Stockbrokers
Association of Australia
Incorporating SDIA

28 August 2014

Mr John Lonsdale
Head of Secretariat
Financial System Inquiry
The Treasury
Langton Crescent
PARKES ACT 2600

By email: fsi@treasury.gov.au

Dear Mr Lonsdale,

Financial System Inquiry
- *Interim Report*

The Stockbrokers Industry Association, as the peak industry body representing wholesale and retail stockbrokers and investment banks in Australia, would like to make the following comments in relation to the Interim Report of the Financial System Inquiry released July 2014.

Our Submission of 31 March 2014 focused on the following areas:

1. Compliance Costs
2. Regulatory Structure
3. Extension of Market Integrity Rules to non-Market Participants
4. Wholesale /Retail Client definitions
5. Use of Share registers
6. Bad Apples
7. Designated Trading Representatives

While we note that not all of the above issues were addressed in the Interim Report, we are pleased that Bad Apples and the Extension of the Market Integrity Rules to non-Market Participants were discussed.

In addition, we note the other streams of work that are relevant to the Inquiry's terms of reference. The Government has announced[1] that there will be an **Enhanced Register of Financial Advisers** to assist clients to verify the status and credentials of their adviser. The Association is pleased to be working with the Government on developing these and other proposals as to **Professional Standards** through the *AFSL Working Group*, appointed by the Acting Assistant Treasurer, Senator the Hon Mathias Cormann. While the first version of the Register will not be able to alert clients to lower level misconduct, usually indicative of Bad Apples, the Register is a good first step.

Our comments on particular aspects of the Interim Report are set out as follows. We have not addressed all of the subject areas in the Interim Report, but have focussed on particular areas more directly relevant to the stockbroking industry.

All the references are to Part 3 of the Interim Report ***Post–GFC Regulatory Response***, citing the topic heading and its page number as the reference:

6. Consumer Outcomes

CONSUMER PROTECTION FRAMEWORK IN FINANCIAL SERVICES 3- 50

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- ***No change to current arrangements.***
- ***Improve the current disclosure requirements using mechanisms to enhance consumer understanding, including layered disclosure, risk profile disclosure and online comparators.***
- ***Remove disclosure requirements that have proven ineffective and facilitate new ways of providing information to consumers, including using technology and electronic delivery.***
- ***Subject product issuers to a range of product design requirements, such as targeted regulation of product features and distribution requirements to promote provision of suitable products to consumers.***
- ***Provide ASIC with additional powers such as:***
  - ***Product intervention powers to prescribe marketing terminology for complex or more risky products.***
  - ***A power to temporarily ban products where there is significant likelihood of detriment to consumers.***
- ***Consider a move towards more default products with simple features and fee structures***

The Inquiry seeks further information on the following areas:

[1] Senator the Hon Mathias Cormann, Acting Assistant Treasurer Media Release: *Establishing an enhanced public register of financial advisers* 17 July 2014

• ***Do similar issues in relation to the PDS disclosure regime apply to prospectuses, and is there a need to review prospectus requirements?***
• ***What evidence is there on the effectiveness of financial literacy strategies in enhancing consumer confidence and decision making at particular points in time, and in achieving increasing literacy over the long term?***

On the question of the adequacy of disclosure, the existing disclosure laws serve a very useful function. Whilst it may be the case that many investors do not take the trouble to read disclosure documents such as PDS's and FSG's, those documents contain very important statements that bind issuers or financial service providers, as the case may be.

The Association does not support watering down those obligations. Advisers and analysts will closely analyse disclosure documents and highlight key features for the benefit of investors, even if not all investors take the time to do so themselves.

The Association does see value in exploring alternative ways of making disclosure to investors. Given the increasing tendency of people to avoid digesting written material, utilising new technology to deliver disclosure is a desirable course of action and a preferable one to considering removing disclosure obligations because they are thought not to work.

As regards conferring greater powers on ASIC with regard to financial products, we note that ASIC has publicly stated its desire for similar powers to those conferred on regulators in overseas jurisdictions. As a general principle, the Association does not support Australia automatically following overseas regulatory design, and strongly argues that overseas provisions should only be adopted if they are suited to the local situation.

