

REGULATION OF WATER MARKET INTERMEDIARIES

**Draft COAG regulation impact statement for
consultation**

April 2013

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Consultation Process

Request for feedback and comments

The Council of Australian Governments (COAG) Standing Council on Environment and Water is seeking input from stakeholders on the most cost effective means to address stakeholder concerns about risk of potential misconduct by water market intermediaries.

Stakeholders are encouraged to make submissions on the options addressed in this draft regulation impact statement (RIS). Submissions received through this process will inform the COAG's final RIS for decision makers. Questions have been included in the draft RIS where specific information is sought from stakeholders.

Submissions are welcome on this draft RIS during the six week consultation period ending on 7 June 2013.

All information (including name and address details) contained in submissions will be made available to the public on the Department's website, unless you indicate that you would like all or part of your submission to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like all or part of a submission to remain in confidence should provide this information marked as such in a separate attachment. A request made under the *Freedom of Information Act 1982* (Cth) for all or part of a submission provided in confidence will be determined in accordance with that Act.

The Australian Government reserves the right to refuse to publish submissions, or parts of submissions, which contain offensive language, potentially defamatory material or copyright infringing material.

While submissions may be lodged electronically or by post, electronic lodgement is preferred. For accessibility reasons, please email responses in a Word or RTF format. An additional PDF version may also be submitted.

Email: watermarkets@environment.gov.au

Mail: Assistant Secretary
Water Policy Branch
Department of Sustainability, Environment, Water Population and
Communities
GPO Box 787
Canberra ACT 2601

Enquiries: Enquiries may be directed initially to Christopher Biesaga (Director, Water Market Section), 02 6274 1420.

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1 Introduction

Stakeholders in the water sector have expressed concerns about the potential for conduct and practices of water market intermediaries to impact on irrigators and other water market participants. Some market participants consider stronger regulation of water market intermediaries (intermediaries) is necessary to minimise the risk of misconduct and poor service provision. Misconduct or poor service provision has the potential to undermine confidence in Australian water markets.

The purpose of the draft regulation impact statement (RIS) is to seek comments from stakeholders on the options under consideration for the potential regulation of intermediaries, in addition to the status quo, and to gather information to inform the final RIS. The final RIS for decision makers will provide an assessment of whether regulation is necessary, and if so, the most efficient and effective regulatory approach.

In accordance with COAG guidelines this draft RIS has been developed to assess the impact of possible regulation. The draft RIS explores the basis for stakeholder concerns and assesses the risk associated with a loss of confidence in intermediaries. It sets out the problem, objective and options to address stakeholder concerns about the conduct of intermediaries. Both regulatory and non-regulatory options are considered. A preliminary impact analysis is also provided.

Stakeholders input on all aspects of the draft RIS is welcome, and questions have been included in the draft RIS where specific information is sought. A summary list of these questions is provided at Attachment A.

2 Context

There are many separate water markets in Australia of varying size and activity. These markets include different water products and transactions types (such as sales or leases). The most common trades involve the transfer of entitlements (permanent trade) or water allocations (temporary trade). Market turnover nationally was estimated at \$1.47 billion in 2010-11, which is lower than in the previous three financial years (see Table 1 below).

Each state and territory has legislative and administrative arrangements in place to facilitate the trade of water rights in that jurisdiction. Dealings in water rights generally require approval or registration at the state and territory level.

Irrigators, communities, the environment, and the economy more broadly can benefit from open and efficient water markets. Water markets have grown following institutional reforms in most states and territories implementing the National Water Initiative (NWI) and earlier reforms agreed by COAG. Significantly, the unbundling of some water rights from land allowed water to be traded separately from land.

Table 1: Estimated market turnover, 2007-08 to 2010-11

	Gross nominal value of total water trades			
Year	2007-08	2008-09	2009-10	2010-11
Total (\$ million)	1681	2821	2962	1470

Source (NWC 2011a, p.36)

Under the NWI Australian governments committed to expand water trade through delivering open water markets. Government action aims to facilitate the operation of efficient water markets, increase opportunities for trading, and minimise transaction costs.

The Australian Government is continuing to pursue a number of initiatives, in partnership with state and territory governments, to improve the functioning of water markets. On 22 November 2012 the Minister for Sustainability, Environment, Water, Population and Communities, the Hon Tony Burke, made the Murray-Darling Basin Plan. The Plan includes water trading rules aimed at removing barriers to water trade and improving water market information. The Australian Government had previously introduced water charge and water market rules under the *Water Act 2007*. A National Water Market System is also under development to assist in the efficient management of state and territory water registry transaction and market information functions.

2.1 Overview of the water market intermediary industry

The continued development of water markets has been accompanied by the emergence of intermediary service providers. For the purposes of the RIS the term 'water market intermediary' (intermediary) means a person who:

- trades water rights on behalf of another person in exchange for a commission or fee;
- investigates water right trading possibilities on behalf of a potential water market participant for a commission or fee;
- prepares documents necessary for the trade of a water right on behalf of a potential water market participant for a commission or fee; or
- provides a trading platform or water exchange for water rights.

Intermediaries are commonly categorised as water brokers or water exchanges. There is not necessarily a clear distinction between brokers and exchanges as intermediaries may provide a mix of the activities described above.

Water brokers typically offer services to facilitate trade and investigate water right trading possibilities. Brokers may also prepare necessary documents. It is difficult to establish the number of intermediaries currently operating in the market as there is no formal registration of intermediaries. Previous research suggests that there are no more than 100 brokers operating across the country (NWC 2011b, p. 119) with approximately 20 to 30 brokers accounting for 80 per cent of broker-assisted trades (Allen Consulting Group 2007, p. 28). Water brokers may also be solicitors, conveyancers or real estate agents. Consultation carried out by the National Water Commission (NWC) (2011b) suggests that the majority of brokers combine water trading with other services such as real estate, and receive a relatively small proportion of revenue from facilitating trade in water (p. 119).

Question 1: *In your experience how many brokers are operating in Australian water markets?*

Water exchanges typically operate a trading platform to match buyers and sellers through an automated process. Exchanges may also assist clients in the preparation of necessary documents. At least five water exchanges operate in Australian water markets – Murray Irrigation Water Exchange, Murrumbidgee Water Exchange, the Riverina Water Exchange, Sunraysia Water Exchange and WaterExchange.

Question 2: *Are you aware of other water exchanges operating in Australian water markets?*

The number of practicing intermediaries changes over time. Stakeholders have suggested that the entry and exit of intermediaries is a function of water prices. Most intermediaries charge for services on a commission basis, with commission varying from 1 to 3 per cent depending on the type of trade and the relationship between the broker and client (ACCC 2010, p. 27). The Allen Consulting Group (2007) noted that reduced water availability during the drought was associated with increased trading activity and higher market prices. This attracted new brokers and traders with more limited experience with water trading (Allen Consulting Group 2007, p. 36).

Question 3: *In your experience does the number of intermediaries operating in Australian water markets change year to year?*

Intermediaries play an important role in water markets by facilitating trade. By bringing potential buyers and sellers together, intermediaries can contribute to increased market liquidity and depth, improve information availability and reduce transaction costs (ACCC 2010, p. 2). A large proportion of water trades are facilitated by intermediaries. It is estimated that 55 to 90 per cent of water allocation trades and 90 to 95 per cent of water entitlement trades are facilitated by brokers or solicitors (NWC 2011b, p. 117). Results of a survey undertaken by the Australian Bureau of Agricultural and Resource Economics – Bureau of Rural Sciences indicate that the majority (77 per cent) of farmers had used the services of an intermediary in some capacity in the two years prior to the survey in 2010 (Ashton 2010, p. 7).

The Australian Water Brokers Association (AWBA) is an industry body representing the interests of water brokers. The AWBA states that its primary role is to set and maintain the highest standards of professional practice, education, ethics and professional conduct for its members and the broader water broking industry. Advice from the AWBA indicates it currently has 34 individual members who between them facilitate more than 80 per cent of those water trades involving a water broker. All AWBA members are required to operate under the AWBA code of ethics and standards.

