

**PRODUCTIVITY COMMISSION'S DRAFT REPORT  
REVIEW OF COST RECOVERY BY COMMONWEALTH AGENCIES**

**COMMENTS BY  
THE AUSTRALIAN SECURITIES & INVESTMENTS COMMISSION**

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Thank you for the opportunity to comment on the draft report of the Commission on Cost Recovery.

The draft report is an interesting and wide-ranging study of an area of some complexity, and the Productivity Commission has covered the field in some depth. We would agree with your assessment that significant further work is required, given the difficulty of the concepts and administrative arrangements included in such a topic.

To assist the Commission, ASIC has some specific comments to make about the report and about the treatment given to the Corporations Law scheme in the report, and makes some observations on the issue of cost recovery as applied to regulation in a more general sense.

**The Characterisation of ASIC and ASIC Revenues**

ASIC is concerned that the report characterises ASIC as a cost recovery funded agency, and refers to the Corporations Law fees which ASIC administers for the Commonwealth as 'ASIC revenues'.

This treatment led to a series of inaccurate attacks on ASIC by media commentators following the release of the draft report, and has continued to shape some commentary by organisations making later submissions to this inquiry.

Defining the characteristics of a 'cost recovery' agency or activity is obviously one of the fundamental conceptual difficulties in the cost recovery area. Your Draft Recommendation 3.1

*"All cost recovery arrangements should have appropriate and clear legal authority. Agencies, with advice from their legal counsels, should identify the most appropriate authority for their charges, and ensure that fees for service are not vulnerable to challenge as amounting to taxation"*

and Draft Recommendation 5.1

*"As a general rule, the funding of cost recovered regulatory activities should be subject to the same budgetary and parliamentary oversight as budget funded government activities"*

are instructive as to the arrangements that are generally considered cost recovery arrangements.

In ASIC's case there are some indicators throughout the report as to our status:-

- ☒ ASIC is budget funded;
- ☒ it receives its monies through Parliamentary appropriation, as a part of the Treasury Portfolio appropriations;
- ☒ there is no reference in the ASIC Act to any fee income or cost recovery arrangement;
- ☒ it is subject to the scrutiny of parliament and its committees; and
- ☒ it is subject to Department of Finance and Administration Pricing Review processes, and is currently undergoing just such a full scale review.

Thus, ASIC displays all of the budget characteristics of a typical budget-funded government agency – producing outcomes according to specific government policies and laws at a cost to government which is considered, funded, and reviewed.

ASIC administers legislation which is founded in both State and Commonwealth powers. ASIC does not develop that legislation, that is the province of the Treasury as policy adviser to the relevant Ministers, the Treasurer and the Minister for Financial Services and Regulation.

That legislation requires the payment of some fees by entities and individuals to allow participation in the various systems, vehicles and schemes encompassed by the legislation.

Those fees are processed by ASIC and paid directly into the Consolidated Revenue Fund. They are not ASIC revenues, are not used by ASIC, are not transferred to any other entity, and the actual quantum of any fee is not set by ASIC but by the Parliament.

Thus, the revenues administered by ASIC are in fact a product of the corporations scheme and by your definitions might even fall into your categories of taxes or levies.

Importantly, you have sought and received legal advice that such payments are legal, however you might define them.

Most importantly, they are not ASIC revenues and should not be represented as such.

In our view, the correct representation of these revenues is that they are Corporations Law revenues paid to the Commonwealth.

Further evidence of this separation of ASIC and the Commonwealth revenues that it administers can be taken from the CLERP 7 law reform process currently underway. The

development of the CLERP 7 reforms is being managed by the Treasury, including the revised fee setting decision-making. Treasury have run industry consultation meetings, some of which have included ASIC representatives to speak on how we will administer the changes proposed.

ASIC is treated as a stakeholder in this development work by the Treasury, rather than as a process owner. This is entirely appropriate given the legislative base for the Corporations Law regime, though it does not fit neatly with a pure cost recovery model.

In summary, ASIC is a budget funded agency with, as one of its functions, the role of administering the collection of Corporations Law revenues for the Commonwealth. ASIC does not receive this revenue, and ASIC's budget is but one of the costs of the national Corporations Law arrangements.