In view of experience in recent years with products that proved to be unsuitable for retail investors, the Stockbrokers Association considers that there are good reasons for ASIC to have powers to intervene in the marketing and/or availability of those products, comparable to powers granted to other similar regulators in other jurisdictions. Such powers should be subject to appropriate oversight mechanisms to ensure that they are used appropriately.

FINANCIAL ADVICE 3-63

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

• ***No change to current arrangements.***
• ***Raise minimum education and competency standards for personal advice (including particular standards for more complex products or structures, such as SMSFs) and introduce a national examination for financial advisers providing personal advice.***
• ***Introduce an enhanced public register of financial advisers (including employee advisers) which***

includes a record of each adviser's credentials and current status in the industry, managed either by Government or industry.
• Enhance ASIC's power to include banning individuals from managing a financial services business.

The Association supports the lifting of standards for personal advice. We are represented on the Government's *AFSL Working Group* which has just finished its Report to the Acting Assistant Treasurer on the **Enhanced Public Register** of financial advisers. The Working Group is now working on the minimum levels of qualifications, training and experience for financial advisers, together with professional standards.
While the **Enhanced Public Register** is a worthy initiative, and will allow consumers to access much more information on the status of their advisers than is currently the case, we hope that the register can go much further in the future. This is essential to address the problem of *Bad Apples*.

Bad Apples is the term used to refer to individuals who move from Firm to Firm, causing legal and regulatory problems for the organisation, and significant losses for clients. Lack of a mechanism for licensed firms to properly identify past misconduct by prospective employees – particularly client losses or breaches which have not given rise to concluded regulatory action – has exacerbated this problem. ASX removed a rule requiring reference checking in 1998. ASIC has recently proposed that such a rule for all AFSL holders, not just for market participants[2].

In 2004, the Association formulated a scheme for specified misconduct by representatives to be reported by Member Firms to a central register. This register would then be checked by Member Firms, prior to hiring. However, due to the **risks** inherent in running such a scheme, the Board resolved not to proceed. (These risks include the Association and/or its Members facing litigation or regulatory action for defamation, malicious falsehood, negligence, interference with contractual relations, TPA anti-competitive and/or misleading or deceptive conduct, and/or breaches of Privacy legislation. In addition it may not capture representatives who move from other sectors - e.g. financial planning - into stockbroking.)
Accordingly, the Association has since 2006 sought law reform to establish a reporting scheme with appropriate legal protections for the financial services industry, along the lines of well-established international schemes. Various statutory models (U.S., U.K., Hong Kong, etc.) provide for compulsory reporting of specified misconduct, and protection in making and accessing such reports. The U.S. scheme, administered by FINRA, is proposed by the Association as a model for an Australian scheme.

[2] ASIC *Main Submission to Senate Economics Committee Inquiry into the performance of the Australian Securities and Investments Commission* October 2013 (Submission 45) *Mandated reference checking* page 156, paragraph 581

In the United States, when a person leaves a licensed firm, the Firm must lodge a 'Form U-5' which discloses matters regarding the person, including:

- Investigation Disclosure – ongoing investigations or proceeding by a regulator
- Internal Review Disclosure - internal review for fraud, etc.
- Criminal Disclosure – convictions for felonies or investment-related misdemeanours
- Regulatory Action Disclosure – concluded actions by a regulator
- Customer Complaints – client claims of over $15,0000
- Termination Disclosure – circumstances of the termination

The Form U-5 disclosures are accessible to investors via FINRA's BrokerCheck, and must be searched by prospective employers. The U.S. system is based on the premise that **consumer protection outweighs the individual adviser's right to privacy**. We trust that one day this premise will drive the regulatory approach to this issue.

ACCESSIBILITY 3-69

The Inquiry seeks further information on the following areas:

- ***What opportunities exist for enhancing consumer access to low-cost, effective advice?***
- ***What opportunities are there for using technology to deliver advice services and what are the regulatory impediments, if any, to those being realised?***
- ***What are the potential costs or risks of this form of financial advice, and what measures could be taken to mitigate any risks?***

Scaled Advice

In Stockbroking, clients often seek advice on a limited basis, for example, a brief inquiry as to which stock(s) to buy or sell. Clients don't often require a full financial plan or advice on their entire circumstances or portfolio of investments. We were therefore pleased to see that the FOFA process acknowledged the different levels of service that a client may require. For example, the Explanatory Memorandum to the FOFA Bill *Corporations Amendment (Future of Financial Advice) Bill* 2011 stated:

