

Analysis of the Bill

Overview

- 1.1 The Government introduced the Bill into the House of Representatives on 18 August 2011. On 24 August 2011 the Selection Committee referred the Corporations (Fees) Amendment Bill 2011 to the committee for inquiry and report.
- 1.2 The Corporations (Fees) Amendment Bill 2011 is a very simple piece of legislation that allows ASIC to charge market participants (such as stockbrokers) fees to support its supervision of these markets.
- 1.3 The real issues in the inquiry are rather the fees that ASIC will then charge under regulations. This is currently the subject of Treasury consultation. Treasury has issued a comprehensive consultation paper, which will serve as an appropriate basis for designing the fee structure. Industry raised legitimate concerns about proposals in the consultation paper. The committee anticipates that Treasury will respond to these concerns, either through further explaining its position or by making appropriate changes.
- 1.4 The committee supports the Bill and its detailed reasons are outlined below.

Background

- 1.5 The Bill amends the *Corporations (Fees) Act 2001*. The Act imposes fees for administrative and regulatory tasks conducted by the Australian

Securities and Investments Commission (ASIC) and other matters under the *Corporations Act 2001*.

- 1.6 The amendments allow ASIC to charge market participants (such as stockbrokers and derivatives traders) for its market supervision functions. Supervising a financial market involves tasks such as:
- monitoring the conduct of participants;
 - monitoring real time trading for signs of breaches of the *Corporations Act 2001*, such as insider trading;
 - handling commercial conflicts of interest; and
 - enforcing compliance with the market's operating rules, which of itself includes:
 - ⇒ what to do if there is an error in a trading message;
 - ⇒ participant record keeping; and
 - ⇒ market manipulation.¹
- 1.7 Under the *Corporations (Fees) Act 2001* currently, ASIC can only charge market operators for this purpose. The main market operator is the Australian Securities Exchange (ASX), although Chi-X Australia is expected to commence trading in competition with the ASX in relation to cash equities at the end of 2011.
- 1.8 In the second reading speech for the Bill, the Assistant Treasurer and Minister for Financial Services and Superannuation gave two reasons why the Government is seeking to levy fees on market participants. Firstly, a 'significant portion' of ASIC's market supervision involves working with participants. Secondly, charging market participants is also consistent with the *Australian Government Cost Recovery Guidelines*.²
- 1.9 The Bill does not set out the fees that ASIC would charge market participants. These are expected to be included in the *Corporations (Fees) Regulations 2001*, which already include a large number of fee amounts. On 26 August 2011, Treasury released its consultation paper, *Proposed financial market supervision cost recovery model*. The closing date for submissions is 23 September 2011.

1 Treasury, *Reforms to the supervision of Australia's financial markets: Exposure draft and consultation paper*, December 2009, <http://www.treasury.gov.au/documents/1673/PDF/consultation_paper_20091201.pdf> viewed 7 September 2011.

2 The Hon. Mr Bill Shorten MP, Assistant Treasurer and Minister for Financial Services and Superannuation, *House of Representatives Hansard*, 18 August 2011, p. 8522.

- 1.10 The consultation paper contains considerable detail on how the Government envisages that cost recovery would work. For example:
- ASIC's regulatory costs on an annual basis commence at \$21.8 million for the second half of 2011-12 and decline to \$16.2 million in 2014-15, reflecting ASIC's higher IT and regulatory framework development costs at the start of the project;
 - in the cash equities market, 16 per cent will be recovered from operators and 84 per cent from participants;
 - among each group, information technology (IT) costs to be allocated by message count and non-IT costs to be allocated by trade count;
 - fees are calculated at the end of a quarter based on activity during that quarter, to ensure amounts are not over or under collected;
 - the ASX 24 futures market will pay \$2.3 million from January 2012 to June 2013 while further consultation is undertaken for this market; and
 - the Government intends to review the system after the first 18 months.³
- 1.11 The idea of charging financial firms for the costs of regulating them has been on the 'policy radar' for some time. It was raised in the inquiry into the financial system in 1997 (the Wallis report). The report stated:
- Recommendation 104: Regulatory agencies' charges should reflect their costs.*
- The regulatory agencies should collect from the financial entities which they regulate enough revenue to fund themselves, but not more. As far as practicable, the regulatory agencies should charge each financial entity for direct services provided, and levy sectors of industry to meet the general costs of their regulation.⁴
- 1.12 ASIC currently collects its operating costs mostly as fees on industry, which it returns to consolidated revenue. It then receives funding under the normal appropriations process. This is demonstrated in the Treasury Portfolio Budget Statements. The 2011 Budget estimates that ASIC will receive \$728.7 million in cash from fees under the *Corporations Act 2001* and charges and unclaimed moneys under the *Banking Act 1959* and the *Life Insurance Act 1995*. A similar sum will be returned to the Official