2.2 Overview of current regulatory arrangements

Intermediaries are subject to applicable laws, including criminal law (which deals with incidents of theft or fraud), contract law (which covers situations where an intermediary breaches conditions specified in a contract), and general market regulatory frameworks that offer consumer protection. The *Corporations Act 2001* (Cth) contains requirements associated with insolvency. The *Bankruptcy Act 1966* (Cth) may also apply where an intermediary is not a company and is unable to pay its debts.

Intermediaries have obligations under the Australian Consumer Law (ACL) which are separate from any contractual or other rights and obligations an intermediary may have with clients (ACCC 2010, pp. 10-11). The ACL provides that businesses and individuals (including intermediaries) must not:

- engage in misleading or deceptive conduct;
- make false or misleading representations;
- accept payment if they are unable to supply;
- engage in unconscionable conduct; or
- use harassment or coercion.

The ACL commenced on 1 January 2011 as the national consumer law which applies in all states and territories. The ACL replaced consumer protection provisions in Commonwealth, state and territory laws. The ACL is administered by several regulators - the Australian Competition and Consumer Commission (ACCC), the Australian Securities and Investments Commission (ASIC) and state and territory fair trading agencies. These regulators provide an avenue for complaints to be heard and for action to be taken under general consumer law.

Intermediaries are required by the ACL to ensure the services provided will be carried out with 'due care and skill' and also be 'fit for purpose' (ACCC 2011).

There is no industry-specific legislation in place to regulate the behaviour of intermediaries.

2.3 Previous research

Work has previously been undertaken to assess stakeholder concerns relating to the conduct of intermediaries. This has included consultation with intermediaries, irrigators, irrigation infrastructure operators, industry bodies, trade approval authorities and other government agencies. This research has also considered possible options for government action to address the concerns raised.

In 2007 the NWC commissioned the Allen Consulting Group to investigate the conduct of intermediaries as it was concerned that maturing water markets may be vulnerable to loss of confidence as a result of poor intermediary behaviour. The Allen Consulting Group consulted with 30 stakeholders representing a cross section of brokers, exchanges, irrigation authorities, industry bodies and government agencies on nine options to address concerns. The resulting report *Improving market confidence in water intermediaries* indicated that available evidence suggests serious misconduct is not widespread and recommended supplementing existing general market regulation with a minimalist regulatory approach, including improved information relating to the rights and obligations of water market participants under the ACL and potentially a voluntary accreditation scheme (Allen Consulting Group 2007). The ACCC has developed a series of guides to assist water market intermediaries and customers in understanding fair trading obligations under the ACL.

Stakeholders raised concerns about intermediary misconduct with the ACCC during development of its advice on the water trading rules in the Murray-Darling Basin Plan. As a result the ACCC explored these concerns and possible options to address them. The ACCC engaged the Australian Bureau of Agricultural and Resource Economics – Bureau of Rural Sciences to conduct a survey of 326 irrigators who had traded water during 2008-09, the findings of which were reported by Ashton (2010). The ACCC also surveyed 39 stakeholders (including state government water management departments, fair trading agencies and irrigation industry organisations) about complaints received about intermediaries between 1 July 2007 and 30 June 2010. The ACCC (2010) found that while there had been few complaints, there was still a moderate level of concern amongst stakeholders relating to the potential for misconduct of water market intermediaries. In the report the ACCC found potential regulatory gaps and recommended that governments further explore measures to address these gaps, in particular to;

- increase the use of trust accounts and professional indemnity insurance;
- establish an industry fidelity fund; and
- ensure that potential conflicts of interest are disclosed.

In 2011 the NWC conducted an analysis of issues that may impede the efficient operation or further development of water markets. The resulting report *Strengthening Australia's Water Markets* included analysis of intermediary regulation. The NWC examined previous work and made a series of recommendations aimed at improving the confidence of the market in the conduct of intermediaries. In developing the report the NWC consulted with a broad range of stakeholders, including 25 members of the AWBA, 20 brokers who were not members, and other stakeholders including irrigators, irrigation infrastructure operators and government agencies. The NWC found that while many issues identified by the Allen Consulting Group (2007) were no longer of concern, there were still potential regulatory gaps in what would be considered sound and ethical fiduciary conduct. The NWC (2011b) recommended that efforts should be made to improve the knowledge of intermediaries about existing legal obligations and that the costs and benefits of a registration scheme should be considered.

In 2011 the Department of Sustainability, Environment, Water, Population and Communities (the Department) engaged PricewaterhouseCoopers (PwC) to assess the costs associated with various options to address stakeholder concerns in response to the work undertaken by the NWC and the ACCC. The resulting report, *Regulation of Water Market Intermediaries*, provided a cost and benefit analysis on four options including licensing, registration, industry-specific statutory requirements and a voluntary accreditation scheme (PwC 2011). This work, in conjunction with the work undertaken by both the ACCC and the NWC, informed the analysis of the feasibility of options explored in section 5 of this paper.

3 Statement of the problem

Stakeholders have raised concerns about intermediary misconduct. Some water market participants are not confident that their interests are sufficiently protected when they employ the services of intermediaries.

Specifically, buyers and sellers are concerned about:

- loss or misuse of client funds held by intermediaries; and
- receiving poor service from intermediaries.

More detail of these concerns is provided in sections 3.1 and 3.2 along with an assessment of the likelihood and direct impact of issues arising, existing regulation and the need for additional government action.

Evidence suggests there have been few problems in the past

Research into the behaviour of intermediaries suggests some cases of inappropriate behaviour, which appear to be serious but not widespread. Stakeholders have reported anecdotal evidence that intermediaries are engaging in inappropriate behaviour with the potential to harm traders' interests (Allen Consulting Group 2007; Ashton 2010; ACCC 2010; NWC 2011). In some cases this behaviour may breach existing regulation. Specific examples are considered in sections 3.1 and 3.2.

Recorded complaints (both formal and informal) to ACCC and other agencies have been relatively low in number (ACCC 2010, pp.18-21). In 2008 and 2010 the ACCC surveyed a number of state water management departments and fair trading agencies, IIOs, and industry organisations about whether complaints had been received in relation to intermediaries. Twenty-three formal complaints were received between 1 July 2007 and 30 June 2010. Only

three of the complaints related to misconduct and the remainder related to matters outside the control of intermediaries such as fees charged by the approval authority. There were over 17 000 entitlement trades during that period (NWC 2008; NWC 2009; NWC 2010) and intermediaries are estimated to have facilitated the majority of entitlement trades (NWC 2011b). The relatively low number of complaints indicates problems are not widespread.

The ACCC (2010, p.19) indicated that some people were unwilling to formally report incidents because they wanted to retain a relationship with the intermediary. This may be because access to alternative intermediaries was limited in the region or because concern about the particular behaviour was not sufficient to prevent the client from engaging the intermediary's services again.

Overall, available evidence suggests intermediary misconduct is not widespread. As discussed in section 2, a considerable volume of water rights is traded each year and a large proportion of trades is facilitated by intermediaries.

Question 4: *Do you consider that there has been any intermediary misconduct? If so, what is the nature of this misconduct? Do you consider it to be widespread? What is the basis for this view?*

Concerns remain about problems in the future

Although stakeholders may have been concerned about the risk of intermediary misconduct in the past, this does not appear to have prevented water market participation or caused buyers and sellers to avoid using intermediary services. Despite this, some stakeholders consider the risk of misconduct unacceptable and that regulation should be introduced to reduce future risk.

The risk of intermediary misconduct may change in the future. Higher prices and trade volumes could attract new intermediaries without ties to the local community making word of mouth less effective at making sure potential clients are aware of any past problems. During the recent drought (2005 to 2010) trade volumes and prices reached historic highs with no corresponding increase in complaints about intermediary misconduct. It is possible that the risk of misconduct may decrease in future as competitive pressures lead to better service.

Question 5: *Do you consider intermediary misconduct is likely to increase in future? What is the basis for this view?*

Water market participants may change their behaviour if there is an incident resulting in substantial financial losses, even if they have previously been aware that there is some risk to using intermediary services. There may be a disproportionate reduction in demand for intermediary services when a low probability incident occurs in the future, even if the likelihood of further incidents remains low. A substantial reduction in the use of intermediary services may result in increased transaction costs and reduced water trading activity. It is difficult to predict the impact of an incident on stakeholders' willingness to use intermediary services and participate in water trading, and there is no evidence to suggest the worst case will eventuate.