> 1.29 These requirements are designed to accommodate the provision of limited advice (also referred to as '**scaled advice'**) that only looks at a **specific** issue (for example, single issue advice on retirement planning) and **'holistic'** advice that looks at all the financial circumstances of the client. In situations where limited advice has been requested by the client the adviser is able to **tailor** the information they obtain about the client solely to what is necessary to provide that form of advice. However, the adviser is required to exercise professional judgement and advise the client if they believe advice on another subject matter could better meet the client's needs and objectives. This reflects the fact that retail clients may not always know what type of advice will meet their needs and objectives. *(emphasis added)*

ASIC Guidance also seeks to facilitate tailored or scaled advice[3]. By way of background to the guidance, ASIC notes that a survey at the time found that **one-third** of Australians prefer scaled or 'piece-by-piece' financial advice rather than comprehensive or 'holistic' advice. (Our Members would suggest that if this survey were solely conducted in **stockbroking**, the figure would be significantly **higher** than one-third.)

While advice may be 'scaled', it does not mean that the client is getting lower quality advice. This is because it still amounts to 'personal advice' under the Act and attracts all of the requirements as to suitability, best interests and client priority obligations introduced by FOFA, together with other consumer protection measures like complaints handling.
Accordingly, we believe that the regulatory policy settings have been improved through the FOFA process. Especially as the new provisions are still bedding-down, we do not see the need for any regulatory change in this area.

INDEPENDENCE 3-72

The Inquiry seeks further information on the following areas:

•***Is there is a case to more clearly distinguish between independent and aligned advisers, and what options exist for doing this?***
•***Would consumers be likely to understand the difference between aligned and independent advisers and, if so, to what extent would this be likely to factor into a consumer's decision to take the advice?***
•***Would consumers be likely to be sensitive to differences in the price of independent or aligned advice?***

In stockbroking, unlike other sectors like financial planning, independence is largely irrelevant. Stockbroking firms are not in the habit of obfuscating their ownership structures via such means as corporate structures or dealer groups. It is the firm that usually holds the AFSL, and the adviser is a representative or Authorised Representative of the firm. This is clear to the client, and is reinforced by disclosures including those in the *Financial Services Guide.*

Indeed, the ownership of the firm may not be always be relevant, because the key is the independence of the products being recommended. In traditional stockbroking advice on listed equities, the advice is product-neutral, unless there is a corporate relationship with the Issuer, which is disclosed.

While some groups are aggressively marketing themselves as *independent*, the fact is that under the current definition of independence under section 923A of the *Corporations Act*, very few are independent. It has been estimated that less than 100 of the approximately

[3] ASIC Regulatory Guide 244 *Giving information, general advice and scaled advice* December 2012

5,000 AFSLs on issue belong to firms which meet that definition. This begs the question as to the utility of the definition, especially given recent amendments to the *Act* made by the FOFA reforms.

The suitability of the advice is the key, not the actual or perceived 'independence' of the adviser or the firm. If there was any doubt previously, FOFA makes it clear that the interests of the client are paramount. Through the best interests duty, and the requirements to give advice that is *appropriate* for the client and to put the client's interests ahead of the adviser[4], it is very clear that even the most *aligned* adviser still has to put the client's interests first.

Independent advisers aggressively market themselves as being superior to aligned advisers, but from the client's point of view this is not necessarily the case. Indeed, the scare-campaign being run by the so-called independent sector may be misleading to clients. You don't go to a Skoda dealer to buy a Holden, and in the same way you wouldn't expect your Bank to market another Bank's products to you. The key is that your Bank must give you advice that is appropriate for your circumstances, which may well mean that another Bank's products are the best for you.

GENERAL ADVICE 3-73

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options:

•No change to current arrangements
• Rename general advice as 'sales' or 'product information' and mandate that the term 'advice' can only be used in relation to personal advice

The delineation between personal and general advice in the Act has been in operation for over 10 years since the 2002 *Financial Services Reforms* came into operation in March 2004.