3 Treasury, *Reforms to the supervision of Australia's financial markets: Exposure draft and consultation paper*, December 2009, <http://www.treasury.gov.au/documents/1673/PDF/consultation_paper_20091201.pdf> viewed 7 September 2011.

4 Financial System Inquiry, *Final Report*, March 1997, p. 532, <<http://fsi.treasury.gov.au/content/FinalReport.asp>> viewed 15 September 2011.

Public Account. ASIC's annual expenses for 2011-12 are estimated to be \$391.4 million.⁵

Scope and conduct of the inquiry

- 1.13 The objective of the inquiry is to scrutinise the technical adequacy of the Bill and its ability to deliver the policy intent.
- 1.14 Details of the inquiry were placed on the committee's website. A media release announcing the inquiry and seeking submissions was issued on Tuesday 31 August 2011.
- 1.15 Three submissions were received which are listed at Appendix A.
- 1.16 A public hearing was held in Canberra on Monday 12 September 2011. A list of the witnesses who appeared at the hearing is available at Appendix B. The submissions and transcript of evidence were placed on the committee's website at <http://www.aph.gov.au/house/committee/economics/index.htm>.

Government policy to make Australia a financial centre

Background

- 1.17 The amendments have been presented in the general context of the Government's reforms to increase competition in financial markets for executing trades. Until 2010, the ASX had the dual roles of being the sole service provider in the Australian equity market as well as supervising the market. By international standards, this is unusual.⁶
- 1.18 In September 2008, the Government established the Australian Financial Centre Forum to progress the Government's program to position Australia as a leading financial services centre in the region. The Forum reported in November 2009.

5 The Hon. Mr Wayne Swan MP, Deputy Prime Minister and Treasurer, *Portfolio Budget Statements 2011-12, Budget Related Paper No. 1.18, Treasury Portfolio*, pp. 149-80, <<http://www.treasury.gov.au/contentitem.asp?NavId=035&ContentID=2027>> viewed 16 September 2011.

6 Australian Financial Centre Forum, *Australia as a Financial Centre: Building on our Strengths*, November 2009, p. 92.

- 1.19 The Forum supported the Government's announcement in August 2009 to change regulatory arrangements so that ASIC would supervise the equity market. This would then facilitate the entry of other stock exchanges. The Forum stated:

The Forum's general position with respect to exchange traded products – as with all other aspects of the financial markets – is that openness to new entrants is an essential condition for competition, efficiency and innovation. Evidence from other countries where traditional exchanges are now competing with new trading platforms suggests that competition has resulted in innovation and generally lower transaction costs.

The Forum thus strongly supports the Government's announcement and the introduction of competition between market operators.⁷

- 1.20 ASIC took over responsibility for market supervision from the ASX on 1 August 2010. When asked whether this transfer was working well, the Executive General Manager of Regulatory and Public Policy at the ASX responded, 'I believe it is'.⁸
- 1.21 Introducing competition between exchanges introduces extra complexity. In particular, activity on one exchange, even if it has a large share of the market, will not give a regulator sufficient information with which to judge compliance standards. Treasury elaborated on this in evidence:
- Currently [ASIC] only supervises one market. It is much more complex to marry together two markets to have whole-of-market oversight. I can market-abuse on ASX equity futures on a Chi-X instrument or vice versa. I can use Chi-X to market-abuse on an ASX instrument. Only ASIC will have the whole-of-market perspective to spot those for the flags to go off. That all costs money, and volumes are going through the roof because IT is getting cheaper for the participants and the high-frequency traders are coming in.⁹
- 1.22 The committee supports the Government's goal in increasing Australia's financial profile and acknowledges that the transfer of market supervision to ASIC is a condition for this.

