are comparable with those in relevant countries; and
    - presentation of ideas or proposals received from clients about how to improve the service to which the fee relates and the departmental response to those ideas.

If a regulator's performance does not meet the standards for that fiscal year by a percentage greater than 10%, the user fee is reduced by a percentage equivalent to the unachieved performance, to a maximum of 50% of the user fee, until the day on which the next yearly report is tabled in Parliament (User Fees Act 2004, s 5.1).

This process creates incentives designed to avoid the ad hoc imposition of cost recovery arrangements that do not pay adequate regard to their broader context and consequences.