In stockbroking, the scheme is well understood. The main category of general advice is **equities research**, which is produced by stockbrokers and investment banks. It contains detailed analysis of a company and possibly forecasts as to price and recommendations to buy/sell/hold etc. However, it is purely product-specific and is not produced with any reference to clients. Advisers then used this research to tailor advice to particular clients. So long as the mandatory general advice warning is delivered, the onus should be on the client to appreciate the distinction. Good advisers ensure that clients do understand the nature of the service they are getting. The key is that the client understands this. This is emphasised in ASIC's extensive policy guidance on the differences between giving personal

[4] *Corporations Act 2001* sections 961B, s961G, and s961J respectively

or general advice, or just giving out information[5]. Any new system of *labelling* of advice runs the risk of causing confusion to the investor (and the adviser).

Some clients might not understand the meaning of the general advice warning, but this illustrates the need to increase financial literacy.

The answer to any perceived issues in this area may lie with **better financial literacy** rather than **better labelling**. Accordingly, we believe that the legal and regulatory policy settings in this area are appropriate and reform is not justified.

CONSUMER LOSS AND COMPENSATION 3-84

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options:

- ***No change to current arrangements.***
- ***Amend the existing regulatory framework for managed investment schemes.***

The Inquiry seeks further information on the following area:
Given the limitations of professional indemnity insurance, what options, if any, exist for addressing the issue of consumer loss?

The stockbroking industry has led the way in compensation arrangements. For many years, our members have been subject to compensation requirements in excess of ASIC or legislative requirements. These existed under former ASX requirements, which are now (since the changes to market supervision in August 2010) set out in the ASIC (ASX) Market Integrity Rules. Our Member firms who provide services to retail clients are already subject to the following requirements:

- Compulsory Professional Indemnity insurance requirements;
- Minimum liquid capital requirements in excess of normal AFS licensees' which are a key feature to ensure that funds are available for compensation to clients; and
- NGF cover: additional client protection exists through the National Guarantee Fund, which guarantees the completion of transactions and protects client property on insolvency or unauthorised transfer on the part of the broker.

These higher standards, are reflected in figures from the **Financial Ombudsman Service** of complaints against stockbrokers. Over recent years there has been a consistent decline in complaints. As the following figures released by FOS show, the downward trend in complaints against stockbrokers post-GFC has continued:

Total disputes accepted against stockbrokers
1 May 2012 to 30 April 2013 – 62 -
1 May 2013 to 30 April 2014 – 51 (↓18%)[6] -

[5] ASIC Regulatory Guide 244 *Giving information, general advice and scaled advice* December 2012

It is often said at the moment that there is a high rate of non-payment of FOS determinations, so that somewhere in the region of 30% of awards are not paid. As FOS figures show, if this is so, it is not from the stockbroking sector but from a relatively small number of rogue financial services firms[7]. Stockbrokers should not have to subsidise these lesser capitalised and regulated sectors.

Accordingly, we do not see the need for any change in this area.

In saying this, we agree with the recommendations of Mr Richard St.John, who conducted a major review of compensation arrangements in the financial services sector for the Government in 2011-12[8].

In relation to the establishment of a **last resort scheme** for compensation, Mr St.John concluded that it would be inappropriate and possibly counter-productive to introduce a last resort compensation scheme at this stage.

In his Report, Mr St.John stated[9] -

> *7.43 A last resort scheme would have the effect of imposing on better capitalised and/or more responsibly managed licensees the cost of bailing out the obligations of failed licensees. It would not work to improve the standards of licensee behaviour or motivate a greater acceptance by licensees of responsibility for the consequences of their own conduct. It could well introduce an element of regulatory moral hazard by reducing incentive for stringent regulation or rigorous administration of the compensation arrangements.*

The Stockbroking industry is an example of a better capitalised sector with higher standards. Any proposal to establish such a scheme must take into account our sector's excellent record in relation to client complaints and award recovery, otherwise it would introduce the risk of **moral hazard**, where less ethical sectors obtain the benefit of protection from better regulated and more ethical sectors like ours. We also showed that Stockbrokers have an excellent record of investor protection, and should not have to subsidise less scrupulous operators. As Mr St.John said[10] –

> *To put it another way, the regulatory platform for financial advisers and other licensees needs to be made more robust and stable before a safety net, funded by all licensees, is suspended beneath it.*