7 Australian Financial Centre Forum, *Australia as a Financial Centre: Building on our Strengths*, November 2009, pp. 92-93.

8 Mr Malcolm Starr, *Committee Hansard*, Canberra, 12 September 2011, p. 13.

9 Mr Laurence White, *Committee Hansard*, Canberra, 12 September 2011, p. 9.

- 1.23 This policy development is soon to bear fruit. Treasury stated that the Government had granted licence to Chi-X Australia to provide operator services. It is expected to commence operating in the fourth quarter this year, subject to its preparedness and it satisfying final conditions for ASIC.¹⁰ Chi-X Australia stated that it is ultimately owned by Nomura International, a Japanese listed financial institution.¹¹ Chi-X also operates in Canada and Europe.

The effects of competition

- 1.24 Increased competition in a market theoretically has positive results through lower prices and improved products and services. For example, the Australian Shareholders Association gave in-principle support to competition at the exchange level.¹²

- 1.25 However, the benefits of competition may not always eventuate in practice or may take time to eventuate. RBS Morgans made this claim in evidence by arguing that Chi-X Australia's market scope will be too narrow to make a difference to those with the least market power:

Yes, the larger companies will benefit from that – the ASX 100 where the liquidity is. As I said in my opening statement, over 70 per cent of the companies listed – who are all domestic, who employ lots of Australians – all only have retail investors investing in them. They have the wide bid-ask spreads. They are not the ones that are going to benefit from the competition that is being introduced. They will continue to have the wide bid-ask spreads and all the rest of it. It is those companies that you would like competition to improve the benefit of it and you are not going to see that.¹³

- 1.26 While this may certainly be true in the short run, the committee is of the view that a much wider range of outcomes are possible in the long run as Chi-X becomes more established and with the potential for other operators enter the market. The Australian Financial Markets Association was also of this opinion:

The debate and the discussions that we have heard from Chi-X have been that the market is starting at the bigger of the ASX 200 stocks and initial stocks, which are the most liquid ones at the

10 Mr James Chisholm, *Committee Hansard*, Canberra, 12 September 2011, pp. 1-2.

11 Mr Michael Somes, *Committee Hansard*, Canberra, 12 September 2011, p. 15.

12 Mr Vas Kalesnikoff, *Committee Hansard*, Canberra, 12 September 2011, p. 33.

13 Mrs Sophia Mitchell, *Committee Hansard*, Canberra, 12 September 2011, p. 24.

moment. That is certainly true. The idea is that over time, as the system becomes more embedded, as there is more infrastructure developed and as other entrants come in, that will work through its way. There is an overall hope that by having more market operators there you might actually find some more liquidity in those less liquid stocks further down the smaller stocks. That is a part of the desire and the long-term objectives of competition.¹⁴

1.27 Therefore, the committee concludes that the right approach is to facilitate market entry and to then see what develops over time. It is difficult to predict the precise results of increased competition for firms, but increased competition is almost always for consumers' benefit.

1.28 The committee also notes that the mere threat of entry of a competitor has caused the ASX to improve its performance, both in terms of price and service. In its latest annual report, the ASX states:

ASX has been preparing for the reality of domestic competition and a more complex environment for market services for several years. According to the Australian Securities and Investments Commission's (ASIC) timetable, new entrants could be operating by November this year. We'll be ready.

