Senior Adviser
Financial System and Services Division
The Treasury
100 Market Street
Sydney NSW 2000

9 October 2015

Dear Senior Adviser

Submission on the Proposed Industry Funding Model for the Australian Securities and Investments Commission ("Consultation Paper")

We refer to the Consultation Paper announced by then Commonwealth Assistant Treasurer, The Hon Josh Frydenberg, on 28 August 2015, and the request for submissions on the proposed industry funding model for the Australian Securities and Investments Commission (ASIC).

We welcome the opportunity to make submissions on a topic that is of considerable importance to financial regulation in Australia. These submissions draw on the international experience with industry funding, and focus on jurisdictions that operate Australia's 'twin peaks' model of financial regulation.[1]

Our submission specifically relates to four of the questions asked under Attachment J of the Consultation Paper:

- Question 8 – Are there any approaches to industry funding adopted by other regulators that you believe should be applied to an industry funding model for ASIC? If so, please describe and provide reasons why.
- Question 13 – Do you support the proposed process for determining funding for ASIC's regulatory activities under an industry funding model for ASIC? If not, why not?
- Question 17 – Do you have any further suggestions for enhancements to be made to ASIC's accountability structure or industry funding model? If so, please provide details.
- Questions 18 – How should the Cost Recovery Stakeholder Panel operate? How should the membership be determined?

Please find a summary of our recommendations on the following page.

Yours faithfully

Andrew Godwin
Melbourne Law School
185 Pelham St, Carlton VIC
+61 3 834 41030
a.godwin@unimelb.edu.au

Dr George Gilligan
Melbourne Law School
185 Pelham St, Carlton VIC
+61 3 834 41079
george.gilligan@unimelb.edu.au

Tim Howse
Melbourne Law School
185 Pelham St, Carlton VIC
timothy.howse@unimelb.edu.au

[1] The views expressed in this submission are the authors' own. This submission draws on research undertaken with the support of the Centre for International Finance and Regulation (CIFR) – CIFR Research Project E018, 'Is Australia's "Twin Peaks" Approach a Model for China?' and CIFR Research Project T021, 'An Analysis of Penalties under ASIC Administered Legislation'.

Summary of recommendations

Recommendation 1 – The proposed industry funding model is consistent with international trends and best practice and should be implemented.

Recommendation 2 – ASIC should consider requiring advance payment from entities that accrue significant expenses in the previous financial year. This will improve ASIC's cash flow, lower borrowing costs, and ultimately reduce the cost of regulation.

Recommendation 3 – ASIC should consider setting a notional maximum limit to the number of hours it spends on particular tasks. Hours worked beyond this limit could be charged at an hourly rate.

Recommendation 4 – Consideration should be given to fee-sharing between ASIC and APRA and both regulators should enter into a Service Level Agreement to address how they will charge each other for their services. Any fee-sharing arrangements between ASIC and APRA should be made explicit to the regulated community.

Recommendation 5 – ASIC's budget should be proposed by ASIC and approved by the Government as in the case of APRA. Further, the criteria on which the proposed budget is approved or rejected by the Government should be transparent.

Recommendation 6 – Efficiency dividends should not be imposed on ASIC if it is industry-funded.

Recommendation 7 – Details of funding and expenditure should be included with sufficient granularity to ensure that there is sufficient regulatory accountability.

Recommendation 8 – Similar to the approach in the UK, consideration should be given to establishing the following working groups or sub-panels as part of the proposed Cost Recovery Stakeholder Panel: a) a Financial Services Consumer Panel; b) an equivalent to the 'Practitioner Panel' to represent larger businesses; and c) a Small Business Panel. Further, consideration should be given to cross-representation on the working groups and an annual survey to determine views of industry as to the cost-effectiveness of regulation by ASIC. Finally, the Panel and working groups/sub-panels should not impact adversely on the operational independence of ASIC.

1 Approaches to industry funding

Recommendation 1 – The proposed industry funding model is consistent with international trends and best practice and should be implemented

1.1 The proposal to charge fees-for-service, along with an annual levy, is in line with jurisdictions that operate the 'twin peaks' model of financial regulation. Industry funding is the dominant method of funding for twin peaks 'market conduct' regulators such as ASIC.

1.1.1 Australia's other peak regulator, the Australian Prudential Regulation Authority (APRA), has a majority of its funding providing by levies that are designed to 'ensure that the full cost of regulation is recovered from those who benefit from it (that is, institutional categories that are regulated).'[2]

1.1.2 APRA occasionally receives 'Special Appropriations from Government to deal with particular matters. For instance, in 2008 APRA received a Special Appropriation of

[2] Treasury and APRA, 'Financial Industry Levies for 2015-16' (Report, 2015) 2.

$45m, payable over the following four years, to assist APRA deal with the global financial crisis.'[3]

1.2 Countries that are moving toward the twin peak model, such as South Africa, recognise the importance of industry funding.[4] When compared to the United Kingdom, the Netherlands, New Zealand, Belgium, and South Africa, Australia stands alone in seeing ASIC almost entirely reliant on government funding.

1.3 In the UK, the Financial Conduct Authority (FCA) charges three types of fees; application fees, annual fees and 'change to permissions' fees.

1.3.1 Application fees range from £1,500 for straightforward matters to £25,000 for complex matters. Fees are payable where an entity is seeking authorisation or registration,[5] irrespective of whether the application is successful. Annual fees are payable by firms that are regulated by the FCA.

1.3.2 The FCA is also empowered to issue 'interim' levies for a variety of matters. For example, in March 2015 an interim levy of £20m was imposed 'on firms in the Life and Pensions intermediation funding class for the costs of Self Invested Personal Pensions related claims.'[6]

1.4 The Netherlands is an important jurisdiction for Australia to consider because its model of financial regulation bears many similarities. Two thirds of the Netherlands' market conduct regulator's expenses – the AFM[7] – are covered by annual levies imposed on market participants.[8]

1.4.1 The Consultation Paper has indicated that ASIC would be seeking to recover almost 75% of its costs through levies by 2018-19.[9] This suggests that there is a broader range of activities for which ASIC is willing to levy fees as compared with the Netherlands.

