SUBMISSION 3

Stockbrokers Association of Australia
Incorporating SDIA

CORPORATIONS (FEES) AMENDMENT BILL 2011
(Market Supervision Fees)

Submission to the House of Representatives Economics Committee Inquiry
12 September 2011

Executive Summary

The Stockbrokers Association would like to raise its members' concerns in relation to the recovery of market supervision fees in terms of -

- Fairness and equity
- A generally rising cost environment
- Impact on other policy objectives, including fostering Australia's growth as a financial centre, and enhancing the quality and availability of advice for investors, and
- The lack of a stringent mechanism to enforce a cost discipline on ASIC so as to keep the supervisory budget under control .

The benefits and savings foreshadowed by multiple markets are impossible to quantify, and may have been overstated.

The Government should allocate sufficient funding to ASIC to ensure the conduct of one of its **core functions**, a function that is crucial to the integrity of Australian markets.

At the very least, fines raised through ASIC enforcement should applied to the cost of ASIC's supervisory functions, thereby reducing the amount which needs to be recovered.

If cost recovery is to be implemented, then a charge imposed directly on trades and messages would be fairer in respect of any share of the cost recovery attributable to market participants than imposing the charge on market participants themselves.

Introduction

The Stockbrokers Association of Australia is the peak industry body representing institutional and retail stockbrokers and investment banks in Australia. Our membership includes stockbroking firms across the spectrum, ranging from the largest wholesale stockbroking firms to medium-sized firms, and down to the smallest firms, having mainly a retail client base.

The Stockbrokers Association is pleased to provide this submission to the Committee on provisions in the *Corporations (Fees) Amendment Bill 2011* dealing with cost recovery of Market Supervision Fees. The main operative part of the Bill amends the Act in order to give ASIC the power to levy fees on stockbrokers, in addition to market operators.

Market Supervision Fees

With the transfer in market supervision from ASX to ASIC in August 2010, ASIC was given the power to charge market operators for market supervision.

For the 2011 Financial Year, ASIC recovered $7.74m in fees, including a contribution of $4.2m from the National Guarantee Fund for 'transitional costs', $3.4m from ASX and SFE directly, with the balance coming from the other small market operators. When Chi-X commences, no more contributions from NGF will be made.

The Bill will enable ASIC to recover fees from market participants as well as market operators.

Treasury has released proposals for cost recovery for the **18 months from 1 Jan 2012 to 30 June 2013**. Costs are broken into implementation costs, fixed costs and ongoing costs, both IT and non-IT. Trade count is the main indicator of ASIC's market supervision costs.

Total costs to be recovered over the 18 month period are **$26.6m**. The proposed split of recovery of these costs is **84% (over $22m) from market participants / 16% from market operators**. For the 83 current ASX trading participants, this amounts to around $310,000 per firm. However, our bigger members are facing the lion's share of this figure, since they have higher turnover, and expect to be faced with fees of several million dollars.

Other Cost Recovery Regimes

As a preliminary matter, it should be noted that stockbrokers have already become subject to the AUSTRAC cost recovery regime introduced recently. In addition, those stockbrokers within groups which come under APRA regulation are also subject to the APRA cost recovery arrangements.

The ASIC cost recovery arrangements can be contrasted with those other regimes. In relation to the AUSTRAC regime, there are potentially many thousand entities that may be liable to a levy in some form. In relation to the APRA levy, there are again a much larger number of APRA-regulated entities. In relation to the ASIC levy, a very large proportion (84%) of a significantly large regulatory cost (amounting to around $22 million) will fall on a relatively small number of market participants (83). This represents a far more heavily concentrated financial burden than each of the other regimes.

Fairness and Equity

This is a new cost impost on stockbrokers, which has not been levied before. The proportion of the fees to be borne by brokers (84%) and the total dollar amount are, in our submission, excessive and inequitable.

In very difficult market conditions, the initial cost recovery round would entail an average fee based on a figure of 83 market participants in the order of $310,000.

Some of the Association’s larger members are facing fees well into the seven figures. At the top end of the “league table”, a broker with market share of 10% of turnover, and who also would have a wholesale client base that, by virtue of the types of trading typical of wholesale clients, would generate a high volume of trade messaging, would be facing a levy that could be in the order of $2 million to $3 million.

The timing is also inequitable, with brokers being charged the full amount from Day One, with no **staggered introduction** being contemplated.