Although water market intermediaries are subject to general laws, some stakeholders advocate the introduction of industry-specific regulation similar to that governing the behaviour of real estate agents and legal professionals. For example, real estate agents and solicitors are required under state and territory legislation to hold client funds in trust accounts. As noted in section 2.1, real estate agents and solicitors may provide water market intermediary

services. Industry-specific regulation in these industries may extend to some of the services they provide for water market participants.

The absence of regulation is not a problem in and of itself if there is no significant impact on water trading. The consultation process will consider the need for industry-specific regulation to address the risk of future intermediary misconduct.

3.1 Loss or misuse of funds held by an intermediary

Trades in water products may take several days or weeks to complete as contracts are exchanged and settled and necessary approvals are sought. Intermediaries may hold funds on behalf of clients during this time as a deposit or prepayment. The NWC (2011b) noted that it is not uncommon for a broker to hold over \$1 million of client funds at any one time (p. 123).

Stakeholders have expressed concern that client funds may be:

- lost when an intermediary becomes insolvent or bankrupt;
- lost through theft or fraud; or
- used improperly.

Question 6: *Do you have any concerns in relation to intermediaries holding client funds? If so, what is the nature of this concern?*

It is important to note that these issues and concerns only arise where client funds are held by intermediaries.

Table 2 outlines an assessment of the direct impact, likelihood and current regulation associated with the issues stakeholders are concerned about. The discussion below considers whether government action is necessary to reduce the impact or likelihood of problems associated with intermediaries holding client funds.

Trust account use can reduce the likelihood

Intermediaries are currently able to establish and operate trust accounts for handling client funds and water market participants can seek out intermediaries using a trust account. Trust accounts are bank accounts in which an individual or company holds funds on behalf of a customer or client. The intention of using trust accounts is to provide greater security for funds held to facilitate a market transaction. The use of trust accounts can assist in separating and identifying funds held on trust from an intermediary's assets, which reduces the risk of client funds being distributed to creditors in the case of insolvency or bankruptcy.

The NWC (2011b) noted examples of brokers not maintaining an audited trust account to hold client funds. Further, it is not known whether all intermediary trust accounts provide the perceived level of protection for client funds.

Not all accounts which are referred to as 'trust accounts' are alike and the degree of protection offered by trust accounts will be a function of how the account was established and the administrative arrangements governing use of the account. For example, the transparency of accounting and the stringency and frequency of audits are important factors determining whether client funds can be identified and separated from other funds. If an intermediary did not strictly apply appropriate accounting and audit standards to a trust account it may not enable client funds to be identified and separated from an intermediary's assets.

Specific administrative standards are required under state and territory legislation for the management of trust accounts by legal professionals and real estate agents. For example, under the *Property, Stock and Business Agents Act 2002* (NSW) licensees must hold client funds in a trust account kept at an authorised deposit-taking institution. The institution must be informed that the account is a trust account and the words ‘trust account’ must appear in the account name (NSW Fair Trading 2012b). The trust account must be audited each financial year (NSW Fair Trading 2012a).

If appropriate administrative standards are followed in establishing, using and auditing a trust account, it is likely that funds held on trust would not be distributed amongst other creditors in the event of insolvency or bankruptcy of an intermediary. The use of trust accounts may also reduce the likelihood of theft or fraud and misuse of client funds by increasing the transparency of funds management. The likelihood of misuse of client funds would also be reduced if intermediaries did not hold client funds in a general company or personal account. For example, employers are more likely to detect theft or fraud early and limit losses if frequent auditing occurs. Use of trust accounts is unlikely to entirely remove the risk of theft or fraud, even under best practice account management practices.

Water market participants can act to reduce the impact

Water market participants may seek to avoid situations where large amounts of money are held by intermediaries. Participants can use intermediaries that do not require large deposits or prepayment or request specific arrangements. For example the buyer and seller could make settlement conditional on approval or registration of the trade, with the buyer providing a cheque to the seller.

Water market participants are entitled to ask intermediaries how client funds will be treated. For example, water market participants may ask whether interest will be earned and to whom it will accrue, if a trust account will be used, and how the trust account is managed. The ACL (discussed in more detail in section 3.2) applies to claims made by an intermediary about the treatment of client funds.

Water market participants experiencing financial loss as a result of an intermediary’s actions may choose to pursue compensation from the intermediary under existing regulation. For example, people affected by a breach of the ACL can seek compensatory orders for loss or damage suffered or likely to be suffered as a result (Australian Government 2010, p. 11). Remedies may also be sought for breaches of common law duty of care or fiduciary duties. If an intermediary becomes insolvent or bankrupt the impacted party may not be fully compensated as rights to damages are subject to the priority of creditors set out in the *Corporations Act 2001* and the *Bankruptcy Act 1996*.

Professional indemnity insurance and fidelity funds can reduce the impact

Intermediaries may choose to purchase professional indemnity insurance to mitigate the risk of not being able to compensate clients for losses in the case of civil action against them (with possible exceptions depending on the insurance policy). Professional indemnity insurance is designed to provide protection for businesses who give advice to clients that may result in financial or other losses to these clients and can provide a degree of cover for mistakes made by intermediaries in the course of carrying out professional duties. Professional indemnity insurance provides some protection for the intermediary from insolvency or bankruptcy in the case compensation must be paid, and by extension reduces the likelihood of funds held on behalf of other clients being distributed amongst other creditors. Research suggests that not all brokers hold professional indemnity insurance (NWC 2011b).

Table 2 - Loss of client funds

Issue	Insolvency and bankruptcy	Theft and fraud	Improper use
Likelihood	<p>Client funds are distributed amongst all creditors of an intermediary.</p> <p>Low to moderate probability</p> <p>May occur in the case that:</p> <ul style="list-style-type: none"> – an intermediary becomes insolvent or bankrupt while holding funds on behalf of a client; and – funds cannot be identified as the client’s property as distinct from the company or the sole trader’s property. 	<p>An intermediary or someone with access to an intermediary’s finances takes client funds without permission.</p> <p>Low probability</p> <p>The NWC (2011b) noted that the risk of loss through fraud or other criminal behaviour is no greater than in other markets (p. 127).</p>	<p>An intermediary uses client funds for private purposes (for example pays other creditors or holds client funds in an interest-bearing account and retains the interest accrued without the client’s knowledge) or withholds funds after settlement.</p> <p>Low to moderate probability</p> <p>Misuse of client funds has been reported however recent research indicates that such behaviour is not widespread (NWC 2011b; ACCC 2010; Allen Consulting Group 2007).</p> <p>The Allen Consulting Group (2007) reported stakeholders had confidentially disclosed examples of client funds being held in an intermediary’s private interest-bearing account and of money being withheld from vendors post settlement (p. 37). As this research did not include verification or investigation, it is not possible to assess the validity of the report or the likelihood of these situations reoccurring.</p>
Impact	<p>Client loses all or some of the funds held on its behalf by an intermediary.</p>	<p>Client loses all or some of the funds held on its behalf by an intermediary.</p>	<p>Client loses interest accrued on funds or the benefit of alternative use of the funds while held unnecessarily by an intermediary.</p> <p>Increased probability that funds are lost in the case of insolvency and bankruptcy or through theft and fraud.</p>
Current regulation	<p>The <i>Corporations Act 2001</i> (Cth) deals with insolvency. Under the Act:</p> <ul style="list-style-type: none"> – a company director has a positive duty to prevent insolvent trading; and – in the case of insolvency, money held on trust for a client may not be company property (and therefore available for distribution to creditors) if it can be identified as the client’s property and separated from company property. <p>The <i>Bankruptcy Act 1966</i> deals with bankruptcy. Property held on trust is excluded from the property available for distribution to creditors, provided it can be identified.</p>	<p>Incidents of theft and fraud are dealt with under criminal law.</p>	<p>An intermediary has a common law duty to take reasonable care to avoid causing a client loss or damage where it is reasonably foreseeable that its conduct might cause loss or damage.</p> <p>An intermediary in a fiduciary relationship with a client is subject to fiduciary duties including obligations not to use its position in relation to the client to take private advantage, and that personal interests cannot conflict with its duty to the client.</p> <p>The ACL prohibits deceptive and misleading conduct, including making false claims about how client funds are treated (ACCC 2010).</p> <p>Contract law applies to contracts between intermediaries and clients, which may contain obligations in relation to client funds.</p>

A group of intermediaries may choose to establish and contribute to a fidelity fund, which is a fund established for the purposes of compensating clients that suffer financial loss as a result of intermediary behaviour. The extent to which financial impact is reduced would depend on the fund arrangements. For example, payouts may be capped or not available in certain circumstances such as where the financial loss is due to criminal behaviour. Rights to draw on a fidelity fund would be expected to reduce the impact of financial loss, and stakeholder concerns, in line with the size and rules of the fund scheme. There may be an issue with the protection provided to funds held in a fidelity fund in the absence of statutory requirements.