1.5 In Belgium, the market conduct regulator – the FSMA – has its operating costs funded by supervised entities.

1.5.1 There are three types of charges; 'a) sectoral contributions from entities subject to permanent supervision; b) variable specific contributions to finance the supervision of specific operations or requests e.g., approval of a prospectus, handling notifications,

---

3 International Monetary Fund, 'Australia: Basel Core Principles for Effective Banking Supervision – Detailed Assessment of Observance' (IMF Country Report No. 12/313, November 2012) 26.

4 Financial Regulatory Reform Steering Committee, 'Implementing a twin peaks model of financial regulation in South Africa' (Report for public comment, 1 February 2013), 8-9.

5 Financial Conduct Authority, 'Application Fees and Variation of Permissions Fees' <http://www.fca.org.uk/firms/being-regulated/fees/application-fees>.

6 Financial Conduct Authority, 'Letter for Life and Pension Intermediation FSCS Interim Levy 2014/15' <http://www.fca.org.uk/your-fca/documents/letter-for-life-and-pension-intermediation-fscs-interim-levy-2014-15>.

7 AFM, 'about AFM' <http://www.afm.nl/en/over-afm>.

8 International Monetary Fund, 'Kingdom of The Netherlands: Publication of Financial Sector Assessment Program Documentation – Detailed Assessment of Observance on IOSCO Principles and Objectives of Securities Regulation' (Report, July 2011) 28.

9 Australian Government, 'Proposed Industry Funding Model for the Australian Securities and Investments Commission' ("Consultation Paper") (2015) 28 [Chart 5].

registration and enrolment as well as giving rulings; c) fixed contributions to finance specific costs e.g., the acquisition of the FSMA's registered office.'[10]

2 Advance payments to the regulator

Recommendation 2 – ASIC should consider requiring an advance payment from entities that accrue significant expenses in the previous financial year. This will improve ASIC's cash flow, lower borrowing costs, and ultimately reduce the cost of regulation

2.1 In the UK, firms whose fees are £50,000 or more in the previous year must pay an advance payment[11] of 50% 'of the amount paid in that year "on-account" towards their PRA and FCA fees in the following years.'[12]

2.1.1 Detailed explanations of calculating fees are provided for in the comprehensive FCA Handbook. Advance payments are dealt with under 'FEES 4.3.6.'[13]

2.2 This 'on-account' fee is particularly important for an industry-funded regulator. In receiving an advance payment, a regulator can 'avoid unnecessary overdraft costs that would otherwise be passed back to firms.'[14]

2.3 An industry-funded regulator, in order to avoid dependence on government appropriations, will require sufficient cash flow to meet its present needs. An obvious way of ensuring the regulator has access to money is to establish a bank overdraft facility. However, in doing so it will incur interest charges. In the context of an *industry-funded* model, this would actually lead to higher regulation costs for everyone.

2.4 An advance payment imposed on entities that incur the greatest costs is arguably the most cost effective way of providing regulator's with access to funds.

2.5 There has not been any suggestion of an advance payment to ASIC. However, consideration must be given to how an operationally independent, cost-effective regulator will be able to meet its ongoing cash flow requirements.

2.5.1 ASIC should consider requiring an advance payment from certain entities. This would make it less reliant on government appropriations and more cost-effective.

2.5.2 For example, ASIC could require an advance payment from entities that accrued more than $80,000 in fees in the previous financial year.

---

[10] IMF, 'Financial Sector Assessment Program: Detailed Assessment of Observance – Insurance Core Principles' (IMF Country Report No. 13/134, May 2013) 42.

[11] Financial Conduct Authority, 'How we decide rates for annual fees' <https://small-firms.fca.org.uk/fees-and-levies/how-we-decide-rates-annual-fees?field_fcasf_sector=unset&field_fcasf_page_category=unset#sthash.np0ZDUoZ.dpuf>.

[12] Prudential Regulation Authority, 'Regulated fees and levies: rates for 2013/14' (Report, 2013) 14. Available at <http://www.bankofengland.co.uk/pra/Documents/publications/ps/2013/ps413.pdf>.

[13] The FCA handbook is available at <http://www.fca.org.uk/handbook>.

[14] Prudential Regulation Authority, 'Regulated fees and levies: rates for 2013/14' (Report, 2013) 15. Available at <http://www.bankofengland.co.uk/pra/Documents/publications/ps/2013/ps413.pdf>.

3 The ‘averaging’ approach to fees-for-service

Recommendation 3 – ASIC should consider setting a notional maximum limit to the number of hours it spends on particular tasks. Hours worked beyond this limit could be charged at an hourly rate

3.1 With respect to the charging of fees for services, the current proposal will mean that the fees payable do not necessarily match the cost to ASIC. This is because:

> *To determine the fees payable, ASIC has calculated the total amount to be recovered from each form type based on the total cost of actioning these forms. The average cost for each form is then calculated with reference to the volume of those forms to be processed in a year. This is based on historical volumes.*[15]

3.2 The justification for adopting this ‘averaging’ approach is to ‘ensure that regulated entities have certainty as to the fees payable and to ensure that fees do not discourage product or service innovations that may take a long period of time to approve in the first instance.’[16] This recognises the importance of competition.[17]

3.3 An additional benefit from this approach would be the administrative cost saving of not having to calculate the actual cost incurred with respect to each regulatory activity.

3.4 In the UK, fees charged to firms seeking permissions vary depending on whether the application is ‘straightforward, moderately complex or complex.’ With respect to consumer credit, there is also a ‘very complex’ category.[18] An example of a ‘moderately complex’ authorisation is ‘[o]perating an electronic system in relation to lending.’[19] Importantly, the FCA

> *[does] not in practice recover the full cost of assessment from the applicants themselves. The costs are shared with existing firms through their periodic fees. This is partly to avoid the risk of application fees acting as a barrier to market entry, partly because all firms benefit from operating in a market that has enhanced integrity due to us ensuring firms meet our threshold conditions before they can enter it.*[20]

3.5 The UK model, like the Australian proposal, recognises the importance of competition and lifting barriers to market entry.