There may be an implicit assumption or expectation that the costs of meeting the levy can easily be passed on by brokers to their clients. The consistent message that we have received from our members is that they will find it **very difficult to pass these costs on to clients**. There has been significant downward pressure on brokerage rates over recent years as a result of intense competition in the stockbroking industry. Brokers have advised us that, as a result of this intense competition, they will have little choice but to bear the costs of the supervision levy themselves.

Moreover, the main determinant of the calculation of fees under the proposed model is turnover (number of trades on the market). Stockbrokers have been subject to a high level of compliance cost already, and this tends to be higher in $ terms in the larger firms whose business is larger and more complex (although in smaller firms, the burden is still a comparable one relative to their size and revenue). The cost recovery model that is being proposed does not factor any reward or acknowledgment for brokers who have invested heavily in compliance, and who have a clean regulatory record. The same levy calculation is applied to all regardless of a firm’s record or resources devoted to compliance.

We submit that it in terms of fairness, and in terms of good regulatory policy, the arrangements should factor in some form of 'risk premium' (or discount) to the amount to be recovered, in order to take account of a firm's compliance performance. This would serve as an encouragement to foster compliance.

It may be also argued that these new fees merely offset the savings that brokers have enjoyed in lower ASX trading fees over the last few years, and the savings to come from future market competition. **This does not necessarily follow**:

- not all brokers have enjoyed the same amount of savings in trading fees over the last several years. Most of the savings arose from the Large Broker Rebate that ASX introduced in 2008. Most brokers did not benefit from this,
- in any event the past savings have been consumed by increased costs which have arisen in connection with the multi-market environment and its associated Rule changes. including necessary changes to systems and IT spending, and
- future savings from narrower spreads and/or further reductions in trading fees are impossible to quantify, either for client or the broker. However, what seems certain is that ASIC Market Supervision Fees will go up.

If the costs were able to be passed on to clients, it would lead to higher costs for investors, when they should be encouraged to access the markets to increase their wealth for retirement. If the costs are not passed-on, it will increase the broker's costs base and threaten their viability. **The reality is that the client is unlikely to see any significant benefits of the move to multiple stock markets.**

Rising Costs Generally

Overall, Stockbrokers are operating in a difficult market, with a range of areas where costs are increasing, but revenue falling. For example,

- multi-markets: significant (5 to 7-figure per firm) expenditure on new trading systems, information services and smart order routers, together with changes in documentation, client agreements and the roll-out of new policies and procedures;
- new ASIC training requirements, which we estimate will cost several million dollars to implement;
- new professional standards requirements, and
- possible new compensation arrangements, and higher FOS compensation limits from 2012.

Against this background, the new supervision fees may severely strain brokers' business models.

Direct Charge on Transactions a Preferable Approach

In view of our above submissions, the Stockbrokers Association believes that, if after considering all relevant matters the Government resolves that cost recovery of Market Supervision Costs must proceed, the preferable approach that would not impose the unfair burden on stockbrokers and other market participants referred to would be if a levy or charge were to be imposed by ASIC directly on transactions (and, if appropriate, on other trading messages), rather than impose the charge on Participants themselves.

It is noted from the Consultation Paper that this is the regime in operation in Singapore, a major market and competitor in the Asia region. The charge is collected by the Exchanges and remitted to the SFC. At least in this alternative, market participants would not be placed under the extremely difficult competitive pressures to shoulder the costs themselves.

It is noted that one potential factor given against the direct fee approach was the potential for over-recovery or under-recovery, as the number of trades and messages could prove to either exceed or fall short of what was anticipated. This is an issue which would need to be managed, however we do not see it as any different under the alternative where market participants were subject to the levy. If the Participants sought to pass the costs on to clients, they would also face the problem of determining how much to recover per transaction and/or message, and hence the potential for over and under-recovery in our view remains as large under that alternative (unless of course the broker were to resolve the dilemma by paying the cost of the levy itself).

Potential Conflict with Other Policy Considerations:

The Stockbrokers Association notes that the Government has been, quite correctly, pursuing certain key policy objectives, namely

a. Increasing the quality of advice, and the extent to which investors seek investment advice.
b. Furthering Australia as a regional financial centre.
c. Boosting Australian savings, including retirement savings

In our view, the proposed cost recovery arrangements will undermine and conflict with these policy objectives.

In relation to the first of these, if brokers are required to shoulder the burden of the cost recovery, then this will **act as a financial incentive for advisers to act in the "indirect", "shadow broker" or "white label broker" space**.