Self regulation and regulation

Existing laws generally deal with an incident once it has occurred. Although the penalties and rights to take action if a breach occurs do create incentives to operate in a lawful manner, stakeholders are concerned that insufficient measures are in place to prevent or reduce the risk of financial loss in the first place.

It is not clear whether the likelihood or impact of problems in the handling of client funds will increase or decrease over time. For example, higher trade volumes and prices may encourage entry of intermediaries who do not use trust accounts or are inexperienced in managing trust accounts, and may instead establish accounts that do not meet the necessary standards to enable client funds to be identified and separated in the case of insolvency. Equally possible is that increased competition amongst intermediaries may lead to a reduction in the size of deposits required and greater incentives to demonstrate use of trust accounts.

Regulation requiring the use of trust accounts could result in a minimal risk of loss of client funds in the case of insolvency and bankruptcy of an intermediary. As the level of protection offered by trust accounts is a function of how the account is established and managed, regulation setting out administrative standards would improve the likelihood that client funds can be identified and separated from other funds. Regulated use of trust accounts will not entirely remove the risk of theft or fraud.

Regulation requiring a minimum level of professional indemnity insurance and for intermediaries to contribute to a fidelity fund would reduce the financial impact on clients in the case of breaches of regulation in relation to holding client funds.

Self regulation could create penalties or disincentives if intermediaries do not use and adequately manage trust accounts, hold professional indemnity insurance or contribute to a fidelity fund. Branding, accreditation or membership of an industry body which requires these standards of its members could differentiate intermediaries who have taken action to reduce the impact and likelihood of problems arising with client funds. Intermediaries may choose to take these actions to have the right to claim membership or accreditation. The benefit to the intermediary in terms of increased business from having this right, as well as the arrangements for determining when this right has been lost, would determine the extent of the incentive to comply with self-imposed standards. The incentive could in practice have a similar effect to legislative penalties however there would be no statutory obligation to take actions to protect client funds. Under a voluntary approach, a client could not have full confidence that intermediaries are required to comply with the administrative standards for trust account use described above.

The AWBA requires its members to adhere to a code of ethics and standards, which includes a requirement to keep client funds “in a special account in an appropriate financial institution” (Article 7) (AWBA n.d.). As discussed above, the level of protection provided by a trust account is a function of how it is established and used. The AWBA code does not include

specific administrative standards for establishing and using a trust account. For example, the code does not specify any record keeping or auditing standards for such an account. The AWBA code does not include a requirement to hold professional indemnity insurance or contribute to a fidelity fund.

3.2 Poor service from intermediaries

Clients of intermediaries are impacted financially by the negotiated price of water right trades, as well as transaction costs including the cost of intermediary services and the time required to negotiate and seek approval or registration of the trade. Payment is made to intermediaries for the services provided (usually on a commission basis).

Water market participants may take advice from intermediaries when considering the price they will accept or pay for the trade. Intermediaries may also investigate trading options (including identifying potential buyers or sellers) on behalf of clients and arrange trades. Generally buyers expect intermediaries will find the lowest available price and sellers expect intermediaries will find a buyer willing to pay the highest possible price. Clients may also have preferences for trades to occur within certain timeframes.

Stakeholders are concerned about not getting value for money when engaging the services of an intermediary. Stakeholders have expressed concern that value for money from intermediary services may be compromised by:

- intermediaries making false claims and misleading clients;
- conflicts of interest; or
- lack of competency.

Question 7: *Do you have any concerns in relation to the conduct of intermediaries when providing services? If so, what is the nature of this concern?*

Table 3 outlines an assessment of the direct impact, likelihood and current regulation associated with the issues stakeholders are concerned about. The discussion below considers whether government action is necessary to reduce the impact or likelihood of problems associated with the service provided by intermediaries.

Training and use of trust accounts can reduce the likelihood

Intermediaries may choose to research guidance material provided by the Commonwealth, state and territory governments on trading rules and trade approval processes, and monitor key water market events such as allocation announcements. This would reduce the likelihood of poor advice or incompetency having a financial impact on clients.

Intermediaries choosing to use trust accounts to hold client funds, as discussed in section 3.1, would also remove any incentive to mislead clients about timeframes for the purpose of retaining client funds in an interest bearing account for longer than necessary.

Water market participants can act to reduce the likelihood and the impact

Water market participants may seek information about the quality of services intermediaries have provided in the past to identify 'good' intermediaries. Water market participants who are impacted by or become aware of intermediary misconduct, conflicts of interest or incompetency may choose to share this information with other water market participants. 'Word of mouth' would reduce the likelihood that the intermediary received repeat or new business without demonstrating improvement.

Table 3 - Poor service from intermediaries

Issue	False claims and misleading behaviour	Conflicts of interest	Lack of competency
Likelihood	<p>An intermediary does not apply fair trading practices in dealings with clients.</p> <p>Low to moderate probability</p> <p>Informal complaints and anecdotal evidence have been reported alleging that intermediaries have:</p> <ul style="list-style-type: none"> – made claims or guarantees about water prices or likely timeframes for settlement of a trade that are false, inaccurate or not delivered; – placed trades on the market at a price that is higher than that agreed to by the client and retained any margin from a sale; – made claims about preferred access to the approvals process; and – misrepresented themselves as a member of an accredited brokers association (ACCC 2010; NWC 2011b; Allen Consulting Group 2007). <p>Few formal complaints have been made alleging misconduct. From 1 July 2008 to 14 September 2012, the ACCC received 5 complaints alleging misconduct relating to intermediaries. In all cases, the ACCC has not pursued the matter further. ACCC (2010) research found one formal complaint was made to an agency other than the ACCC between 1 July 2007 and 30 June 2010.</p> <p>Of the few surveyed irrigators experiencing a problem or concern with an intermediary, 26% said they had been misled about prices, 17% said they had been misled about something other than price and 20% said there had been a delay in receiving sale proceeds (Ashton 2010).</p>	<p>An intermediary acts according to interests that do not match those of the client (if this is not disclosed it may be an example of misconduct).</p> <p>Low to moderate probability</p> <p>Informal complaints and anecdotal evidence have been reported alleging that intermediaries have:</p> <ul style="list-style-type: none"> – acted in self-interest by; <ul style="list-style-type: none"> a) acting as a principal in trading water without disclosing this to all parties; b) providing market valuations while having an undisclosed present or contemplated interest in the water right; c) advising clients to sell water to preferred buyers at below market price in order to secure buyer commissions; and – acted for more than one party in a transaction where this is inconsistent with the duty owed to another client (ACCC 2010; NWC 2011b; Allen Consulting Group 2007). <p>Concerns have been raised about potential conflicts of interest where approval authorities and irrigation infrastructure operators also provide intermediary services (ACCC 2010). Case studies considered by the NWC found no clear evidence that irrigation infrastructure operators are acting inappropriately in multiple roles (NWC 2011b, p.77).</p>	<p>An intermediary is unfamiliar with or fails to inform clients of relevant trading rules, trade approval processes or key water market events.</p> <p>Low to moderate probability</p> <p>Mistakes and lack of knowledge leading to trades being delayed or rejected have been reported (ACCC 2010; NWC 2011b).</p> <p>Of the few surveyed irrigators experiencing a problem or concern with an intermediary, 31% said there had been delays in submitting trade to the approval authority and 29% said there had been mistakes such as incorrect or incomplete forms (Ashton 2010).</p> <p>The NWC (2011b) noted a competency issue with solicitors not having adequate knowledge of carryover rules. Otherwise, it was noted that there had been an improvement in broker competency since 2007 and remaining problems are isolated (NWC 2011b, p. 124).</p>