3.6 New Zealand charges entities at set rates to complete various actions, but charges additional *hourly rates* if the action exceeds a certain duration.[21]

3.6.1 For example, an application for a market services licence to cover ‘acting as a provider of a peer-to-peer lending service’ has a prescribed fee of $6,238.75. Where the total

---

15 Consultation Paper, 20.

16 Consultation Paper, 20.

17 The Financial System Inquiry (FSI) Final Report recommended that ASIC ‘be given an explicit competition mandate’ and that ‘periodic reviews of the state of competition should be conducted’: FSI, ‘Final Report’ (November 2014) 237.

18 Financial Conduct Authority, ‘Regulatory fees and levies: policy proposals for 2014/15 (CP13/14) – revised proposals on consumer credit application fees’ (December 2013) [2.3].

19 Ibid [2.5].

20 Ibid [2.3].

21 FMA, ‘Fees and levies’ <https://fma.govt.nz/compliance/fees-and-levies/>.

time spent on the application exceeds 40 hours, then the FMA will charge between $178.25 and $230.00 per hour of additional work.[22]

3.6.2 FMA fees are determined by the Ministry of Business, Innovation and Employment (MBIE),[23] and set out in the *Financial Market Conduct (Fees) Regulations 2014*. The MBIE is a member of the Council of Financial Regulators.[24] The current fees were determined after submissions were made by industry in response to a discussion document released by the MBIE.[25]

3.6.3 Critically, with respect to the methodology behind the calculation of the flat fee, the MBIE further noted:

> *Within the model for flat flee plus hourly rate, the flat fee is based on FMA's estimate of how long it would take to process a 'standard' application under each licence category. Specifically, the flat fee is an estimated average of a low to medium risk individual or entity rather than an average of the licence group as a whole, which would include high-risk and resource intensive applications.* ***Removing outliers from the estimation process for the flat fee should allow a relatively low fee for the majority of applicants.*** *The hourly rate component of the model allows FMA to recover costs from resource intensive applications such as those deemed high risk, complex and those who submit incomplete or inadequate applications*.[26]

3.6.4 Arguably, this more accurately reflects the user-pays principle because the hours worked, and therefore *cost incurred*, relates to the intensity of regulation required. This flexible 'upper limit' approach is one that should be considered by ASIC. It would provide regulated entities with a degree of certainty concerning fees, but would avoid treating all applications identically. As suggested by the MBIE, '[t]his is the fairest and most accurate form of cost recovery, particularly where the nature of applications may be varied.'[27]

3.7 The current proposal vis-à-vis ASIC does not appear to remove outliers from the averaging process for the purposes of determining the flat fee. This potentially *increases* the fees payable by entities that are low risk and medium risk, and *decreases* the fees payable by entities that are high risk.

3.8 While it is clearly desirable to encourage 'innovative' services and products and reduce barriers to market entry, this needs to be weighed carefully against the increased costs to low and medium risk entities.

3.9 As discussed in Section 8, there may be scope for an industry sub-panel to provide input on the appropriate method of calculating the 'average' fee. For example, a small business sub-panel may advocate for a change to the method of calculating the average fee or hourly rate

---

[22] *Financial Market Conduct (Fees) Regulations 2014* Sch 1 & 2.

[23] FMA, 'Fees and levies' <https://fma.govt.nz/compliance/fees-and-levies/>.

[24] Reserve Bank of New Zealand, 'Council of Financial Regulators – Terms of Reference' (August 2013) (accessed 7 October 2015) <http://www.rbnz.govt.nz/regulation_and_supervision/banks/relationships/4525791.html>.

[25] See generally Minister of Business, Innovation and Employment, 'Financial Markets Conduct Act Register Fees and Other Financial Markets Authority Fees and Levies' (Discussion Document, May 2014).

[26] Ministry of Business, Innovation and Employment, 'Financial Markets Conduct Act License Fees and Increase of Other Financial Markets Authority Fees' (Regulatory Impact Statement, 11 March 2014). Emphasis added.

[27] Minister of Business, Innovation and Employment, 'Financial Markets Conduct Act Register Fees and Other Financial Markets Authority Fees and Levies' (May 2014, Discussion Document) 15.

as it applies to small business. Any shortfall would presumably need to be met through Crown funding or the annual levy.

3.10 One possible disadvantage of hourly billing is that it can create a disincentive for regulators to use their time efficiently.

4 Fee-sharing between the regulators

Recommendation 4 – Consideration should be given to fee-sharing between ASIC and APRA and both regulators should enter into a Service Level Agreement to address how they will charge each other for their services. Any fee-sharing arrangements between ASIC and APRA should be made explicit to the regulated community.

4.1 The current proposal is that there will be a 'single industry funding model for ASIC and the ATO and APRA would no longer recover the costs of these activities on ASIC's behalf.' In the UK, the FCA regularly collects fees on behalf of the Prudential Regulation Authority (PRA), and other UK regulators. This has the potential to result in 'collective efficiencies.'

4.2 Consideration should be given to how the new funding model proposes to deal with expenses incurred by Australia's *prudential regulator*, APRA, in assisting ASIC to carry out its functions. Effective cooperation between the regulators is an essential aspect of Australia's current model of financial regulation.

4.3 Moving toward an industry funding model means that regulated entities are entitled to know that their fees are actually being used for the regulation they require and are not being diverted to another regulator for unrelated prudential regulation. It follows that there should be a mechanism in place to ensure that APRA is reimbursed where APRA uses its own resources to assist ASIC, and vice versa.

4.3.1 In the Netherlands there are 'netting arrangements', which are expressed in their 'Covenant'[28] – the equivalent to Australia's Memoranda of Understanding between ASIC and APRA.[29] It states that 'the supervisors make netting arrangements on the coverage of costs incurred in the context of activities which they perform on each other's behalf in the context of supervision and the levying of charges.'[30]

4.4 The UK is an important jurisdiction for analysing the various mechanisms that can be used to share costs.

4.4.1 The Memorandum of Understanding (MoU) between the FCA and PRA[31] provides that the 'FCA may collect fees and levies on behalf of the PRA and will pass on what is

---

28 Covenant between Stichting Autoriteit Financiële Markten and De Nederlandsche Bank N.V. Unofficial translation available at <http://www.toezicht.dnb.nl/en/binaries/51-213295.pdf>.