ASX has, for example, upgraded to new trading platforms, reduced headline transaction fees for equity market customers and introduced new functionality that has reduced market impact costs, enlarged trading capacity and dramatically quickened execution speed. In readiness for multiple market operators, ASX has also developed a trade acceptance service that will clear and settle trades executed on other trading venues in an identical manner to trades executed on ASX's own equity market.¹⁵

1.29 ASIC noted in evidence that the ASX has also made price reductions to the net effect of \$23 million in 2010-11 and \$21 million in this current year.¹⁶

1.30 Treasury argued that, in order to consolidate these benefits, it is necessary to continue with the legislation.¹⁷ The committee agrees with this comment. The threat of competition has already driven the ASX to reduce its prices and improve its services. These benefits are much more likely to be retained, and further benefits are likely, by proceeding with the Bill.

14 Mr David Love, *Committee Hansard*, Canberra, 12 September 2011, p. 29.

15 ASX Limited, *2011 Annual Report*, p. 3, <http://www.asxgroup.com.au/media/PDFs/ASX_Limited_Annual_Report_2011.pdf> viewed 15 September 2011.

16 Mr Mark Adams, *Committee Hansard*, Canberra, 12 September 2011, p. 9.

17 Mr Laurence White, *Committee Hansard*, Canberra, 12 September 2011, p. 9.

Quantum of regulation

1.31 The Bill itself is straightforward and applies a charge for a service that facilitates a commendable policy goal. From this perspective, the Bill is minor. However, the Australian Financial Markets Association suggested that the Bill is part of a continuum of regulatory changes in the finance industry that are developed in isolation without consideration of the total regulatory impact:

AFMA's principle concern with the bill is in the overall, ad hoc nature of the cost recovery process across the financial system and the cumulative effect that the multiplicity of new regulation is having on the efficiency of Australia's financial markets. New government regulation and charges that increase friction in conducting financial transactions affect how business views the competitive environment and the relative attractiveness of doing business in Australia compared to other jurisdictions. 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 service charges, which are growing in number.¹⁸

1.32 This is not a new problem. In 2006, the Taskforce on Reducing Regulatory Burdens on Business reported on the costs and drivers of regulation. It found that a 'silo' approach by agencies meant that businesses could be subject to a large number of regulations that were rarely considered in total by policy makers:

... each regulatory solution tends to be devised within individual government agencies. Within such policy 'silos', the cumulative impact of regulation across government is poorly understood and rarely taken into account.¹⁹

1.33 The scope of regulation of the finance industry is outside the scope of the inquiry. However, the committee notes that business stated a preference for a more coordinated approach to regulation.

18 Mr David Love, *Committee Hansard*, Canberra, 12 September 2011, p. 27.

19 Taskforce on Reducing Regulatory Burdens on Business, *Rethinking Regulation*, January 2006, p. ii, <http://www.regulationtaskforce.gov.au/__data/assets/pdf_file/0007/69721/regulationtaskforce.pdf> viewed 19 September 2011.

Should ASIC levy a fee on market participants?

1.34 The Stockbrokers Association of Australia argued that the benefits of a vibrant stock market benefitted the whole country, rather than just market participants. It therefore concluded that ASIC's market supervision activities should be funded through general revenue.²⁰

1.35 The committee accepts that the community receives a benefit from well-functioning markets, either as investors or as participants in the general economy. But as the ASX noted in evidence, it is clear that stockbrokers receive a greater benefit by being a select group of just under 100 firms that directly participate in these markets.²¹ The committee concludes that it is appropriate to levy stockbrokers a market supervision fee on the basis that they are receiving a substantial benefit from it.

1.36 Stockbrokers also raised concern that they would not be able to pass on the costs due to the current tight market. Any costs that they absorb would come directly off their bottom line. The Australian Financial Markets Association gave an overview of profitability in the industry:

It is a time when there is, as we have heard, intense competition – profitability is certainly likely to be down this year, and we are hearing that brokers are doing it tough ... there is considerable cost pressure on houses, and it is going to be very difficult to pass these costs through, so one can see that there is going to be another need for the firms to bear these costs in the near term. They will find it very hard to pass these through to the clients in the present environment.²²