Impact	<p>Client pays more or receives less for the traded water right than otherwise expected. Distorted price signals prevent some efficient trades occurring.</p> <p>Client bases business decisions on unrealistic expectations about prices or timeframes for trades. Buyer loses the benefit of water use and seller loses foregone interest (or alternative benefit) on sale proceeds during delay period.</p>	<p>Client pays more or receives less for the traded water right than otherwise expected. Distorted price signals prevent some efficient trades occurring.</p>	<p>Client pays more or receives less for the traded water right than otherwise expected.</p> <p>Client buys water rights that do not meet business needs (for example cannot be traded to region where irrigation occurs).</p> <p>Trade application delayed or rejected. Buyer loses the benefit of water use and seller loses foregone interest (or alternative benefit) on sale proceeds.</p>
Current regulation	<p>Under the ACL it is illegal for intermediaries to</p> <ul style="list-style-type: none"> d) engage in misleading or deceptive conduct; e) make false or misleading representations; f) accept payment if they are unable to supply; g) engage in unconscionable conduct; and h) use harassment or coercion. <p>The ACL includes enforcement powers for the ACCC and state and territory fair trading agencies, including the ability to issue public warning notices about traders where the regulator has reasonable grounds to suspect that a breach has occurred (Australian Government 2010, p. 10). Regulators and people affected by a breach of the Australian Consumer Law may also seek various remedies.</p>	<p>The ACL may be breached if an intermediary's failure to disclose a conflict of interest has the effect of misleading or deceiving a customer.</p> <p>An intermediary in a fiduciary relationship with a client is subject to fiduciary duties including obligations not to use its position in relation to the client to take private advantage, and that personal interests cannot conflict with duty to the client.</p> <p>The Murray-Darling Basin Plan provides that approval authorities must declare interests in a trade (including in the activities of any intermediary involved) which is submitted to it for approval before the authority approves or rejects the trade. The authority must also disclose information about any trade it approved and was also a party to on its website. The provisions take effect from 1 July 2014.</p>	<p>There are no legislative requirements for intermediaries to undertake training or meet designated service standards.</p> <p>Misleading or deceptive conduct regarding skills or experience is covered by the ACL.</p>

Water market participants may seek information from multiple sources when forming expectations about price and timeframes for trades. For example, the National Water Market System website and state and territory water register websites contain statistics about prices paid in past transactions, as well as information about how to trade, rules and restrictions and trade processing time standards.

Water market participants are entitled to ask intermediaries about any interests the intermediary has in the trade and whether the intermediary acts for another party. Intermediaries may choose to make declarations or commitments regarding how information will be disclosed and how situations where there is the potential for conflicts of interests will be treated. For example, an intermediary may publish information on its website stating that it will not act for a client when buying or selling on its own behalf. The ACL deals with situations where false or misleading representations are made.

Water market participants experiencing financial loss as a result of an intermediary's actions may choose to pursue compensation from the intermediary under existing regulation. For example, people affected by a breach of the ACL can seek compensatory orders for loss or damage suffered or likely to be suffered as a result (Australian Government 2010, p. 11). This may be a lengthy process involving legal and other costs.

Professional indemnity insurance and fidelity funds can reduce the impact

As discussed in section 3.1, professional indemnity insurance and fidelity funds can reduce the impact of financial loss in some circumstances.

Self regulation and regulation

Some stakeholders consider the current level of risk to be unacceptable. Stakeholders remain concerned that insufficient measures are in place to identify 'bad' intermediaries and prevent misconduct, conflicts of interest and incompetency from impacting on water market participants. There are no industry-specific requirements to reach certain competency standards or clearly defining an intermediary's obligation to its clients in terms of conflicts of interest.

It is not clear whether the likelihood or impact of problems with intermediary services will increase or decrease over time. Higher trade volumes and prices may encourage entry of intermediaries who are less knowledgeable and experienced with water markets and trading. Alternatively, it would be expected that poor service would result in lower repeat business and damage to the intermediary's reputation. Ashton (2010) found that the majority of irrigators who used an intermediary selected one on the basis of previous experience with the intermediary or word of mouth. Increased competition amongst intermediaries may also lead to better service provision. For example, the ACCC (2010) found that it is now less common for brokers to act for both parties to a transaction.

Regulation requiring intermediaries to meet competency standards may reduce the likelihood that poor service is provided and would provide assurances for water market participants who are not able to access information about previous service provided by an intermediary. The ACCC (2010) noted measures taken by industry to improve the competency of intermediaries (for example the AWBA developing training courses for members), taken in combination with market pressures suggest government regulation of competency is not required. Similarly, the NWC (2011b) noted that competency among brokers has improved since 2006.

Regulation requiring adherence to, and monitoring compliance with, a code of conduct may reduce the likelihood that intermediaries will engage in misconduct. Inclusion of a requirement to disclose conflicts of interest would remove confusion and impose a positive obligation on an intermediary trading on its own behalf or acting for more than one party in a transaction.

As discussed in section 3.1, self regulation could create penalties or disincentives if intermediaries do not disclose conflicts of interest, hold professional indemnity insurance or contribute to a fidelity fund. The AWBA code of ethics and standards includes commitments to not engage in misleading or misrepresenting behaviour, to promote the interests of clients and disclose conflicts of interest (AWBA n.d.).

The ACCC can prescribe mandatory and voluntary industry codes of conduct under the *Competition and Consumer Act 2010* that set out positive obligations for intermediaries. It also has the ability to work with industry to develop and provide an oversight role on any non-prescribed voluntary code of conduct. The ACCC published guidelines for developing voluntary industry codes of conduct in July 2011. Industry codes are not generally prescribed unless evidence exists to indicate that self regulation has been attempted within an industry and failed to address the identified problem (The Treasury 2011, p. 5).

3.3 Summary

Evidence indicates misconduct is not widespread. The risk of misconduct remains of concern to some stakeholders. Current legislation covers many aspects of intermediary behaviour but there are no requirements for intermediaries to undertake industry-specific actions which may prevent problems arising. Stakeholder concerns may be based on a perception that the risk is higher or there is less protection available under the current regulation.

Government action could address stakeholder concerns by improving understanding of the risks and regulatory arrangements already in place, or changing regulatory arrangements to reduce the impact and likelihood of problems arising. Specific areas where regulation could reduce the risks include:

- the use and adequate management of trust accounts to handle client funds;
- a requirement to hold a level of professional indemnity insurance; and
- positive obligations on intermediaries to disclose conflicts of interest.

4 Objective of governments

Australian governments are committed to achieving effective and efficient water markets that allow water to move to its highest value use.

The objective of governments is to ensure there is appropriate regulation of intermediaries so that the risk of intermediary misconduct and lack of confidence in intermediary services does not limit the ongoing development of water markets in Australia. The most appropriate option will have the highest net benefit.

5 Statement of options

The draft RIS focuses on the options identified as most appropriate for further consideration for addressing the risk of intermediary misconduct and stakeholder concern about this risk. The four options presented are:

1. maintaining the status quo;
2. publishing additional guidance material for intermediaries and water market participants;
3. providing advice on a voluntary accreditation scheme; and
4. introducing industry-specific regulation (licensing scheme).

A detailed description of each of these options is provided in sections 5.1 to 5.4.

