13 August 2021

Australian Securities and Investments Commission

By email:

Dear ASIC Team

Re: Cost Recovery Implementation Statement: ASIC industry funding model (2020–21)

The Australian Financial Markets Association (AFMA) welcomes the opportunity to comment to ASIC on the Cost Recovery Implementation Statement (CRIS) that outlines the ASIC industry funding model for 2020-21. With our membership of over 120 financial services firms, AFMA represents a wide spectrum of financial market participants operating in Australia that are subject to ASIC's cost recovery fees and levies. These include banks, stockbrokers, dealers, market makers, market infrastructure providers and treasury corporations.

The ASIC Cost Recovery model is flawed, but beyond scope of this consultation. There is currently insufficient accountability for large variances and overshoots which create a major impediment to doing business in Australian Financial Markets.

The categories of 'market infrastructure and intermediaries' and 'financial advice' have been particularly impacted by the significant variances in the estimated and actual costs over time. The market intermediary charges were put in place to enable market competition, yet the charges for messages came close to preventing the establishment of competition. These charges have also been a factor in the withdrawal of some significant participants from certain local markets, and subsequent reductions in liquidity. Through their volatility and increases over time they continue to create significant business challenges that should be addressed through a redesign of the charging system.

Financial advice is an area that ASIC's own work has agreed is no longer delivering affordable services for most Australians due to an excess of regulatory costs. ASIC's cost recovery program adds to the challenges that have created this outcome through its volatility and rising costs.

This submission addresses some of the high-level policy concerns held by AFMA that have become more pronounced in recent years. We trust our comments will be of assistance.

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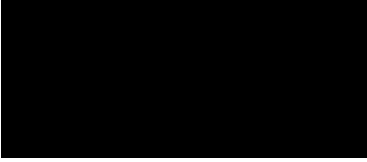
Please do not hesitate to contact us via the Secretariat for more information.

Sincerely



Nikita Dhanraj
Policy Manager

Volatile costs for the Intermediaries sector

ASIC's cost recovery arrangements continue to produce volatile cost fluctuations for investors and intermediaries each year. In March 2021, ASIC released its estimates for what it would charge each sector for the previous financial year (2019-20). At the same time, it released a statement on its actual charge. The actual charge for large futures participants was around 2.5 times higher than the predicted amount (see table below) and the previous year's charge.

Futures exchange participants saw increases in (1) the increase in unit trading cost from $0.0042 per lot to $0.0114 per lot (up 271%) and (2) an increase in the unit messaging cost from $0.00091 per message to $0.0019 per message (up 209%).

This type of volatility is unfortunately not unusual (see table below). Such unpredictability creates significant challenges for intermediaries providing services in the sector and ultimately increases costs further for investors.

Depending on the business model of the relevant intermediary firm this unpredictability can either impact the firm or directly impact investors. For intermediary firms that bill investors on an accrual basis these can cause investors to receive large and unexpected bills for transactions that are up to 21 months old.

For intermediaries bearing the charges, these are large unbudgeted expenses. The potential for large unbudgeted expenses creates pricing pressures that are not in the interest of investors.

We also note challenges with the per message charges. These are impossible for investors to know in advance and while we understand the theoretical reasons for including them in the calculation, we would argue the theoretical benefit is far outweighed by the frictions they create for intermediaries and ultimately costs for investors.

INTERMEDIARIES	ASIC Levy 18-19			ASIC Levy 19-20				ASIC CRIS 20-21	
	Estimated	Actual	*Estimated vs Actual Diff*	Estimated	Actual	*Estimated vs Actual Diff*	*Actual YoY Diff*	Estimated	*Actual vs Estimated (YoY)*
Large Securities Exchange Participants	16.744	16.242	-3.00%	16.947	19.849	17.12%	22%	18.995	-4.30%
Large futures exchange participants	3.827	2.169	-43.32%	2.046	5.101	149.32%	135%	6.383	25.13%
Securities dealers	1.594	2.465	54.64%	2.657	1.391	-47.65%	-44%	1.369	-1.58%
Corporate advisors	4.425	5.916	33.69%	5.034	4.678	-7.07%	-21%	2.527	-45.98%
OTC Traders	4.584	7.877	71.84%	8.089	9.661	19.43%	23%	10.497	8.65%
Retail OTC traders	5.366	4.848	-9.65%	5.523	10.384	88.01%	114%	11.164	7.51%
Wholesale electricity dealers	0.125	0.082	-34.40%	0.073	0.028	-61.64%	-66%	0.091	225.00%
Source: ASIC									

We note also in passing that the CRIS provides little visibility into the use of funds or investment raised from the industry for enforcement activities. These enforcement activities are a major reason for the large variances between estimated and actual costs. The explanations provided by ASIC in relation to them do not provide significant insight into where these costs are incurred.

Alternative funding models

Paragraph 20(a) of the CRIS states that the industry funding model used by ASIC ensures that the costs of the regulatory activities undertaken by ASIC are borne by those creating the need for regulation. The variable nature of the cost recovery makes it difficult for participants not working on an accrual basis to pass on these costs to the institutional clients which are driving them. We propose changes below that would go a long way to address the uncertainties.