29 Memorandum of Understanding between the Australian Prudential Regulation Authority and the Australian Securities and Investments Commission, 18 May 2010. Available at <http://www.apra.gov.au/AboutAPRA/Documents/ASIC-MoU.pdf>.

30 Covenant between Stichting Autoriteit Financiële Markten and De Nederlandsche Bank N.V. cl 1.10.1.

31 *Memorandum of Understanding (MoU) between the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA)*. Available at <http://www.fca.org.uk/your-fca/documents/mou-between-the-fca-and-the-pracoordination>.

collected to the PRA.' Importantly, '[t]he FCA may charge the PRA an administrative fee for this service.'[32]

(i) The FCA and PRA are under a duty to 'prepare and maintain a memorandum which describes in general terms… the role of each regulator in relation to the exercise of functions conferred by or under this Act.'[33] This MoU must be reviewed at least once a year, given to the Treasury and tabled before Parliament.[34]

(ii) The Bank of England – who is the parent entity of the PRA – considers the MoU to be a document through which it 'expects to be held to account by Parliament, through the Treasury Select Committee.'[35]

(iii) Despite the fact the Australian MoU appears to have limited practical utility, it may nevertheless be a useful document to make provision for fee-sharing. Updating the document would be inexpensive and straightforward.

4.4.2 The UK regulators concluded a Provision of Service Agreement (PSA) in April 2013.

(i) The PSA deals with 'issuing invoices and collection of levy monies, the provision of information systems, enforcement and intelligence services, contact centre and data migration.'[36]

(ii) In 2015 the annual charge for these services was £7.7m, and the FCA owed the PRA £2.4m at 31 March 2015.[37] While this is a limited amount of money in the context of the FCA's £445.7m budget,[38] it is nevertheless important that an industry funded regulator can explain with precision where it incurs expenditure.

(iii) ASIC and APRA should enter a Service Level Agreement to address the precise details of charging each other fees.

4.4.3 Any fee-sharing arrangements between ASIC and APRA should be made explicit to the regulated community.

5 Proposed process for determining ASIC's funding

Recommendation 5 – ASIC's budget should be proposed by ASIC and approved by the Government as in the case of APRA. Further, the criteria on which the proposed budget is approved or rejected by the Government should be transparent.

32 *Memorandum of Understanding (MoU) between the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA)*.

33 *Financial Services Act 2012* ("FS Act"), Part 2 amendments to the *Financial Services and Markets Act 2000* ("FSM Act") s 3E(1)(a).

34 FS Act, Part 2 amendments to the FSM Act s 3E(4),(5) & (6).

35 Bank of England, Memoranda of Understanding <http://www.bankofengland.co.uk/about/Pages/mous/default.aspx>.

36 Financial Conduct Authority, 'Annual Report and Accounts 2014/15' (31 March 2015) 127.

37 Ibid 127.

38 ASIC, 'Annual Report 2013-2014' (Report, 2014) 7.

5.1 As outlined in Chapter 4 of the Consultation Paper, the proposed process for determining ASIC's budget appears to be as follows:

1. ASIC identifies sectoral risks and regulatory activities;
2. ASIC identifies industry sectors and populations;
3. ASIC apportions budget to activities;
4. *Government consults with stakeholders;*
5. *Total budget determined by Government;*
6. Government determines levy calculation mechanism.[39]

5.2 It appears that the Australian government remains responsible for approving the quantum of ASIC's budget. A key question for ASIC is *how* the Government will go about determining the budget.

5.2.1 What are the factors or considerations that the Government will rely on to determine what the total budget should be? Ideally, there should be transparent criteria that Government must have regard to in either approving or rejecting a proposed budget.

5.2.2 The absence of criteria would have the capacity to undermine the operational independence of ASIC through opaque measures taken with respect to its budget.

5.2.3 It would also lessen ASIC's accountability to the regulated community because ASIC would have less control over the budgets it sets.

5.3 In the Netherlands, each supervisor prepares its budget in consultation with an advisory panel consisting of representative organisations.[40] This appears to perform the same functions as the proposed 'Cost Recovery Stakeholder Panel.'

5.3.1 The 'Supervisory Board' of the Dutch AFM must approve the budget, and then submits the budget to the Minister of Finance (MoF).

5.3.2 The MoF can only withhold the approval of the budget if it is contrary to law or public interest.[41] During the year, if there are substantial differences between the approved budget and the actual budget, the financial supervisors must notify the MoF.[42]

5.4 Similarly, in Belgium the FSMA's budget must be approved by its Supervisory Board.[43]

5.5 As noted in the Consultation Paper, the US Securities and Exchange Commission (SEC) is funded through

> *an annual appropriation from the US Congress. However, this appropriation is budget-neutral, because it is offset by securities transaction fees payable by self-regulatory organisations. The transaction fees are collected, held and directly spent by the SEC.*
>
> …

---

[39] Emphasis added. See page 17.

[40] International Monetary Fund, 'Kingdom of The Netherlands: Publication of Financial Sector Assessment Program Documentation – Detailed Assessment of Observance on IOSCO Principles and Objectives of Securities Regulation' (Report, July 2011) 28.

[41] Ibid 28.

[42] Ibid 28.

[43] IMF, 'Financial Sector Assessment Program: Detailed Assessment of Observance – Insurance Core Principles' (IMF Country Report No. 13/134, May 2013) 42.

> *The US Securities Exchange Act 1934 requires the SEC to annually set a fee rate — as a percentage of transaction value — that is reasonably likely to equal the annual appropriation. However, this fee rate can be adjusted by the SEC mid-year if necessary.*[44]

5.6 The SEC also has a 'reserve fund' of up to $100 million which can be accessed in certain circumstances.[45]The SEC's industry funding model is important because 'Congress and the President can decide the size of the SEC's appropriation without diverting resources from other priorities or adding to the nation's debt.'[46] The model is advantageous to the extent that it has no impact on the government budget.