Other possible options have not been proposed. The NWC (2011b) recommended that governments explore the costs and benefits of a registration scheme for brokers, under which brokers must register before operating in the industry and publicly disclose information on business characteristics. The processes and costs of establishing and managing a registration scheme were estimated to be similar to the licensing scheme (option 4), while providing fewer benefits. A registration scheme would not address the risk (and stakeholder concerns) about loss of client funds. A stand-alone mandatory trust account requirement has not been examined as an option within the draft RIS. The mandatory trust account requirement is covered in the licensing scheme option (option 4) and the costs of a mandatory trust account scheme are estimated to be similar to that of a licensing scheme.

The establishment of a fidelity fund has not been included in any of the options. Preliminary estimates of the ongoing cost to industry were approximately \$1.3 million per year, in addition to the cost to establish and manage the fund. This was not considered a feasible inclusion given the magnitude of the problem.

5.1 Status quo (option 1)

Maintaining the status quo would involve no additional government involvement in the regulation of intermediaries and no legislative change. Maintaining the status quo does not prevent consideration of the need for regulation in future if the nature and extent of the problem changes.

Intermediaries would still be subject to regulation under general laws (as discussed above in section 2.2 and section 3). The ACCC has published fact sheets about water trading and the fair trading rights and obligations of intermediaries under the ACL to assist with compliance. This information would continue to be provided under the status quo.

As discussed in section 3 there are various actions water market participants and intermediaries (individually and as a group) can take to reduce the risk of adverse outcomes from misconduct. For example, intermediaries are able, but not obliged, to open and hold a trust account at any financial institution that offers the service, acquire professional indemnity insurance and disclose conflicts of interest where relevant.

The risk of adverse outcomes, and stakeholder concerns regarding the risks, may be partially addressed if a large proportion of intermediaries undertake these actions and sufficient assurances are provided. There are no regulatory barriers preventing the intermediary industry from forming and maintaining a self regulation scheme requiring participants to adhere to a set of standards.

As discussed in section 3, the AWBA code of ethics and standards requires AWBA members to keep client funds in an account (although it does not specify administrative standards for establishing and using the account to protect client funds) and disclose conflicts of interest. It does not require an intermediary to hold professional indemnity insurance. Advice from the AWBA indicates it is considering the need to review the code of ethics and standards.

Question 8: *Do you have reason to believe that the majority of intermediaries will take action to deal with the matters of stakeholder concern under the status quo?*

Question 9: *What do you consider should be included in an industry code of conduct?*

5.2 Publication of additional guidance material for intermediaries and water market participants (option 2)

This option would involve a role for government in publishing guidance material on best practice for intermediaries. This would be in addition to the guidance material the ACCC published regarding fair trading rights and obligations.

Governments would develop and publish voluntary best practice guidelines for intermediaries and stakeholders to consider when participating in the Australian water market. The guidance material would:

- specify that a trust account should be used to hold client funds;
- outline the steps required to open and operate a trust account to a standard allowing identification and separation of client funds in the case of intermediary insolvency and bankruptcy (replicating what would be required under legislation in option 4);
- indicate what constitutes an appropriate level of professional indemnity insurance; and
- set out minimum standards of professional conduct, including the disclosure of conflicts of interest where appropriate.

This option would involve no legislative change. The guidance material would not constitute law and would have no legal standing. The information in the guidance material would not replace or substitute any existing standards, laws or other rules and regulations. Adherence to the guidance material would be voluntary and intermediaries would not be required to comply with the guidance material in order to operate in the industry.

Government would have no additional monitoring or compliance role under this option. Claims made by intermediaries in relation to the guidelines would be subject to the ACL, compliance with which is regulated by the ACCC and state and territory fair trading agencies.

The risk of adverse outcomes from misconduct would be reduced if intermediaries adhere to the guidelines. Stakeholder concerns may also be partially addressed if intermediaries adhere to the guidelines and are able to make credible assurances about adherence. An industry body or

a group of intermediaries may choose to adopt the guidelines as a standard and monitor and report on intermediary behaviour (similar to option 1).

The publication of additional guidance material would not prevent an intermediary industry body from developing additional or alternative standards for intermediary behaviour. For example, the AWBA code of ethics and standards would not be impacted and intermediaries could choose to adhere to the guidance material in addition to the AWBA code. The guidance material would cover matters not addressed by existing self regulation (such as administrative standards for establishing and using a trust account and appropriate levels of professional indemnity insurance).

5.3 Voluntary accreditation scheme (option 3)

This option involves an industry-run voluntary accreditation scheme (VAS), developed in consultation with governments if necessary. Government involvement may take various forms.

The VAS would be implemented and administered by an appropriate industry body. An appropriate industry body would:

- have the capacity to establish and administer the scheme;
- be in a position to maximise the number of accredited intermediaries;
- be accessible to intermediaries on a national level; and
- not place any restrictions on the ability of an intermediary to become accredited in addition to the requirements of the scheme.

Amendments could be made to the functions of an existing industry body, such as the AWBA, or a new body may be established.

A code of conduct would be developed by the industry body. Government would advise that the code of conduct include the following elements (which reflect the key elements of the voluntary best practice guidelines in option 2):

- a requirement that a trust account should be used to hold client funds;
- steps for the establishment and use of trust accounts (including how to establish an account, how client funds are to be treated, and minimum record keeping and audit requirements);
- a requirement to hold a minimum level of professional indemnity insurance; and
- minimum standards of professional conduct (including the disclosure of conflicts of interest).

This option would involve no legislative change. Accreditation under the scheme would be voluntary and intermediaries would not be required to be accredited in order to operate in the industry. The code of conduct would not replace or substitute any existing standards, laws or other rules and regulations. Claims made by intermediaries in relation to accreditation would be subject to the ACL, compliance with which is regulated by the ACCC and state and territory fair trading agencies.

If an intermediary became accredited compliance with the code of conduct would be compulsory to maintain accreditation. The VAS would include monitoring and enforcement

mechanisms to ensure the code of conduct is applied effectively in practice. Effective codes of conduct typically incorporate administrative elements such as compliance mechanisms, the ability to collect accurate data from members, a complaints handling strategy, monitoring and auditing mechanisms and ongoing reviews of effectiveness.

Government would not be involved in the administration of the VAS and would not be responsible for monitoring and enforcement of accredited entities. In some cases a breach of the code of conduct might also constitute a breach of Commonwealth, state or territory law. It would be expected that the industry body would report possible breaches to the relevant jurisdiction. General monitoring and enforcement of compliance with existing legislative requirements would continue as for the status quo (option 1). Government would monitor the effectiveness of the VAS.

The risk of adverse outcomes from misconduct would be reduced if intermediaries became accredited and complied with a code of conduct including these elements. For example, the code of conduct would include obligations for intermediaries to undertake actions and there would be penalties for non-compliance, including the possibility of de-accreditation. Unlike most existing regulation, this means action could be taken against accredited intermediaries for non-compliance even if there is no actual impact on clients. This may partially address stakeholder concerns by providing additional incentives for intermediaries to take action to prevent impacts on clients from occurring.

Implementation of the VAS would not prevent intermediaries and industry bodies from developing alternative self regulation approaches. The VAS would cover some matters not addressed in the existing AWBA code of ethics and standards (similar to option 2) and include monitoring and enforcement of compliance by accredited intermediaries. The interaction between the VAS and other self regulation approaches would be considered by the industry body during implementation.

Question 10: *What existing intermediary industry bodies could be involved in the VAS?*

Question 11: *What other industry bodies might be able to perform this function?*

Question 12: *Do you consider there are ways in which government could be involved in the VAS? If so, what are these?*

5.4 Industry-specific regulation – licensing scheme (option 4)

This option involves government implementing a licensing scheme for intermediaries. The licensing scheme would replicate the key elements of the voluntary best practice guidelines (option 2) and the VAS (option 3). The scheme would be administered by government and it would be compulsory for all individuals and businesses providing intermediary services within Australian water markets.

Government, in consultation with relevant stakeholders, would develop regulatory arrangements requiring intermediaries to:

- be licensed in order to provide intermediary services;
- keep any funds held on behalf of a client in a trust account;

- take specific steps when establishing and using a trust account (including minimum record keeping and audit requirements);
- hold at least a minimum level of professional indemnity insurance coverage; and
- comply with standards of professional conduct (including regarding the disclosure of conflicts of interest).