[6] FOS Ombudsman Alison Maynard Presentation at 2014 Annual Stockbrokers Conference May 2014
[7] Financial Ombudsman Services *The Circular – Unpaid Determinations: Update* August 2014
[8] Richard St.John *Report on Compensation arrangements for consumers of financial services* April 2012

[9] Richard St.John *Report* page 143 paragraph 7.43
[10] Richard St.John *Report* page 145 paragraph 7.50

7 Regulatory Architecture

REGULATORY BURDEN 3- 91

The Inquiry seeks further information on the following areas:

- ***Is there evidence to support conclusions that the regulatory burden is relatively high in Australia when considered against comparable jurisdictions?***
- ***Are there examples where it can be demonstrated that the costs of regulation affecting the financial system are outweighing the benefits?***
- ***Are there examples where a more tailored approach could be taken to regulation; for example, for smaller ADIs?***
- ***Are there regulatory outcomes that could be improved, without adding to the complexity or volume of existing rules?***
- ***Could data collection processes be streamlined?***
- ***If new data is required, is there existing data reporting that could be dropped?***
- ***Instead of collecting new data, could more be made of existing data, including making more of it publicly available?***

We comment later in this Submission that the regulatory burden in relation to market supervision is extremely high by reason of the design of the Cost Recovery model that has been adopted for the ASIC market supervision budget. (See the comments under 3-108 below). The costs are high because of the amount being recovered, and the relatively small number of stockbroking entities who are bearing the lion's share of the burden. We have commented on how this regulatory burden has operated counter to a number of key Government objectives.

This regulatory burden has also led to a regulatory gap in that it has served as an incentive to entities to leave the well-regulated stockbroking sector, thereby avoiding the costs of regulation, and to operate in the less regulated securities dealer sector.

The key, as we say, is for a redesign of the cost recovery arrangements so that the burden is shared more fairly amongst the full spectrum of those who derive a benefit from market regulation; and for ASIC to direct more effort and resources towards the lightly regulated sectors such as the securities dealer sector, and to take stronger and more frequent enforcement action.

Better use of data collection. One area which merits exploring is the identification of companies and individuals. At present, vast amounts of financial and human resources are devoted on a continuous basis worldwide in carrying out customer identification (KYC) processed.

Every time a person or entity seeks to do business or seeks a financial service, or many other services, they will most likely have to undergo KYC procedures. This process might therefore be duplicated many times over as the customer is in turn identified by each service provider, which will ask for the same documents, carry out the same searches, identification and verification procedures, and so on.

The main (but not only) reason for rigorous KYC procedures has been Anti Moneylaundering (AML) requirements. However, the FATCA requirements emanating from the US, soon to be followed by the Common Reporting Standard emanating from the G20, will see further customer identity processes being embarked upon many times over throughout the world.

Rather than perpetuate this ongoing duplication of effort, one potential solution which warrants consideration is for the creation of a central customer identification database to be maintained in a jurisdiction. A person or entity, if it chose to participate in the database, could be identified once according to a global standard, and that information could then be made available (if authorised by the person) to any entity to enable them to satisfy their KYC processes for each of the relevant statutory regimes that are applicable. This could have the potential for considerable savings in time, effort and money, both for the client (who has to satisfy the same KYC requests) and for the entities undertaking the KYC processes.

CONDUCT REGULATION 3- 106

The Inquiry seeks views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- ***No change to current arrangements.***
- ***Impose AFSL requirements for providers of fund administration and technology service of sufficient scale.***
- ***Apply market integrity rules for licensed securities dealers that provide investor services substantially similar to market participants of a licensed financial market.***
- ***Introduce a mechanism to allow a heightened level of regulatory intensity to be applied where risk arises outside the conduct perimeter.***

The existing AFSL regime already contains a great deal of flexibility for ASIC as regards the various competencies that must be evidenced in order for an AFSL to be granted, and to continue to be held. It is up to ASIC to set appropriate standards and to enforce those standards including by implementing a satisfactory surveillance and monitoring program.

There are a number of instances where ASIC has not demonstrated sufficient monitoring of AFSL behaviour in key sectors of the market. These include the area of financial advice, of which so much has recently been written, and also the area of securities dealers, who provide services akin to stockbrokers but are not subject to the higher capital, conduct and supervision standards of the Market Integrity Rules. The number of securities dealers offering services akin to stockbroking has grown significantly due to the lower capital, IT, compliance, regulatory and supervision costs, but ASIC’s monitoring has not kept pace. On occasion, these entities misrepresent themselves as being stockbrokers, which is a term that is restricted to market participants under the Act[11].