### **The Cost Recovery Dilemma – Tidy accounting or effective economic policy**

A signal issue for any cost recovery scheme is to identify the beneficiaries of any action so as to correctly apportion costs. In the areas of economic regulation and law enforcement these are not simple attribution exercises. It is reasonable to argue that much of ASIC's work produces general economic and community benefits rather than merely specific outcomes.

### **Regulation as a tool of economic policy**

You will be aware that ASIC was moved from the Attorney-General's Portfolio to the Treasury Portfolio several years ago in recognition of the significant economic impact flowing from the application of regulation and enforcement. ASIC's predecessor the Australian Securities Commission commenced operation in 1991 at a time when Australian companies borrowing or raising funds overseas were being charged higher risk premiums on their borrowings in foreign capital markets in recognition of the then financial and regulatory state of the Australian corporate sector. Conversely, economic commentators, international experts, and Australia's Treasurer have all attributed Australia's positive economic circumstances throughout the 1997 Asian Crisis as being in part the result of the strong regulatory structures in place in the Australian corporate sphere.

These are but two examples of the macro impact of regulation and enforcement activity. The benefits to Australia's corporates include lower financing and hedging costs, reduced losses through dealing with insolvent companies, reduced levels of corporate collapse, greater certainty, and an environment more conducive to the entering of long-term contracts – arguably, the inverse of the characteristics of some international markets where institutions and regulation are less strong. Thus, individual regulatory activities can and do have a significant effect beyond the parties directly involved.

Similarly, cost recovery is a difficult challenge for regulators at the micro level. Regulation is usually not seen as a 'service' or a 'product' by those companies and individuals receiving it. The work of the Kennedy School at Harvard University is instructive to this debate. In common with other regulators, ASIC is an organisation whose business, in part, is to 'impose obligations' on individuals and entities. These obligations reflect community expectations as expressed through the Parliament. Unlike an organisation whose role is essentially prudential where the benefit imposed on a regulated entity has measurable commercial benefit to that specific entity, some of ASIC's functions as a conduct and disclosure regulator are often community-retributive, producing a general good, and the companies and individuals who receive the most intense regulatory and enforcement attention are often insolvent or impecunious – a systemic weakness in any scheme for particularising and imposing costs.

It is arguable that even in specific functions where ASIC might be able to identify and attribute full costs there may still be a greater economic benefit or policy at risk through that attribution and recovery.

Examples include the attribution of full cost recovery to the processing, surveillance, and enforcement action around mergers and acquisitions, and fundraising. The fees charged in these areas do not meet cost recovery principles, yet the community economic benefits flowing from such activity are high and this might well be the greater policy imperative – the encouragement of new enterprise and capital creation through a lowering of entry costs. Another example might be the cost of obtaining a license under the laws administered by ASIC. A policy imperative here may be that all industry participants are licensed, and the license cost decision may be more influenced by not wanting to drive industry participants outside of the regulated system through the imposition of higher licensing costs, with the trade off being the reduction in risk of capital loss or inefficient capital application by investors dealing through unregulated players.

These macro and micro policy application examples provide an alternative view of the issues involved in funding regulation and enforcement. In the area of corporate regulation it is ASIC's view that there exists a compelling case for agency funding to meet government policy objectives, and a lesser case for individual activity cost attribution and recovery. This policy-driven purpose approach reflects the current reality of ASIC's funding model and is a considered, mature and pragmatic approach to the complexities of this field.

### **Cost recovery risks for regulators**

Your report identifies several risks associated with cost recovery based funding arrangements. Regulatory and information agencies with a primarily service provision character can form very different relationships with their 'funders', than can an enforcement-focused regulator. You rightly point to regulatory 'capture' and to 'gold plating' as the extremes of any 'regulator-fee payer' relationship.

ASIC operates daily in highly charged and aggressive circumstances – contested court hearings, criminal proceedings, takeover battles, major fundraisings, foreign company and adviser actions, the loss of life savings, forcing disclosure on directors, putting companies into liquidation.

This environment is one where today's stakeholders are tomorrow's targets, and where ASIC decisions can produce major commercial advantage or disadvantage. It is an environment where there would be great moral hazard attached to the regulator if we were also in a direct financial relationship with one side or other of the transactions which we regulate or prosecute.