5.7 In the UK, the government appears to play a very limited role in determining the FCA's budget.

5.7.1 The FCA is responsible for proposing its fees policy, consulting stakeholders on the policy, collecting information from firms, issuing policy statements and invoicing regulated firms. The FCA 'may make rules providing for the payment to it of such fees… as it considers will enable it to meet expenses incurred in carrying out its functions or for any incidental purpose.'[47]

5.7.2 Every year, the FCA reports to Treasury on its progress. The Treasury then 'submits a report to Parliament that examines [the FCA's] performance against [its] statutory objectives, and how [it has] dealt with major regulatory cases.'[48]

5.8 It is worth noting the funding arrangements with respect to APRA. The Minister makes an annual determination 'to provide the legal basis to impose a levy.'[49] In its FSI submission, APRA identified its budgetary approval process as follows:

> *APRA's budget is proposed by the APRA Members and put to the Government for consideration and endorsement. Once endorsed, it is included in the annual Treasury Portfolio Budget Statements. If APRA is asked to undertake significant new activities, or considers it is inadequately resourced to meet future demands, it will submit a New Policy Proposal. As part of the standard Budget process, any public comments or concerns about APRA's resourcing and activities are able to be raised in pre-Budget submissions.*[50]

5.8.1 It is clear that the Australian government has the final say with respect to APRA's budget. This is potentially a precarious position for a regulator. APRA has noted:

> *Since APRA's establishment, successive Governments have strongly supported APRA, ensuring that APRA's financial resources are sufficient to enable it to discharge its supervisory and other responsibilities. Nonetheless, endorsement of the budget proposed by the APRA Members is not guaranteed and, on occasion, New Policy Proposals by the APRA Members have been reduced.*[51]

5.8.2 The fact that a regulator's budget is 'not guaranteed' creates significant uncertainty. This in turn has the potential to undermine operational independence. One explanation

---

44 Consultation Paper, 13.

45 Ibid, 13.

46 US Securities and Exchange Commission, 'Strategic Plan – Fiscal Years 2014-2018' (Report, 2014) 9.

47 Financial Conduct Authority and Prudential Regulation Authority: Schedules to be substituted as Schedules 1ZA and 1ZB to FSM Act 2000, Schedule 3 insertion of Schedule 1ZA, s 23(1)(a).

48 FCA, 'Who we report to' <https://www.fca.org.uk/about/operate/who>.

49 Treasury and ARA, 'Financial Industry Levies for 2015-16' (Report, 2015) 2.

50 Australian Prudential Regulation Authority, Submission, *Financial System Inquiry*, 50-1.

51 Ibid 50-1.

as to why the government continues to 'endorse' APRA's budget is that fact that there is a problematic stakeholder consultation process. The Treasury's 'Financial Industry Supervisory Levy Methodology Review 2014' made the following remark:

> *One stakeholder indicated that 'it is difficult for industry stakeholders to question APRA's overall costs when the funding decision is not open to consultation'. This reflects different expectations of the annual levies consultation process. The Government decides the amount regulators will be funded as part of the budget process, which is concluded prior to the release of the annual consultation paper.*[52]

5.8.3 From the above, it appears that stakeholder consultation is important in enabling a regulator to set its own budget. APRA has noted:

> *APRA would support a transparent process of consultation on its funding needs with interested stakeholders as part of the normal pre-Budget submissions process, before Government approval of APRA's budget, rather than afterwards through the levies determination process.*[53]

5.9 It is worth considering whether Australia should adopt a similar requirement as is found in the Netherlands, whereby the MoF can only object to the budget proposal if it is contrary to law or the public interest.[54]

5.10 The alternative is that Australian Government will have the final say on the budget, thereby retaining ultimate control over ASIC's funding arrangements. As noted above, we have queries about this in terms of the impact on the operational independence of ASIC.

6 Efficiency dividends

Recommendation 6 – Efficiency dividends should not be imposed on ASIC if it is industry funded

6.1 ASIC and APRA are currently subject to an 'efficiency dividend.'[55]

6.2 APRA has stated that its funding has been reduced as a result of general 'efficiency dividend' requirements that the Government had imposed 'with the objective of driving efficiency savings and improving its overall budget position.'[56]

6.3 It has also noted that such a mechanism is 'not well-suited to an industry funded regulatory agency' and would 'ultimately compromise financial safety but make no contribution to the Government's budgetary objectives.'[57]

6.4 If ASIC is to move toward to an industry funding model, where its budget is largely determined by the cost of regulation, the imposition of an efficiency dividend could potentially undermine

[52] Treasury, 'The Financial Industry Supervisory Levy Methodology Review' (Response Paper, 16 April 2014) 5.

[53] APRA, Submission, *Financial System Inquiry,* 55.

[54] International Monetary Fund, 'Kingdom of The Netherlands: Publication of Financial Sector Assessment Program Documentation – Detailed Assessment of Observance on IOSCO Principles and Objectives of Securities Regulation' (Report, July 2011) 28.

[55] Australian Government, 'Proposed Industry Funding Model for the Australian Securities and Investments Commission' ("Consultation Paper") (2015) 4

[56] APRA, Submission, *Financial System Inquiry,* 6.

[57] Ibid 6.

the model. The government should therefore have limited involvement in imposing compulsory savings measures. There are other, more effective means of ensuring a regulator is accountable for its expenditure, as discussed below.

7 Enhancements to ASIC's accountability

Recommendation 7 – Details of funding and expenditure should be included with sufficient granularity to ensure that there is sufficient regulatory accountability.