1.37 The committee accepts that some parts of the finance industry are very competitive and that stockbrokers may not initially pass on the ASIC supervision fees. However, it is possible that firms may pass on the fees when the market is growing. The Australian Shareholders Association stated that 'Any increased costs would always be passed on'.²³ It also said that the industry is profitable over the long term:

Certainly when competition becomes tighter it is harder for some people to compete and therefore there is more pressure not to pass on the costs. I worked at Macquarie Bank for quite a while and spent quite a bit of time with the brokers downstairs and I never

20 Mr Peter Stepek, *Committee Hansard*, Canberra, 12 September 2011, p. 17.

21 Mr Malcolm Starr, *Committee Hansard*, Canberra, 12 September 2011, p. 13.

22 Mr David Love, *Committee Hansard*, Canberra, 12 September 2011, p. 29.

23 Mr Vas Kalesnikoff, *Committee Hansard*, Canberra, 12 September 2011, p. 31.

really felt much concern that anybody there was struggling because costs were not being passed on.²⁴

1.38 It appears to the committee that, while the industry may well have to absorb the fees in the short term, it could pass them on in the medium term.

1.39 The final and perhaps the most important reason for charging market participants relates to barriers to entry for market operators. If a market participant is operating in one exchange it can expect that some of the fees the operator pays to ASIC will be passed on to it. If the participant decides to transfer some of its business to a second exchange, it faces the risk of paying higher total fees because this second exchange will also be passing on some of the fees that it pays to ASIC. The option for the second exchange is not to pass on the fees at the expense of profitability. Treasury stated in evidence:

One of the disadvantages of charging fees to operators alone is that new participants would potentially be disincentivised from trading on an alternative venue. If we accept the proposition that we want to encourage competition between the trading venues, if you were charging fees solely to operators rather than basing it on the activity of the individual participants, there would be a disincentive and this would therefore potentially increase the barriers to entry for operators. That is one of the key pieces of information.²⁵

1.40 Chi-X Australia also gave evidence that imposing a fee on the operator and giving it discretion in how it passes on the fee can distort competition. This especially occurs when operators have different business lines and they can potentially cross-subsidise them. This has led to mandated pass-through in Canada:

... my understanding is that in Canada they have acknowledged the point that is being made about market operators and the inefficiencies of indirect fee imposition and to an extent it is acknowledged that while a category of fee may be imposed on an operator it is on the basis that it is passed through directly to participants so that there can be no competition or arbitrage in those areas.²⁶

24 Mr Vas Kalesnikoff, *Committee Hansard*, Canberra, 12 September 2011, p. 33.

25 Mr James Chisholm, *Committee Hansard*, Canberra, 12 September 2011, p. 3.

26 Mr Michael Somes, *Committee Hansard*, Canberra, 12 September 2011, p. 13.

- 1.41 The committee concludes that allowing ASIC to charge market participants is important in promoting competition among market operators and is a further reason to support the Bill.

Commencement date

- 1.42 The Bill is scheduled to commence on 1 January 2012. Industry provided evidence that this was very soon, given that the consultation paper was released at the end of August. The Australian Financial Markets Association stated, 'the details and the quantum have as quite a surprise to industry'.²⁷ RBS Morgans gave some of the detail about how they plan their operations and how the Bill has made this more difficult:

We need to give our branches and our clients full visibility and certainty around what they will be paying – that transparency. We even start the process of effectively setting our own budgets and forecasts at least six months before the beginning of the new financial year ... So if you are being levied or you are unable to accurately forecast and you know that it will change quarter by quarter, the variability could be quite high, given that they are looking at a straight pass through of asset like costs. I think that would make it very difficult to appropriately price those services, particularly around our business model. It is not only brokerage for clients but contract notes for our managed branches out there in the network and it becomes a very difficult, uncertain thing. Ideally, you would want to build in a lot of buffer but that is a very difficult thing for us to do when you are working in a very competitive environment.²⁸

- 1.43 The committee accepts that stockbrokers face uncertainty about the fees. However, this needs to be kept in perspective. In the first instance, the committee expects that brokers have a reasonable idea of what their fees will be. The Australian Financial Markets Association acknowledged that firms were working with estimates and CommSec stated that their fees would be approximately \$1.3 million annually.²⁹ Further, the proposed system will bed down over time and firms will be able to more closely estimate their fees as they develop experience with how the system works.