New legislation or amendments to existing legislation at the state, territory and possibly Commonwealth level would be required to establish the scheme. It is anticipated that civil penalties would be included to enable regulators to take action in response to breaches. All existing regulatory arrangements would continue to apply.

Arrangements for developing and implementing the licensing scheme would need to be negotiated between the Commonwealth and state and territory governments. An intergovernmental agreement may be developed to ensure consistency of the regulatory framework and accompanying legislation across jurisdictions. Depending on the detail of the regulation, a number of options may be given consideration including referral of powers from States to the Commonwealth or mirror legislation. The scheme may involve arrangements to recover the costs of licensing from intermediaries.

A licensing scheme would reduce the risk of misconduct and address stakeholder concerns about this risk by providing additional incentives for intermediaries to take action to prevent impacts on clients from occurring.

A licensing scheme would remove the need for self regulation of the matters covered by the scheme. Intermediaries and industry bodies may undertake self regulation of additional matters.

6 Preliminary impact analysis

This section describes the impacts of proposed policy options (outlined in section 5) to identify the extent to which each option meets the objective (outlined in section 4). An overview of the costs and benefits, stakeholders impacted and issues associated with each of the proposed options is provided in sections 6.1 to 6.5, with additional details about the estimated costs provided at the end of each section. A summary comparing the four options is provided in section 6.5.

Both quantitative and qualitative assessments are provided. Indicative quantitative information about the expected costs of implementing the options is based largely on the findings of PwC (2011). Actual costs would vary according to the size of the intermediary market at any given point in time and market factors (such as the cost of insurance, banking and audit services).

This is a preliminary analysis based on information available to date. It is anticipated that stakeholder feedback on the draft RIS will provide additional detail to inform the final RIS.

Question 13: *When using an intermediary do you seek assurances that the intermediary:*

- a) maintains an audited trust account for holding client funds;*
- b) holds professional indemnity insurance (and if so the premium and extent of coverage);*
and
- c) implements arrangements to disclose conflicts of interest to clients?*

Question 14: *The preliminary impact analysis contains many assumptions and estimates of the costs and benefits associated with the four options. Where you consider these assumptions and estimates could be improved, please provide additional information or details of alternative suggestions.*

6.1 Status quo (option 1)

Maintaining the status quo involves no change and no costs to governments, intermediaries or water market participants in addition to those that arise under current arrangements.

Intermediaries may already be taking measures to reduce the risk of impacts on clients. Stakeholders have indicated in previous consultation that some intermediaries use some form of trust account, hold of professional indemnity insurance and adhere to the AWBA code of ethics and standards. Costs incurred by intermediaries in undertaking these activities are expected to occur in the absence of government action.

The risk of adverse outcomes resulting from intermediary misconduct and associated stakeholder concerns are likely to persist under the status quo. As discussed in section 3, it is not clear if this risk would increase or decrease over time in the absence of government action.

6.2 Publication of additional guidance material for intermediaries and water market participants (option 2)

Additional guidance material would be developed by the Commonwealth and state and territory governments in consultation with stakeholders. As discussed in section 5.2, the guidelines would outline best practice in terms of trust account establishment and management, holding professional indemnity insurance and disclosure of conflicts of interest. The guidelines would be publicly available.

The costs and benefits of publishing additional guidance material are presented in Table 4, along with the stakeholders impacted and issues and constraints. More detailed cost estimates are provided in section 6.2.1.

Table 4 – Key costs and benefits of publishing additional guidance material for intermediaries and water market participants (option 2)

	Description	Extent	Stakeholders impacted	Issues and constraints
Guidance material costs	Costs associated with developing guidance material, publication and communications	Initial costs estimate of about \$150 000 and ongoing cost of \$5000 per year (see table 5).	Commonwealth, state and territory governments.	Resourcing
Costs to participate in the scheme	Cost for an intermediary to: <ul style="list-style-type: none"> • establish, use and audit a trust account; • hold professional indemnity insurance; and • disclose conflicts of interest. 	Depends on the number of intermediaries who decide to adhere to the guidelines (see table 6). Assuming 25 intermediaries, initial total cost of about \$55 000 and ongoing total cost of about \$85 000 per year. Assuming 30 intermediaries, initial total cost of about \$80 000 and ongoing total cost of about \$125 000 per year.	Intermediaries and water market participants (through higher prices or commission for intermediary services).	Financial constraints For ease of analysis the cost estimates are based on an assumption that all intermediaries bear the same participation costs. In reality some intermediaries will face higher costs (for example professional indemnity insurance premiums are likely to vary across intermediaries).
Reduction in risk and concerns	Concerns about misconduct addressed may be addressed through increased information about what constituted best practice. Advising of appropriate steps to establish, manage and audit trust accounts may reduce the risk of loss in the case of insolvency and bankruptcy, theft or fraud and misconduct. Advising on an appropriate level of professional indemnity insurance may reduce the risk that intermediaries cannot compensate affected parties in the case of civil action. Informing intermediaries and water market participants about the benefits from disclosure of conflicts of interests may increase information provided to clients of a key factor determining quality of service.	No requirement to adhere to guidelines, extent of risk reduction dependent on how many choose to comply (25-30 represents around 30 per cent of intermediaries but probably a much larger percentage of intermediary-facilitated trades) Some reduction in risk. Absence of monitoring and enforcement limits extent to which concerns are addressed.	Water market participants and intermediaries.	Intermediaries will only choose to comply if the private benefits outweigh the cost. If intermediaries comply then this suggests the benefits are at least equal to any additional costs incurred to adhere to the guidelines.

The publication of guidance material is unlikely to have a significant impact on the number of intermediaries given the absence of any requirement to take action or monitoring. It is anticipated that intermediaries would only incur the additional costs of adhering to the guidelines if the expected benefits exceed the cost. This is most likely to be the case for intermediaries already taking some of the actions that would be included in the guidelines and intermediaries deriving the majority of business revenue from water trading. There may be some distributional impacts if intermediaries adhering to the guidelines attract business from intermediaries that do not or vice versa.

Intermediaries would be expected to pass the additional costs of adhering to the guidelines on to clients. Some water market participants may be willing to pay more for the reduced risk associated with the additional actions taken. Further, some water market participants not previously willing to engage the services of an intermediary may do so if there is confidence that the intermediary adheres to the guidelines. If water market participants are not willing to pay more for intermediary services when the risk of misconduct is lower, then few intermediaries would be expected to incur additional costs in order to adhere to the guidelines.

Question 15: *Would additional information about intermediary best practice assist you when using intermediary services?*

Question 16: *If additional guidance material were provided, what remaining concerns would you have about intermediary misconduct?*

6.2.1 Breakdown of costs for option 2

PwC (2011) did not provide indicative cost estimates for the publication of additional information. Some of the PwC cost estimates have been adapted to the description of this option (for example, staff and communication cost estimates are used). The estimated costs of developing and implementing the additional information are outlined in Table 5.

The participation cost for intermediaries will depend on the number of intermediaries who choose to establish, use and audit a trust account, hold professional indemnity insurance, and disclose conflicts of interest in accordance with the guidelines. Details of the expected participation cost per intermediary are outlined in Attachment B, with the cost per intermediary adhering to the guidelines estimated to be about \$5000 initially with ongoing costs of about \$8400 per year.

Table 5 - Publication of additional guidance material costs

Activity	Resources	Initial	Ongoing
Develop guidance material	Policy and legal officers to prepare guidance material and undertake consultation (Commonwealth \$80 000, states and territories \$50 000)	\$130 000	\$0
Publication and communication	Publishing of pamphlets, postage, media bookings, website changes	\$20 000	\$5000
Total cost		\$150 000	\$5000

The total participation cost for the scheme is presented in Table 6. As adherence to the guidelines is optional and no monitoring of voluntarily compliance is proposed, it is assumed that between 25 and 30 intermediaries would adhere to the guidelines. It is assumed that

5 intermediaries already use trust accounts, hold professional indemnity insurance and disclose conflicts of interest so there would be no additional cost for them to adhere to the guidelines. It is also assumed that approximately 20 intermediaries undertake some of these actions and the additional cost for them would be half of the initial and ongoing costs of these activities. It is assumed that all these intermediaries would take the additional steps necessary to adhere completely to the guidelines.