'Capture' is an easily defined concept but, as your report addresses, a difficult concept to quantify and quarantine. Even the appearance of capture could severely affect a conduct and disclosure regulator's effectiveness, and particularly its court actions.

It is of course for all of these reasons that ASIC is a budget funded agency subject to the normal Parliamentary and DOFA budget processes.

### **Corporations Law revenues and their associated costs**

Throughout the draft report various references are made to the quantum of ASIC revenues, the lower quantum of costs, and the 'surplus' which this generates. Media commentators particularly highlighted this issue. In your Draft Recommendation 6.4 you assert that cost recovery arrangements should not include activities such as policy development, ministerial or parliamentary services and international obligations, and your argument is that these activities should be funded from general taxation.

ASIC takes issue with your representation of the revenues/costs numbers involved in the Corporations Law fees arrangements.

The Corporations Law fees revenues have been growing in line with the growth in the number of companies and other regulated entities in Australia. These fees form part of total Commonwealth revenues. The only cost item attributed against these revenues in your report's tables is ASIC's budget – though you do separately detail the transfer payment to the States, which has also received some unfavourable attention.

ASIC's view is that the overall Corporations Law scheme finances are a matter for Government, but makes the following observations:-

- ☒ The scheme finances as represented in your draft report show a widening gap between government revenue and scheme costs. Essentially the scheme operated in deficit for many years, and is now in surplus.
- ☒ The costs to government of corporate regulation and enforcement are more far-reaching than is generally understood or represented in your report. This is not a

simple ASIC-fees relationship – many other bodies are institutionally (and constitutionally) involved. These costs include elements of the budget funding of:-

- ASIC
- Treasury
- Commonwealth Director of Public Prosecutions
- Australian Federal Police and the National Crime Authority
- Federal Courts
- Commonwealth agencies *eg.* Attorney-General's, Immigration, Customs, Austrac, Australian Taxation Office, Parliamentary departments and committees
- State Directors of Public Prosecution
- State Courts
- State Police Forces including CIB and Fraud Squads
- Other State agencies *eg.* Attorney-General, State Revenue Office, Fair Trading Offices.

- ☒ The negotiations leading to the National approach to corporate regulation resulted in the Commonwealth making an annual payment to the States through the Federal Budget. ASIC is not involved in that transfer payment.
- ☒ To simply identify the ASIC budget as the only relevant cost in these arrangements is potentially a misrepresentation. Your tables throughout the Report might reflect that, at a minimum, the actual cost to government of this scheme in 1999/2000 is \$144.8 million (ASIC expenses) plus \$135.0 million (State transfer payment) – a total of \$279.8 million – a cost recovery / total expenses percentage of 129%, not the 249% quoted. Treasury could provide to you the relevant figures for other Commonwealth agencies, the inclusion of which would likely reduce this percentage to the 110% - 120% range.
- ☒ ASIC's budget funding as compared to measurable benchmarks such as number of regulated entities (population), total funds invested (sector specific), number of complaints to ASIC about corporate behaviour (public demand), has been declining. We seek to address this through the current ASIC pricing review, and ASIC will be seeking to better tie its funding levels to reliable workload indicators like population and demand.

### **Response to Case Study**

ASIC's situation is examined in some detail in your case study-financial regulatory agencies. Some comments on your analysis follows.

1. Your view that the beneficiaries of ASIC regulation are limited to company shareholders and consumers of specialised financial services would seem to demonstrate a limited understanding of the range and scope of ASIC activities. The actual beneficiaries are all persons or entities who interact with companies, and all who are involved with any financial product. The beneficiaries of ASIC regulation are

therefore all businesses and companies, and almost all citizens. As argued earlier, ASIC is an organisation whose outputs are usually in the nature of a benefit for all corporates and a general public good. ASIC's funding model accurately reflects this reality.