27 Mr David Love, *Committee Hansard*, Canberra, 12 September 2011, p. 28.

28 Mr Jeffrey Oates, *Committee Hansard*, Canberra, 12 September 2011, p. 21.

29 Mr David Love, *Committee Hansard*, Canberra, 12 September 2011, p. 28; Mr Sheridan Thompson, *Committee Hansard*, Canberra, 12 September 2011, p. 22.

- 1.44 The committee acknowledges that stockbrokers face increased risk from the Bill and its timing, but is of the view that these risks can be managed and that they will diminish over time as the system beds down.

Discipline on fee levels

- 1.45 During the hearing, stockbrokers raised the question of whether ASIC would be subject to sufficient discipline in relation to the amount of fees it levies, or whether it would be able to be able to freely increase its revenues through the fees. RBS Morgans stated:

Given the knowledge that the funds will be recovered, how confident can we be that those budget requests will be subject to that appropriate challenge and scrutiny? Will there be that frank and fearless review of requests for funding et cetera if it is subject to that full cost recovery?³⁰

- 1.46 Similarly the Stockbrokers Association of Australia was also concerned about cost discipline on ASIC, but from the perspective of the quality of its outputs. In particular, it suggested that ASIC may seek 'to build a Rolls Royce solution, when only a Holden was needed'.³¹

- 1.47 The committee put this issue directly to ASIC, who responded that they are subject to the discipline of the Budget process:

I think it goes to some of the points that Mr Chisholm referred to: the reviews that we are going through. So, through this process, in putting forward our allocations or appropriations, we have to go through the appropriation process to outline those, then on an ongoing basis we are audited, and through this review process we will continue to be reviewed, so we intend to be as transparent as possible about our costs ...

That is not true [being able to easily increase staff] because any additional costs that we incur for supervision can only be appropriated if we go through the appropriations process.³²

- 1.48 This issue involves two sort of discipline. The first is the discipline on ASIC to control its costs. This is driven by the efficiency dividend, which requires portfolios to find annual savings (1.5 per cent in 2011-12) after
-

30 Mr Jeffrey Oates, *Committee Hansard*, Canberra, 12 September 2011, p. 21.

31 *Submission 3*, p. 7.

32 Mr Mark Adams, *Committee Hansard*, Canberra, 12 September 2011, p. 10.

their expenses are indexed for inflation. It is also driven by the scrutiny of the Expenditure Review Committee of Cabinet when agencies seek extra funds and in Parliament when the Treasurer tables the resulting Budget legislation.

- 1.49 The second discipline relates to keeping fees low. This is driven by ASIC keeping its spending down. It is also driven by the scrutiny of the relevant Minister, who must present new regulations in the Parliament, and that of the Parliament itself, which has the opportunity in either chamber to disallow proposed regulations under the *Legislative Instruments Act 2003*.
- 1.50 ASIC faces multiple layers of scrutiny over any decisions to increase fees and so the committee considers that there is sufficient discipline on ASIC to ensure that fees are maintained at a reasonable level.

Issues in the consultation paper

- 1.51 While the consultation paper is not strictly within the committee's terms of reference, it provides important context to how the Bill is likely to work in practice. Having the consultation paper publicly available has improved the transparency of the inquiry.
- 1.52 The committee also appreciates the large amount of work that went into the consultation paper. Industry also took this view. The Australian Financial Markets Association stated at the hearing:
- We are not actually criticising the quality of the current paper; we think that is quite commendable. The Treasury – compared to, maybe, some other recent government consultations on cost recovery – has done a very good job.³³
- 1.53 But as might be expected in most consultations, industry did raise concerns about some of the detail. These matters are described below. The committee does not make any particular comments or conclusions about them, except that they raise important issues that warrant consideration by Treasury. The committee has itself also raised the issue of risk sharing at the end of the report.