[11] Section 923B

Significantly, Market Participants subject to the Market Integrity Rules are also subject to Market Supervision Fees, currently running at $14m per annum across the sector.

In relation to these areas, the level of regulatory risk definitely requires a heightened level of regulatory intensity. However, this does not require any new 'mechanism'. It simply requires greater and more targeted effort by ASIC in identifying what needs to be addressed, and making the decision to deploy resources to follow this up. If ASIC does not have sufficient resources to do this adequately, then ASIC needs to demonstrate why its resources are not adequate, and for either existing resources to be re-prioritised, or for the Government to provide additional resources if this is warranted.

Provided that an appropriate regulatory and supervisory regime, and appropriate professional standards and investor protection, are applied to the securities dealer sector, then the growth of this sector should not pose the same regulatory risk than the Association believes it does at present. However, it is our view that an appropriate regulatory framework is not yet in place, and this should be addressed as a matter of high priority. We have therefore submitted for a number of years that the market integrity rules be extended to those whose businesses are akin to stockbroking.

REGULATORY INDEPENDENCE AND ACCOUNTABILITY 3- 108

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- ***No change to current arrangements.***
- ***Move ASIC and APRA to a more autonomous budget and funding process.***

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- ***No change to current arrangements.***
- ***Conduct periodic, legislated independent reviews of the performance and capability of regulators.***
- ***Clarify the metrics for assessing regulatory performance.***
- ***Enhance the role of Statements of Expectations and Statements of Intent.***
- ***Replace the efficiency dividend with tailored budget accountability mechanisms, such as regular audits and reviews to assess the regulators' potential for savings.***
- ***Improve the oversight processes of regulators***

This topic raises some very significant issues.

On one level, the idea of moving ASIC and/or APRA onto a more autonomous budget and funding model presents some advantages. In theory, those agencies would be less susceptible to denial of adequate funding for their purposes in cases when government

funding sources were subject to acute budgetary pressure. Autonomous funding has the potential to safeguard funding for critical programs, and to allocate the costs fairly according if sound principles of cost recovery were used.

There are however some dangers in moving to such a model, which have already been directly experienced in relation to the model used for ASIC's Cost recovery of its market supervision costs.

I. Impact of Unfair cost allocations

Under the ASIC Cost recovery model, the stockbroking industry has been the subject of cost recovery arrangements arising from three key areas. Under the model employed, the stockbroking industry bears the financial burden of the overwhelming proportion of the ASIC Market Supervision cost recovery levy (some 78% of the total amount).

We note the reference on page 3-110 to various cost recovery principles, including:-

> *'Total funding should be proportionate to the size, complexity and nature of the regulated population.'*

This in our view has clearly not been the experience of the stockbroking industry in relation to the ASIC Cost recovery model. No amount of representations to Treasury, to ASIC and to the Department of Finance and Deregulation, have had any influence in causing any reconsideration of this model.

Included in these representations have been submissions that the cost recovery liability be shared more evenly with other sectors directly involved in this area of ASIC's function, including fund managers, listed entities and securities dealers. This has not eventuated.

Therefore, the Stockbrokers Association has grave reservations as to the extent to which the principle of proportionality will be applied to ASIC funding arrangements. The Association would be most concerned as to the impact of a disproportionate sharing of the cost recovery burden if ASIC and/or APRA were to move to a full cost recovery model.

II. Lack of holistic approach to funding ASIC and APRA

The stockbroking industry is an example of an industry where there multiple applications of cost recovery is already in operation. Apart from ASIC Cost Recovery, stockbrokers are already liable for the AUSTRAC cost recovery levy to fund that agency's anti- money laundering supervisory function, shortly to extend to recovery of all of AUSTRAC's budget. In addition, members that are part of a group that is APRA–regulated may already also bear a share of their group's APRA cost recovery arrangements.