2. Your comments (F13) on service provision through the internet are partly accurate. ASIC's Annual Reports detail the exponential growth in the number of free searches now conducted over the internet. ASIC's workforce in this area has been reducing, though as with much technology the actual workload experience is that while paper-based processing work declines there is a substitute demand from consumers for other information, for electronic products, for telephone-based clarification and support.
3. Your acknowledgement of the lack of a direct relationship between ASIC's appropriations and the fees it collects is appreciated, and should be included in the Report Overview.
4. The reference to industry complaints about ASIC competition (F14) should be wholly withdrawn. Your author has obviously picked up on an inaccurate press story placed by a competitor. That competitor had lodged a complaint with the Competitive Neutrality Complaints Office, which has investigated the complaint and ASIC is confident that the CNCO will find that our pricing meets the competitive neutrality principles. As you say, you have not received any evidence – the entire reference should be withdrawn.
5. Your reference to ASIC fees generally not varying with respect to the identity and size of the applicant (F19) may be misleading. Fees for the different categories of companies, and for the size of licensed entities do in fact vary.
6. The quoted comments from ASFA and your point about resource allocation 'inefficiency' (F25 and elsewhere) require a response. ASIC's activity in the superannuation area includes responding to complaints received from superannuation fund members about conduct and disclosure problems, surveilling suspect funds and conducting investigations into illegal behaviour and super fund collapses. The wider benefits of regulation as a behaviour-shaper for superannuation funds and their executives are obviously not acknowledged by the ASFA comments. I note ASFA's chosen statistical period is 'to 1996'.

ASIC assumed regulatory responsibility in this area in July 1998. Suffice to say that losses in more recent times do not support ASFA's contention, and ASIC is currently involved in investigating some high profile and high value superannuation collapses.

This paragraph should be deleted or substantially modified.

7. Your contention that consumers should bear the cost of supervision of their investment adviser (F26) is novel. The pure outcome of this approach would be that any consumer who loses their investment through criminal misbehaviour by their advisor will also be charged for the cost of the action brought by ASIC. This is of course a nonsense. The current approach whereby an adviser pays a license fee to allow their participation in the industry is sound in public policy terms.

Similarly, your view that the beneficiaries of regulation governing conduct and disclosure are limited to a firm's consumers and its shareholders (F26) is disputed. You might like to add the firm's creditors (*eg.* financiers and suppliers) downstream producers reliant on the firm's output and other contractual partners, its insurers, its auditors and advisors and their insurers, its staff and directors, the communities in which it operates *etc.*

8. It is suggested that your example "... *Mrs. Bloggs apples*" quote (F27) is entirely irrelevant and misleading. ASIC does not regulate food standards, and the more general point is obscure. In fact, the ensuing beneficiary pays discussion in effect supports the current system of the payment of company annual fees to participate in the regulated markets.
9. Finally, the point that high levies may discourage overseas investment in Australia (F25) should either be supported with evidence or removed. ASIC is unaware of any company which regarded the incorporation fee or annual return fee as financially significant in its international decision-making.

### **Comment on the Guidelines for cost recovery**

ASIC notes the guidelines proposed. As all ASIC fees are included in legislation, and this already undergoes detailed scrutiny, and ASIC's budget is not linked to the fees paid to the Commonwealth, we do not see this process as having applicability to ASIC.

An ASIC representative attended a workshop conducted by the Productivity Commission on the draft guidelines and recorded the following views:-

- ☒ the Guidelines are reasonable at a high level but underestimate the degree of difficulty in getting to the necessary detail;
- ☒ the Guidelines offer no scope for consideration of political and/or industry realities;
- ☒ the Guidelines (and often industries themselves) underestimate the benefits of regulation to consumers;
- ☒ the Guidelines raise concerns about additional overheads in yet more audit committees, review boards *etc.*;



- ☒ a better understanding of who are really the beneficiaries would assist in any decision as to who pays. The flowcharts in the Guidelines are too simplistic; and
- ☒ overall, some form of improved Guidelines may be worthwhile.

Thank you for the opportunity to comment on the Draft Report. As detailed, ASIC's principle concerns with the report lie in the areas of:-

- ☒ the application of the cost recovery arrangements per se to ASIC;
- ☒ the dichotomous nature of the cost recovery / economic policy debate;
- ☒ the incorrect badging of Corporations Law revenues as ASIC revenues, and the incorrect attribution of ASIC's budget as the only cost of the scheme; and
- ☒ some specific case study issues which need correction.

The Commission's Draft Report makes a thorough analysis of a difficult topic, and ASIC congratulates its authors.

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