33 Mr David Love, *Committee Hansard*, Canberra, 12 September 2011, p. 27.

Higher initial costs

- 1.54 RBS Morgans raised concerns in evidence that the consultation paper proposed 'to immediately pass through significant, one-off, asset-like project costs'.³⁴ The Australian Financial Markets Association agreed, noting that businesses would spread the costs over three to five years:

... an initial reaction has been concern about the upfront attribution of the IT costs of the system. That is not normal, from business practice. It is quite normal to amortise those costs. We recognise that the government has to build system capacity to deal with the issues that you get when you have got a large number of participants – it is commendable, in fact, that it is doing that – but in normal accounting practices it would be normal to amortise those over three to five years rather than taking most of the hit upfront. I think that is what is driving a lot of the early initial costs in the system.³⁵

- 1.55 When the supervision proposals were announced in 2009, the *Mid Year Economic and Fiscal Outlook* listed total one-off capital costs for ASIC of \$6.1 million from 2009-10 to 2010-11.³⁶ The consultation paper details the costs over the first three and a half years as in table 1.1.

Table 1.1 Total estimated costs for ASIC's market supervision and competition functions (\$m)

Activity	FY12(2 nd ½)	FY13	FY14	FY15
Transfer of supervision	4.74	9.90	9.90	9.90
Competition	6.16	8.97	6.72	6.31
Total	10.90	18.87	16.62	16.21

Source Treasury, *Reforms to the supervision of Australia's financial markets: Exposure draft and consultation paper*, December 2009, p. 17, <http://www.treasury.gov.au/documents/1673/PDF/consultation_paper_20091201.pdf> viewed 7 September 2011.

- 1.56 On an annualised basis, the consultation paper proposes that ASIC would recoup over \$12 million of its competition costs in 2011-12. The fees for this category would effectively halve by 2014-15 to a little over \$6 million.

34 Mr Jeffrey Oates, *Committee Hansard*, Canberra, 12 September 2011, p. 18.

35 Mr David Love, *Committee Hansard*, Canberra, 12 September 2011, p. 29.

36 The Hon. Mr Wayne Swan MP and the Hon. Mr Lindsay Tanner MP, *Mid Year Economic and Fiscal Outlook 2009-10*, 2009, p. 216, <http://cache.treasury.gov.au/budget/2009-10/content/myefo/download/MYEFO_2009-10.pdf> viewed 19 September 2011.

Incentives for high levels of compliance

1.57 The consultation paper proposes that ASIC's fees should be calculated on volumes of messages and trades because these drive its costs. It also gives a breakdown of the activities that ASIC will be funding through the fees:

- market supervision, including real time surveillance;
- participant supervision;
- regulatory framework and market structure analysis;
- investigations and enforcement;
- markets disciplinary panel;
- information technology; and
- ASIC shared services.³⁷

1.58 Some of these costs appear to be very general and that would apply across the industry, such as market supervision and information technology. Others would appear to be specific to firms, such as investigations and the disciplinary panel. These costs may have less relation to volumes. The Australian Stockbrokers Association stated that this cost structure represents a missed opportunity to give brokers incentives for high standards of compliance.

One thing we saw as being absent from this whole regime was a way in which you could encourage compliance as a matter of public policy by ensuring that those who have invested in good compliance and have a clean record do not then pay the same share of the levy as everyone else. In our view, there needs to be some incentive to bring that out.³⁸

Shadow brokers

1.59 These firms are also termed 'indirect brokers' or 'white labellers'. They are entities which hold an Australian financial services licence that allows them to provide broking-type financial services to clients. However, they are not ASX market participants, so are not able to execute, clear and settle client trades themselves. Instead, they use the services of a market participant to execute, clear and settle client trades on their behalf.

³⁷ Treasury, *Reforms to the supervision of Australia's financial markets: Exposure draft and consultation paper*, December 2009, pp. 18-19, <http://www.treasury.gov.au/documents/1673/PDF/consultation_paper_20091201.pdf> viewed 7 September 2011

³⁸ Mr Peter Stepek, *Committee Hansard*, Canberra, 12 September 2011, p. 22.