7.1 Other jurisdictions recognise a variety of accountability mechanisms for their regulators. The following are examples from overseas:

7.1.1 New Zealand recognises a State Services Commission (SSC) which is the 'standard crown entity monitoring process.'[58]

7.1.2 In the UK, the Treasury can appoint an 'independent person' to review the efficiency of a regulator in discharging its functions.[59] The FCA must 'report to the Treasury on the extent to which its regulatory objectives have been met.'[60]

7.1.3 The UK prudential regulator is subject to performance reviews by the Oversight Committee of the Court (The Bank of England). The PRA is also subject to an annual audit by the National Audit Office.[61]

7.1.4 Previously, the Dutch AFM had to prepare audited accounts each year for approval by the Minister. The auditor's report contained an assessment about whether the resources used by the AFM were in accordance with the governing legislation, and whether the management of the organisation was sufficient for the purposes of discharging its obligations.[62] This provision was repealed on 1 January 2013.

7.2 It is interesting to note the use of *multiple* Boards, as is the case in the Netherlands and Belgium, where the 'Supervisory Board' is tasked with budgetary considerations, and the 'Executive Board' is charged with the day to day operations of the regulator.[63]

7.2.1 In Belgium, the Supervisory Board is responsible for approving the budget of the market conduct regulator.[64]

7.2.2 With the National Bank of Belgium (NBB) – Belgium's prudential regulator – responsibility for approving the budget lies with the 'Council of Regency', who works closely with the 'Budget Committee.'[65]

---

58 State Services Commission, 'State Services Commissioner – role and functions' <http://www.ssc.govt.nz/sscer>.

59 FS Act 2012 (UK), section 6 amendments to the FSA Act 2000, s 1S.

60 Financial Conduct Authority, 'Annual Report and Accounts 2014/15' (31 March 2015) 90.

61 Emma Murphy and Stephen Senior, 'Changes to the Bank of England' (Bank of England Quarterly Bulletin 2013 Q1) 23.

62 *Act on Financial Supervision* (2006) [unofficial translation] s 1:33 [Repealed].

63 See, for example, Netherlands Authority for the Financial Markets, 'Supervisory Board' (accessed 22 February 2015) <http://www.afm.nl/en/professionals/over-afm/organisatie/rvt>.

64 IMF, 'Financial Sector Assessment Program: Detailed Assessment of Observance – Insurance Core Principles' (IMF Country Report No. 13/134, May 2013) 42.

65 Ibid, 41.

7.3 Belgium makes provision for significant government involvement in the NBB's board meetings. The Belgian Minister is able to appoint a personal representative who attends the NBB's board meetings.[66] Belgium also requires appearances in front of Parliamentary Committees after the publication of the annual report.[67]

7.4 Annual reports are the most common mechanism designed at ensuring there is sufficient regulator accountability in respect of funding. All twin peak countries require their market conduct regulator to produce an annual report.

7.5 Most jurisdictions rely on some form of parliamentary oversight. In the UK, the Treasury Select Committee is appointed to examine the expenditure of the PRA.[68]

7.6 The current proposals that ASIC report annually on its performance vis-à-vis its objectives, produce a Cost Recovery Implementation Statement, and create a Cost Recovery Stakeholder Panel, are broadly in line with international trends. However, details of funding and expenditure should be included with sufficient granularity to ensure that there is sufficient regulatory accountability.[69] In addition, there is scope for the Parliamentary Joint Committee on Corporations and Financial Services to perform an important role in terms of monitoring and reviewing the activities of ASIC in this regard and also protecting the public interest.

7.7 It is questionable whether '[d]etermining fee amounts every three years would provide certainty for regulated institutions and provide an incentive for ASIC to ensure that it is delivering its services at most efficient cost.'[70] To an extent, this undermines the significance of ongoing stakeholder consultation. The UK FCA conducts consultations every year.[71]

8 Operation of the Cost Recovery Stakeholder Panel (CRSP)

Recommendation 8 – Similar to the approach in the UK, consideration should be given to establishing the following working groups or sub-panels as part of the proposed Cost Recovery Stakeholder Panel: a) a Financial Services Consumer Panel; b) an equivalent to the 'Practitioner Panel' to represent larger businesses; and c) a Small Business Panel. Further, consideration should be given to cross-representation on the working groups and an annual survey to determine views of industry as to the cost-effectiveness of regulation by ASIC. Finally, the Panel and working groups/sub-panels should not impact adversely on the operational independence of ASIC.

8.1 The Consultation Paper notes that 'stakeholder engagement would be central to an industry funding model.'

---

66 Statutes of the National Bank of Belgium, as modified by the Law of 22 February 1998 Establishing the Organic Statute of the National Bank of Belgium, Article 41. The Statutes of the National Bank of Belgium are available at <https://www.nbb.be/doc/ts/enterprise/juridisch/e/statutes_e.pdf> and the Law of 22 February 1998 Establishing the Organic Statute of the National Bank of Belgium at <https://www.nbb.be/doc/ts/enterprise/juridisch/e/organic_act.pdf>.

67 Law of 2 August 2002 on the supervision of the financial sector and on financial services, 2 August 2002, Article 65.

68 Emma Murphy and Stephen Senior, 'Changes to the Bank of England' (Bank of England Quarterly Bulletin 2013 Q1) 23.

69 For a discussion of the trend towards increasing empiricism in reporting in the context of enforcement date, see George Gilligan et al, 'Regulating by numbers: the trend towards increasing empiricism in enforcement reporting by financial regulators' in *Law and Financial Markets Review* (forthcoming, 2015).

70 Consultation Paper, 24.

71 Financial Conduct Authority, 'Fees publications' <https://small-firms.fca.org.uk/fees-and-levies/fees-publications?field_fcasf_sector=unset&field_fcasf_page_category=unset>.