Alternative funding model for futures exchange participants

AFMA suggests ASIC considers for futures participants implementing a "per lot" fee model charged to clearing rather than executing brokers similar to that used by the National Futures Association (NFA) in the USA. This fee is associated to each futures trade and is a separate line item in futures statements. While there are some differences in the purposes of the ASIC Cost Recovery and the NFA assessment fee[1], the model gives market users certainty of the cost of regulation and accurately links the costs with the demands of clients and activities, creating the need for regulation. Critically the charge must not be subject to change after it is announced for the upcoming year.

This proposed approach would allow clarity and certainty for investors, and for intermediaries to ensure they are implementing an efficient charging structure that is much less likely to result in unexpected and unbudgeted variances.

AFMA would also like ASIC to consider a minor technical change to the calculation of the total number of lots traded by a large futures exchange participant, specifically relating to spread/strategy trades. Currently ASIC will consider the strategy as well as the underlying legs of the strategy when totalling the number of lots. For example, trading one ten-year exchange listed roll strategy (consisting of two underlying quarterly futures) would be calculated as three lots. Our view is that this should only equate to two lots (the two underlying quarterly contracts) as they are ultimately the positions taken by the market user. This would also help align with the information used by internal clearing systems and futures client statements. A move to an NFA style charging regime as suggested based on charging the settlement broker may implement this change as the settlement broker would see the underlying legs.

Alternative funding model for securities exchange participants

[1] NFA Assessment Fee Model.

AFMA suggests ASIC enable securities participants to implement a similar charging structure based on a per transaction charge that is fixed and known in advance. Such a model would bring increased predictability, allow for ease of accurate pass-through to investors and prevent investors and intermediaries receiving large, unexpected bills for activities up to 21 months ago.

OTC trader count methodology

A key priority for the industry is to resolve the uncertainties around the OTC trader metric used in calculating cost recovery allocations. In order for a fair distribution of substantial costs for the industry it is important that there is a widespread common understanding of the application of the OTC trader count methodology.

There currently is a lack of certainty around the intended application of the definition, particularly in relation to staff that might work for two or more entities, and staff that may execute occasional bookings to an entity where this activity is not ordinarily carried out by them.

AFMA understands that the OTC Trader metric currently could potentially be read on a technical basis to include overseas staff working on foreign listed markets, such as US Cash Equities and Futures as only Australian listed markets have been excluded from the OTC Trader metric. The industry is of the understanding that this is not the intent of the metric. For clarity we would request that both domestic and international listed markets be explicitly excluded from this headcount metric. This clarity would be appreciated and aid consistency on approach across our members.

Firms are working on a good faith basis around the uncertainties but are keen to have the uncertainties resolved.

AFMA has undertaken a project to propose revised drafting which we would be pleased to share with ASIC for your consideration.

Unsustainable costs for the Financial Advice sector

The financial advice sector has gone through a number of high-cost regulatory changes beginning with FOFA that have rendered financial advice inaccessible for a majority of Australians. ASIC itself has recognised that the cost of advice is typically five times what people are willing to pay.

AFMA's representations to the government, including to ASIC's consultation *CP 332 Promoting access to affordable advice for consumers*, note several drivers of increased costs of providing and receiving good quality advice. A common basis for these increases is that the move to shift risks to the providers has increased the resourcing requirements and risks, and thereby costs which are passed on to the decreasing numbers of retail investors that can still afford advice.

Considering these costs, many firms have either left the advice space or have substantially reduced the size of their advice businesses. This presents a concerning regression towards an Australian financial advice sector with increasingly uncompetitive conditions for new and existing firms, and reduced choice for consumers.

The ASIC cost recovery model for the advice sector contributes to these high-cost conditions of the industry at an ever-increasing rate.

FINANCIAL ADVICE SECTOR	**ASIC Levy 18-19**			**ASIC Levy 19-20**				**ASIC CRIS 20-21**	
	Estimated	Actual	*Estimated vs Actual*	Estimated	Actual	*Estimated vs Actual*	*Actual YoY Diff*	Estimated	*Actual vs Estimated (YoY)*
Licensees that provide personal advice to retail clients on relevant financial products	25.031	33.028	31.95%	40.17	56.189	39.88%	70.13%	71.39	27.05%
Licensees that provide personal advice to retail clients on products that are not relevant financial products	1.232	0.125	-89.85%	0.168	1.264	652.38%	911.20%	1.76	39.24%
Licensees that provide general advice only	0.836	0.737	-11.84%	0.829	2.089	151.99%	183.45%	2.971	42.22%
Licensees that provide personal advice to wholesale clients only	0.855	0.181	-78.83%	0.245	0.048	-80.41%	-73.48%	0.043	-10.42%
Total									**98.10%**

Source: ASIC

AFMA members that are captured under the financial advice sector by ASIC Cost Recovery, risk facing unsustainable levies, with the ASIC recovery costs for financial advisers increasing by more than 340 percent over the last four years. Given previous years' trends, the actual levy figure could be significantly higher, and the CRIS could underestimate the final costs to financial advisers on a per advisor basis due to the declining number of registered financial advisers in Australia.

The primary concern in this regard is that the levy amount each year has been unpredictable which makes it impossible for financial planning service providers to effectively budget. The levies have also been increasing at high rates. The Government's Compensation Scheme of Last Resort is expected to add to these regulatory costs borne by firms.

AFMA suggest ASIC reviews the causes for its charges on financial advisers and considers whether its overall regulatory stance towards the industry is optimised given the net outcomes on the sector of the current regulatory settings and charges. It is possible that spiralling charges at a time of a falling number of advisors are not in the best interests of the industry even when offset against the intended benefits of ASIC's additional work in the area.