- 1.60 Shadow brokers are subject to the same requirements as other financial service licence holders and ASIC regulates them in the same way as it does other financial service licensees.
- 1.61 RBS Morgans stated in evidence that they did not believe that there was a level playing field between market participants and shadow brokers and that the latter group enjoy a 'free ride'. They also stated that shadow brokers have lower compliance standards than market participants and that their conduct has knock-on effects to market participants with professional indemnity insurance.³⁹ This then raises the question of whether market participants would be better off as shadow brokers. The Stockbrokers Association of Australia commented:
- There are obviously already incentives to leave a very expensive, well-regulated sector of the market and to go to an area where you are not faced with the same sorts of costs. It has been happening already and our association has been highlighting that for quite some time now. I think a significant regulatory response is needed ...
- Obviously it would be a difficult decision for a firm to take. To be a market participant entitles you to call yourself a stockbroker and there is a prestige behind that. I am not suggesting that members would jump ship willy-nilly – and I would like to think that they would not – I am just highlighting the cost incentives may be too much to bear.⁴⁰
- 1.62 Chi-X Australia stated that, under the UK regime, shadow brokers are directly billed by the Financial Services Authority because they have an obligation to report directly to the Authority.⁴¹
- 1.63 In the ASIC Market Integrity Rules, shadow brokers are treated no differently than a market participants' other clients. This matter is subject to review. In a consultation paper in November 2010, ASIC posed a question regarding whether the scope of the Market Integrity Rules ought to be extended to other financial services providers, examples being

39 Mr Jeffrey Oates, *Committee Hansard*, Canberra, 12 September 2011, p. 19.

40 Mr Peter Stepek, *Committee Hansard*, Canberra, 12 September 2011, p. 24.

41 Mr Michael Somes, *Committee Hansard*, Canberra, 12 September 2011, p. 13.

shadow brokers and fund managers.⁴² In its response in April 2011, ASIC reported that there was widespread industry support for this proposal.⁴³

Risk sharing

- 1.64 The consultation paper puts forward options for cost recovery. The preferred option allows ASIC to calculate costs and apportion them amongst industry according to some form of volume calculations. The advantage with the model is that it avoids over recovery and the adjustment in fees that would follow. It provides certainty for ASIC and Government as fees charged are based on actual costs. For participants and operators, there is some uncertainty in estimating likely costs for the coming quarter, but there are benefits in not being undercharged or overcharged.
- 1.65 Alternative options include the application of a fixed fee, which may improve certainty for business. ASIC would then face the risk of potentially over or under recovering costs with a resulting adjustment in fee to ensure accurate cost recovery. This would again create uncertainty and risk for business.
- 1.66 There is no easy solution to apportioning risk under full cost recovery. But it is important to note that the various options carry different levels of uncertainty for the various parties.

Conclusion

- 1.67 The Bill should pass because it is an appropriate way of funding ASIC's market supervision activities. Transferring these activities to ASIC is a necessary condition for introducing competition in exchange markets. The prospect of competition has led to lower transaction costs and improved services from the ASX. The Bill is not the centrepiece of the shift to competition, but it is informed by competition principles and will be an important part of the 'competition infrastructure'. The Bill should pass.

42 ASIC, *Australian equity market structure: Proposals*, Consultation Paper 145, November 2010, p. 52, <[http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/cp-145.pdf/\\$file/cp-145.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/cp-145.pdf/$file/cp-145.pdf)> viewed 16 September 2011.

43 ASIC, *Response to submissions on CP 145 Australian equity market structure: Proposals*, Report 237, April 2011, p. 8, <[http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/REP237-published-29-4-2011.pdf/\\$file/REP237-published-29-4-2011.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/REP237-published-29-4-2011.pdf/$file/REP237-published-29-4-2011.pdf)> viewed 16 September 2011.

Recommendation 1

1.68 **The House of Representatives pass the Corporations (Fees) Amendment Bill 2011.**

Julie Owens, MP
Chair
20 September 2011