Careful thought needs to be given to the financial impact that further cost recovery, should ASIC and/or APRA move to full autonomous cost recovery of their entire budget, on the financial sector (which has elsewhere been identified as a key source of creation of high quality jobs for Australians to replace job losses in other industries that are disappearing). The consideration of funding ASIC and APRA should not be considered in isolation. There needs to be a holistic picture of the cumulative burden of cost recovery already in place in relation to the financial sector, particularly the stockbroking industry, and the distortive or weakening impact that may flow from continued application of cost recovery to that industry or group.

III. Conflict with other Government Policy Objectives

Careful thought needs to be given as to the extent to which further cost recovery would undermine key Government policy objectives identified and being pursued. These include:

(a) **Fostering Australia as a regional financial centre**. It has been a key objective of this Government to foster Australia's growth as a regional financial centre. The Government has sponsored the Johnson Committee, and has committed to executing a number of the key reforms which were advocated by the Report issued by the Johnson Committee. One of the key elements in Australia's push to establish its regional credentials is its equity market. Adding further cost burden onto participants in Australia's equity markets would run counter to this objective and would weaken the sector at the very time that the Government is seeking to grow it.

(b) **Fostering employment in the financial services industry.** -Australia has been suffering weak employment growth in recent years, and the Government has been providing assistance to key industries to ensure that jobs are retained in Australia. It seems illogical to pursue initiatives to preserve employment in areas such as manufacturing, where Australia's comparative advantages globally would not be strong, when at the same time add further cost recovery arrangements which would weaken employment in the financial services sector, where Australia is potentially well placed to create skilled jobs for Australians and to export services to the region.

(c) **Increasing -the extent to which Australian investors to seek advice in relation to their investments.** The Government has stated a policy objective of increasing the availability of quality investment advice to ordinary Australians, and increasing the extent to which Australian investors seek investment advice. Imposing additional cost recovery on the stockbroking industry runs counter to this objective, and would exacerbate the job losses

that have already followed the imposition of the existing ASIC cost recovery arrangements.

(d) **Fostering - the growth of investment funds in particular, funds in superannuation accounts.** The Government has implemented various policies to introduction in the equities markets to increase efficiency and to drive down transaction costs to investors. Reductions in transaction costs have a significant bearing in the amount of funds in managed investments. The impact of a fees on the overall balance of superannuation funds over an investor's lifetime has been well documented. Whilst competition has driven down exchange fees, the introduction of cost recovery arrangements have served to load fees back onto the industry, undoing the benefits of competition. Adding further cost recovery to ensure all of ASIC and/or APRA's funding would further run counter to this particular Government objective.

IV. Lack of Supervision of Agency Spending

Any move towards placing APRA and/or ASIC on a full autonomous funding model should not occur without the introduction of adequate supervision over the level of spending, and the ability of the industries who will bear the cost of funding those agencies with having some say on the amounts they are being called upon to pay.

The ASIC Cost Recovery arrangements have highlighted the lack of transparency over project spending, and the inability of market participants to have any real input on that spending. ASIC has recently recovered approximately $42 million from industry, predominantly from the stockbroking industry, to pay for an enhanced electronic market surveillance system. This amount has subsequently been revised down and an amount of $5 million returned back to industry due to the project coming in under budget.

Whilst the industry did not take issue with ASIC's need for a new system, market participants did not have any understanding why the cost of the system needed to be so high. Participants have considerable understanding of the costs of developing electronic trading software, being an essential part of the business of many of them, and could not see why a surveillance system should have cost as much as was budgeted. However, there was no mechanism or ability to have any input into the process. There is an inherent lack of fairness in being asked to pay for a budget over which one has no control. If ASIC and/or APRA were to move to an autonomous fully cost recovered model, there would need to be some means of close supervision to ensure that industry could have confidence that prudent discipline and cost control was being applied by those agencies in setting their budgets.

EXECUTION OF MANDATE 3- 120

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- ***No change to current arrangements.***
- ***Strengthen competition considerations through mechanisms other than amending regulators' mandates.***
- ***Refine the scope and breadth of ASIC's mandate.***
- ***Review the penalty regime in the Corporations Act.***
- ***Review mechanisms to attract and retain staff, including terms and conditions.***

The Inquiry seeks further information on the following areas:

- ***Are changes needed to strengthen and/or refocus ASIC?***
- ***Is the current enforcement regime adequate? Does ASIC have adequate powers?***
- ***Are there alternative mechanisms for promoting better consideration of competition within financial sector regulation?***

ASIC possesses a formidable range of remedies available to it under legislation to deal with conduct falling under its mandate. To the extent that there has been public criticism of ASIC over the years, from our observation this has stemmed from accusations that ASIC has failed to act, or has acted too late, when issues have arisen. It has not been that ASIC wanted to act but did not have the power to do so.