8.2 The ‘Cost Recovery Stakeholder Panel’ is explained as follows:

> *If an industry funding model is adopted, the Government would establish an ASIC Cost Recovery Stakeholder Panel. This Panel would be responsible for providing views to the Government on the implementation and delivery of an industry funding model. The new Cost Recovery Stakeholder Panel would include representatives from the Treasury, ASIC and each industry sector. Given the size of ASIC’s regulated population this Panel would be supported by working groups representing each industry sector, which would report to the Panel on a regular basis. This will ensure that stakeholders’ views are considered by the Panel.*
>
> …
>
> *The current ASIC Market Supervision Cost Recovery Stakeholder Panel will be subsumed into the new Cost Recovery Stakeholder Panel if Government decides to introduce an industry funding model for ASIC’s regulatory activities.*[72]

8.3 The existing ‘Market Supervision Cost Recovery Stakeholder Panel’ was established in late 2011 ‘to provide stakeholder perspectives to the Government on financial market supervision proposals and approaches for cost recovery. Treasury chairs this Panel and ASIC also attends Panel meetings.’[73] Treasury and ASIC ‘regularly meet with the Market Supervision Cost Recovery Stakeholder Panel to discuss their views on financial market supervision proposals and approaches for cost recovery.’[74] Membership of the Panel includes

> *[r]epresentatives from ASX and Chi-X, market participant and industry representative bodies (e.g. the Australian Financial Markets Association (AFMA), The Stockbrokers Association of Australia (SAA), the Financial Services Council (FSC) and the Australian Shareholders Association (ASA)), some market participants and a financial markets academic sit on the Market Supervision Cost Recovery Stakeholder Panel.*[75]

8.4 The Netherlands already utilises advisory panels constituted by industry representatives in determining the market conduct regulator’s annual budget. This forms part of the budgetary approval process.[76]

8.5 The UK also has an extensive consultative process in place for determining the annual levy amount.[77] The FCA is ‘required to make and maintain effective arrangements for consulting practitioners and consumers on the extent to which its general policies and practices are consistent with its general duties. It does this through the Consumer Panel, Practitioner Panel, Smaller Business Practitioner Panel and Markets Practitioner Panel.’[78]

---

72 Consultation Paper, 26.

73 ASIC, ‘About the new market supervision and competition cost recovery regime’ <http://asic.gov.au/regulatory-resources/markets/market-supervision-and-competition-cost-recovery/about-the-new-market-supervision-and-competition-cost-recovery-regime/>.

74 ASIC, ‘Market Supervision Cost Recovery Impact Statement: 1 July 2013 to 30 June 2015’ (Consultation Draft) 28. See <http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/2013/ASIC%20Market%20Supervision%20Cost%20Recovery/Key%20Documents/PDF/Consultation_draft_CRIS.ashx>

75 ASIC, ‘About the new market supervision and competition cost recovery regime’ <http://asic.gov.au/regulatory-resources/markets/market-supervision-and-competition-cost-recovery/about-the-new-market-supervision-and-competition-cost-recovery-regime/>.

76 International Monetary Fund, ‘Kingdom of The Netherlands: Publication of Financial Sector Assessment Program Documentation – Detailed Assessment of Observance on IOSCO Principles and Objectives of Securities Regulation’ (Report, July 2011) 28.

77 FCA,’Fees publications’ <https://small-firms.fca.org.uk/fees-and-levies/fees-publications?field_fcasf_sector=unset&field_fcasf_page_category=unset>.

78 Financial Conduct Authority, ‘Corporate governance of the Financial Conduct Authority: Adopted by resolution of the Board on 1 April 2013’ (January 2015) 4.

8.6 The FCA is obliged under the *Financial Services Act 2012* s 6 to bring various panels into existence. It is also under a duty to 'consider representations' that are made to it by the FCA Practitioner Panels…The FCA must also from time to time publish in such manner as it thinks fit, its responses to the representations.[79] This creates an ongoing consultation process, and should be considered vis-à-vis ASIC.

8.7 Importantly, each of the UK Panels is 'allocated an annual budget from the FCA to fund specific projects which the Panel considers necessary in order for it to fulfil its duties under [its] terms of reference. The Panel can request approval from the FCA Board for additional funding if required.'[80]

8.7.1 The UK has four stakeholder panels, each of whom must publish an annual report. The current proposal for ASIC has noted that the new Cost Recovery Stakeholders Panel would 'be supported by working groups representing each industry sector, which would report to the Panel on a regular basis.'[81]

(i) The UK Financial Services Consumer Panel (FSCP) is 'an independent statutory body, set up to represent the interests of consumers in the development of policy for the regulation of financial services. [It] work[s] to advise and challenge the FCA from the earliest stages of its policy development to ensure they take into account the consumer interest.'[82]

(a) The FCA Board appoints FSCP members with the approval of Treasury. The FCA must 'secure that membership of the Panel is such as to give a fair degree of representation to those who are using, or are or may be contemplating using, services other than in connection with business carried on by them.'[83]

(b) Members serve for a maximum period of two three-year terms, and are recruited through 'a process of open competition.'[84]

(c) In 2015, the Panel conducted a survey of stakeholders that

> *included the FCA and wider regulatory family, external organisations, trade associations and consumer groups. Results from the survey show that FCA staff and external stakeholders regard the Panel's work as relevant and topical. Its research is seen as rigorous, and there was broad acceptance among all groups of stakeholders that the Panel understands the needs and experiences of consumers.*[85]

(ii) The Practitioner Panel is designed to provide 'input from the point of view of the industry as a whole.'[86] The Panel's 'key remit is to represent the interests

[79] FCA Practitioner Panel, 'Background' <https://www.fca-pp.org.uk/background>.

[80] FCA Practitioner Panel, 'FCA Practitioner Panel Terms of Reference (12 December 2013). Available at <https://www.fca-pp.org.uk/sites/default/files/fca-pp-tor-20131212.pdf>

[81] Consultation Paper, 26.

[82] Financial Services Consumer Panel, 'What is the Panel' < https://www.fs-cp.org.uk/consumer-panel/what-panel>.

[83] Financial Services Consumer Panel, 'Terms of reference' <https://www.fs-cp.org.uk/consumer-panel/terms-reference>.

[84] Ibid.

[85] Financial Services Consumer Panel, 'Annual Report 2014/2015' (Report, 2015) 29. Available at <https://www.fs-cp.org.uk/sites/default/files/fscp_annual_report_2014-2015_final.pdf>.