There is already a trend for advisers to migrate to the lesser regulated, indirect broker space. As these entities are not Market Participants, they escape ASX regulation, and the ASIC Market Integrity Rules do not apply. This has been identified already as a regulatory issue, a threat to the quality of advice and a threat to market integrity generally. The Stockbrokers Association has for some time lobbied for recognition of this trend, and for an appropriate regulatory response, such as the application of the Market Integrity Rules to this sector.

If this trend continues, the result may be that there will be fewer and fewer market participants, and more indirect participants. The more that investors seek advice from this sector, rather than from well-regulated Market Participants, the more potential risk there is to investors and to the quality of advice received by them. In our view, this will create a demand for more ASIC supervisory attention and the need for more resourcing, in a context where the burden of ASIC cost recovery will be falling on ever-fewer shoulders.

As regards the second policy objective, namely, Australia as a regional financial centre, Australia's financial markets do not exist in isolation. We compete with other countries in our region and with their markets. This includes countries which provide financial incentives to do business. Other markets are seeking to capture Australia's market activity and Australian investment funds.

In this context, reducing the cost of market transactions is an important step in competing with other markets in our region. Conversely, adding a cost component back onto market transactions, or imposing financial imposts on market participants (as the case may be), will be **detrimental to the ability of Australia's markets to compete in our region**, and will **not further the policy objectives and strategies articulated in the Johnson Committee Report**.

As regards the third policy objective, lowering transaction costs can have a significant impact on the value of investment funds over time. Over a working lifetime, such as with superannuation or managed funds, the benefit of these savings can amount to a significant sum to retirees and other investors.

Lowering transaction fees is regarded as one of the main potential benefits flowing to all investors from the move to free the Australian market to competing market operators. In the event that the amount levied through the cost recovery model was passed on to investors by way of a transaction fee, then this would undermine the benefit flowing from a multi-market environment. It would conflict with the Government policy underlying the market changes, and also policies seeking to boost retirement savings and reduce the future burden on Government spending arising from the need to fund pension payments.

Set-off against Fines

According to ASX Annual Reports, in the last 3 financial years, ASX levied a total of $5.9m in fines on market participants (i.e. stockbroking firms):

2009	$0.948m
2010	$3.3m
2011	$1.67m
Total	**$5.9m**

In 2009, the maximum ASX fine rose from $250,000 to $1m, and this has been carried over to the ASIC Market Integrity Rules. No one has been fined $1m – the $1.35m fine of Tricom in 2010 included 4 maximum fines of $250,000 because of the time at which the misconduct occurred. Although we have not seen any fines out of the new ASIC Markets Disciplinary Panel, it is reasonable to expect that the level of fines will increase.

Formerly, ASX previously received and retained any fines, using them to offset costs and also to provide funding for industry development and education expenses.

We appreciate that the arrangements under which ASIC, as a Commonwealth body, operates cannot be the same in relation to fines. However, drawing on the strong historical precedent of ASX, and further to our submission above regarding the need to factor inducements to encourage compliance and discourage non-compliance into any cost recovery framework, we submit that a mechanism should be found whereby, for example, the Government should make an allocation to ASIC of an amount equal to the level of fines collected, so as to reduce the amount of the portion of the supervision costs to be recovered from Market Participants.

ASIC's Cost Discipline

We are concerned that any cost recovery arrangements should contain within them a robust cost-control framework in relation to the costs that are sought to be recouped. This is so that proper discipline is applied by the agency, in this case ASIC, in setting the budget that is eventually sought to be recouped. It would be extremely unfair for the stockbroking industry to bear the costs of an exponentially increasing budget, without being in any position to influence the spending that is at the heart of the cost recovery.

So far, the Stockbrokers Association believes that that ASIC has handled to transfer of market supervision very well. Nevertheless, we remain concerned at the potential that in the future, ASIC could look, when dealing with its market supervision obligations, to build a **Rolls Royce solution, when only a Holden was needed**.

We note that, in discussions with Treasury, we have been assured that processes will be transparent, and that there is an eventual review of costs under Government guidelines, however we are concerned that this will be after the event, and that in the meantime, there is the potential that necessary cost discipline might not be applied.

We are once again grateful for the invitation to raise these matters with the Committee in the process of the enactment of these important matters of policy and law reform.

We would be happy to address the Committee further on any matters raised in this Submission.

STOCKBROKERS ASSOCIATION OF AUSTRALIA
12 September 2011