For this reason, the Stockbrokers Association has not identified any areas where it considers that ASIC needs more powers added to its armoury (save for the comments regarding powers to intervene in relation to unsuitable products which we make under 3-50 above). We do not believe that giving additional powers to ASIC is a high priority.

The Association notes that the Interim Report has identified the absence of powers of disgorgement of profits in relation to non-criminal proceedings, unlike some jurisdictions such as Canada. If the availability of disgorgement remedies exists in criminal proceedings, then there is no logical reason why those remedies ought not to be available in civil proceedings as well.

However, the Association is opposed to an agency being both judge and jury, and the Australian Constitution is drafted on that basis. The Association therefore does not support giving ASIC the power to impose financial penalties or to itself make orders for compensation or disgorgement of profits. Those orders should remain the province of a judicial body.

In relation to ASIC's mandate and consideration of how to re-focus ASIC. We support the operation of the existing mechanism for review and public accountability of ASIC's

performance. This mechanism, particularly the review by parliamentary committee, has highlighted key performance issues and has served to focus ASIC's performance quite well, in our view.

We would have some concerns about how changing ASIC's mandate to increase the focus on competition would impact on the key mandate of ensuring that Australia's financial markets are fair and transparent, supported by confident and informed investors and consumers. The importance of this to the reputation and standing of Australia's markets should not be underestimated. Whilst we strongly support the drive to enhancing the competitiveness of Australia's market, and support this as being an important consideration for ASIC in the exercise of its powers and functions, it would be dangerous if the objective of enhancing competition was elevated to such a degree that it became difficult to balance competing objectives in its mandate, and if emphasis on competition impacted on the delivery of ASIC's key mandate. The latter, if it did occur, would be more likely to harm Australia's competitiveness, in our view.

CONCLUDING REMARKS

The Stockbroking Industry has been caught up in 5 years of regulatory reform as collateral damage to the reaction to a few notorious financial failures, not of its making. This is because in the post-FSR 'one-size-fits-all' AFSL regulatory environment, unfortunately stockbrokers have similar AFSLs to financial planners. This is unfortunate, because there are good reasons for viewing Stockbrokers differently.

Stockbrokers have always been subject to a higher level of regulatory supervision than other sectors. Being market participants, they were subject to regulation by the ASX and now, since ASIC took over market supervision in 2010, they are subject to supervision by a special division of ASIC - ASIC Market Supervision - which took over from ASX. An additional body of rules, the Market Integrity Rules, applies in addition to the normal AFSL duties. In particular, these rules apply management and supervision requirements far above the level and complexity of those which apply to other financial advisers and financial planners. In addition, the rule against *Unprofessional Conduct*[12] encompasses conduct which is unfair or dishonest towards clients, and carries a maximum penalty of $1m. Other sectors do not have such rules, or if they do, they apply on a much lower level and are subject to semi-professional enforcement.

[12] *ASIC Market Integrity Rules (ASX Market) 2010* Rule 2.1.5

Moreover, stockbrokers pay for ASIC supervision through Market Supervision Fees, currently running at around $14m per annum. Financial advisers and planners, despite taking up substantial ASIC resources, do not contribute to the cost of supervision.

The current (August 2014) maelstrom of commentary on the problems of financial advice has again been caused by one or two celebrated cases. They do not prove that the whole financial advice system or regulatory architecture has failed. **In the current deregulatory environment, it is inconceivable that *another* round of regulatory reform is necessary**.

It is now time to allow the bedding-down of the new FOFA provisions, which only commenced on a staged basis on 1 July 2013 and whose final operative detail has only just been finalised.

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The Association is grateful for the opportunity to make this further submission for the assistance of the Inquiry. We would be happy to appear and make further submissions or to provide further information to the Inquiry at your convenience.

Should you require any further information, please contact Doug Clark, Policy Executive, on (02) 8080 3200 or email dclark@stockbrokers.org.au .

Yours sincerely,

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