[86] Financial Conduct Authority, 'FCA Statutory Panels' <https://www.fca.org.uk/about/operate/who/statutory-panels>.

of practitioners of larger firms, and to provide input to the FCA from the industry in order to help it in meeting its statutory and operational objectives in an effective manner.'[87] Its members are chosen as 'senior level representatives of each of the major regulated sectors.'[88]

(a) There is cross-representation between Practitioner Panel Board and the Smaller Business Practitioner Panel Board (SBPP), with the Chairman of the SBPP also being a member of the Practitioner Panel.

(b) Cross-representation is a useful and inexpensive way of ensuring there is operational coordination between two different entities.

(c) The Practitioner Panel also commissions an annual survey that 'aims to understand firms' views of the way the FCA is regulating the industry.'[89] The use of surveys is beneficial because it provides an empirical basis for assessing the effectiveness of the regulator at engaging with stakeholders. This should be considered with respect to ASIC as a means of enhancing its accountability.

(d) The Practitioner Panel is important because '[o]f the firms on which the FCA currently levies its fees, the top one hundred are responsible for 53.9% of those fees.'[90] The top 100 firms would most likely be represented by the Practitioner Panel.

(iii) The Smaller Business Practitioner Panel (SBPP) 'represents smaller regulated firms, who may otherwise not have a strong voice in policy making.'[91] Unlike the other sub-panels, it is 'not a statutory Panel but enjoys the same operational independence as the other Panels.'[92] It appoints 'senior level representatives of eligible practitioners to serve on this panel. Eligible practitioners are: "practitioners representing firms of small or medium size within their sector – whether by market capitalisation, funds under management, size of balance sheet and employees etc."'[93]

(a) In its Annual Report, the SBPP noted that '[s]maller firms differ in the way they communicate with the regulator. Many do not have dedicated resources dealing with regulatory information in the way that larger firms have. The Smaller Business Panel continues to provide constructive input to the FCA's work and our job is to raise the issues that are specific to smaller firms.'[94]

---

87 FCA Practitioner Panel, 'Background' <https://www.fca-pp.org.uk/background>.

88 Financial Conduct Authority, 'FCA Statutory Panels' <https://www.fca.org.uk/about/operate/who/statutory-panels>.

89 FCA Practitioner Panel, 'Annual Report 2014/15' (Report, 2015) 7.

90 Financial Conduct Authority, 'Annual Report and Accounts 2014/15' (31 March 2015) 86.

91 Financial Conduct Authority, 'FCA Statutory Panels' <https://www.fca.org.uk/about/operate/who/statutory-panels>.

92 Financial Conduct Authority, 'One minute guide – Panels (practitioner, smaller businesses, consumer)' <http://www.fca.org.uk/firms/being-regulated/meeting-your-obligations/firm-guides/organisations/guide-panels>.

93 Financial Conduct Authority, 'FCA Statutory Panels' <https://www.fca.org.uk/about/operate/who/statutory-panels>.

94 FCA Smaller Business Practitioner Panel, 'Annual Report 2014/15' (Report, 2015) 3.

(b) A Panel or sub-panel that represents small businesses will be crucial in Australia, given the importance of small business to the Australian economy.

(iv) Finally, the Market Practitioners Panel provides 'external and independent input from the point of view of financial market participants.'[95] Its members are chosen 'as senior level representatives of sectors participating in financial markets, with some specific requirements for membership in the legislation.'[96] There is extensive cross-representation with other Boards. [97]

8.8 It is worth considering the ways in which a Stakeholder Panel may undermine ASIC's operational independence. There are a number of relevant considerations:

8.8.1 Will the opinions of the Panel be advisory, will ASIC be required to have regard to them, or will ASIC have to consider them on an 'if not, why not' basis? The UK FCA must publish responses to the various panels. Similarly, in the Australian context, it may be desirable to require ASIC to publish responses to Panel representations, bearing in mind that they would not be binding on ASIC. This would minimise any perceived impact on its operational independence, while at the same time requiring it to articulate the reasons behind its response. This has the potential to increase transparency and accountability.

8.8.2 How many panels are appropriate? Should there be *one* Stakeholder Panel composed of a number of sub-panels or working groups, or should there be a number of distinct panels as is the case in the UK.

(i) The UK has four panels. In Australia, it would arguably be appropriate to recognise a Small Business Panel. Another panel might be the equivalent of a 'Practitioners Panel', which caters to the interests of big businesses.

(ii) It may also be appropriate to create a Financial Services Consumer Panel.

8.8.3 Who will be on the Panel? How will members of the panels or working groups be selected? Will criteria be identified, as is the case in the UK? Laying down the requirements in a 'terms of reference' or equivalent would be a good means of ensuring that there is transparency. Appointment to or removal from a board could be subject to the approval of ASIC or Treasury.

8.8.4 As is the case in the UK, each Panel could be required to produce an annual report on its meetings and deliberations.

8.8.5 Another key consideration is how the public interest might best be served through the creation of the sub-panels – as distinct from the individual interests of the various sub-panels. The membership of the panels will never be a perfect cross-section of Australian society. However, the 'Consumer Panel' may be the most appropriate sub-panel to represent public interest considerations given that the majority of the public are consumers of financial products.

---

95 Financial Conduct Authority, 'FCA Statutory Panels' <https://www.fca.org.uk/about/operate/who/statutory-panels>.

96 Financial Conduct Authority, 'FCA Statutory Panels' <https://www.fca.org.uk/about/operate/who/statutory-panels>.

97 FCA Markets Practitioner Panel, 'Terms of Reference' (12 December 2013) cl 10. Available at <https://www.fca-mpp.org.uk/sites/default/files/mpp-tor.pdf>.

8.8.6 If the recommendations of the sub-panels are non-binding and they have limited powers, the sub-panels' key utility will be the dialogue they create with ASIC and their ability to convey the views of the relevant stakeholders. So long as their recommendations and ASIC's responses are published, it should be possible to achieve transparency and accountability without affecting ASIC's operational independence.

* * * * * *

We hope that this submission assists the Inquiry in its deliberations. If you require further information please do not hesitate to contact us.