It is not anticipated that the costs of developing and publishing the guidelines would be recovered from intermediaries. This means the cost to industry would be limited to the participation costs.

Table 6 - Total participation costs, assuming 25 and 30 intermediaries adhere to the guidelines

	Total initial cost	Total ongoing cost
25 intermediaries adhere to guidelines	\$55 000	\$85 000
30 intermediaries adhere to guidelines	\$80 000	\$125 000

6.3 Voluntary accreditation scheme (option 3)

A VAS option would be established and operated by industry. As described in section 5.3, to be accredited intermediaries would need to establish and use trust accounts, disclose potential conflicts of interest, hold a minimum level of professional indemnity insurance, and undertake ongoing compliance requirements. For intermediaries that become accredited, the VAS would in practice have a similar effect to many of the obligations of a licensing scheme. The main costs and benefits of a VAS are presented in Table 7 along with the stakeholders impacted and issues and constraints. More detailed cost estimates are provided in section 6.3.1.

It is estimated that costs would be lower if VAS administration was undertaken by an existing industry body such as the AWBA (which has an existing management structure and currently represents a large number of intermediaries). Coverage of the scheme may be greater if an established industry body administers the VAS.

The introduction of a VAS may have an impact on the number of intermediaries operating in water markets if the cost of participating prevents some intermediaries from seeking accreditation and there is an impact on non-accredited intermediaries. The VAS may have anticompetitive effects on the market for intermediary services if the obligations and minimum requirements associated with the VAS:

- increase the costs and complexity of carrying on intermediary business or establishing a new intermediary business; or
- lead to the exit of existing intermediaries from the markets for intermediary services.

The ACCC is responsible for the regulation of anti-competitive behaviour and can authorise businesses to engage in anti-competitive arrangements or conduct when it is satisfied that the public benefit from the arrangements outweighs any public detriment.

Table 7 – Key costs and benefits of a voluntary accreditation scheme (option 3)

	Description	Extent	Stakeholders impacted	Issues and constraints
VAS costs	Costs associated with existing industry body administering the VAS	Initial costs estimate of about \$210 000 and ongoing cost of about \$170 000 per year (see table 8). If a new industry body was established initial costs estimate of about \$660 000 and ongoing cost estimate of \$1.18 million (see table 9).	Intermediaries and water market participants (through higher prices or commission for intermediary services).	There may be additional administrative costs if cost recovery is pursued which have not been estimated.
Costs to participate in the scheme	Cost for an intermediary to: <ul style="list-style-type: none"> • become accredited; • establish, use and audit a trust account; • hold professional indemnity insurance; and • disclose conflicts of interest. 	Depends on the number of intermediaries who decide to become accredited and continue operating (see table 10). Assuming 30 intermediaries, initial total cost of about \$78 000, ongoing total cost of about \$130 000 per year. Assuming 60 intermediaries, initial total cost of about \$240 000, ongoing total cost of about \$385 000 per year.	Intermediaries and water market participants (through higher prices or commission for intermediary services).	Financial constraints For ease of analysis the cost estimates are based on an assumption that all intermediaries bear the same participation costs. In reality some intermediaries will face higher costs (for example professional indemnity insurance premiums are likely to vary across intermediaries).
Reduction in risk and concerns	Concerns about misconduct partially addressed through voluntary positive obligations and industry oversight of compliance. Specifying steps to establish, manage and audit trust accounts would reduce the risk of loss in the case of insolvency and bankruptcy, theft or fraud and misconduct. Requiring professional indemnity insurance reducing risk that intermediaries cannot compensate affected parties in the case of civil action. Accredited intermediaries must disclose conflicts of interest	Only accredited intermediaries subject to requirements. Cover of risk of loss of client funds in the case of insolvency and bankruptcy dependent on uptake of the scheme and the level of compliance with administrative standards in relation to trust accounts.	Water market participants and intermediaries	Level of take up of scheme by intermediaries. Effectiveness of monitoring and enforcement, and transparency of governance arrangements to clients and other water market participants. The VAS would need to include incentives for intermediaries to comply with the code of conduct.

As the VAS would be voluntary, intermediaries would only incur the additional costs of accreditation if the expected benefits exceed the cost. This is most likely to be the case for intermediaries already taking some of the actions that would be required under the code of conduct and intermediaries deriving the majority of business revenue from water trading. The value market participants place on accreditation when selecting an intermediary would be a key determinant of how many intermediaries are likely to participate in the VAS, as the costs will result in higher prices for intermediary services. It is possible that non-accredited intermediaries would be able to offer cheaper services and gain market share by avoiding costs associated with VAS accreditation.

Water market effectiveness may be impacted if a VAS results in higher transaction costs (both through the cost of participation in the VAS and reduced competition if fewer intermediaries continue to operate overall).

Question 17: *Would you be more likely to participate in water trading if you could use the services of an intermediary accredited under the VAS?*

Question 18: *If a VAS were implemented, what remaining concerns would you have about intermediary misconduct?*

6.3.1 Breakdown of costs for option 3

PwC (2011) provided indicative cost estimates for a voluntary scheme requiring the use of trust accounts, professional indemnity insurance, and disclosure of conflicts of interest. These costs have limited application to the VAS outlined in section 5.3. The PwC estimates have been adapted to the parameters of the VAS (for example, the agency responsible for bearing staffing costs has been changed).

The costs of establishing and administering a VAS would be largely independent of the number of intermediaries that choose to become accredited. For example, the costs of establishing enforcement mechanisms would be incurred regardless of the take up of the VAS. The costs associated with establishing and administering the VAS will differ depending on whether an existing industry body is used or a new industry body is established. The estimated scheme costs associated with each body is outlined below in Tables 8 and 9.

Table 8 – VAS costs - Developing an existing industry body

Activity	Resources	Initial	Ongoing
Adapting existing industry body functions and developing VAS policies and procedures	Staff to develop compliance, enforcement and communication policy, adapt website and consult with stakeholders. Additional board meetings.	\$210 000	\$0
Administration, monitoring and evaluation	Staff to deal with accreditation, monitor compliance and report on scheme	\$0	\$160 000
Enforcement	Additional board meetings to make decisions on enforcement issues	\$0	\$10 000
Total cost		\$210 000	\$170 000

Table 9 – VAS costs – Developing a new industry body

Activity	Resources	Initial	Ongoing
Establishing a new agency	Board, CEO and staff to establish existing agency and develop necessary compliance, enforcement and communication policies.	\$660 000	\$0
Administration, monitoring and evaluation	Ongoing Board, CEO and staff costs to deal with accreditation, monitor compliance and report on scheme.	\$0	\$1 165 000
Enforcement	Additional board meetings to make decisions on enforcement issues	\$0	\$10 000
Total cost		\$660 000	\$1 180 000

The number of intermediaries that become accredited under the VAS will impact participation costs. Costs per intermediary associated with setting up, using and auditing trust accounts, holding professional indemnity insurance and disclosing conflicts of interest are outlined in Attachment B. The estimated costs of these requirements under the VAS are about \$5000 initially with ongoing costs of about \$8500 per year (including \$100 to be accredited).

The total participation costs faced by intermediaries would depend on how many become accredited under the VAS. Given the voluntary nature of the VAS it is unlikely that all current intermediaries will become accredited so participation costs have been estimated assuming that between 30 and 60 intermediaries become accredited. It is assumed that 5 intermediaries already use trust accounts, hold professional indemnity insurance and disclose conflicts of interest so the additional cost to be accredited would be about \$100, as outlined in Attachment B. It is also assumed that approximately 20 intermediaries already undertake some of these actions and the additional cost for them would be half of the initial and ongoing costs of these activities, plus the accreditation costs. Table 10 incorporates these assumptions and provides the total participation costs associated with an uptake of the VAS.

Table 10 - Total participation costs, assuming 30 and 60 accredited intermediaries

	Total initial cost	Total ongoing cost
30 accredited intermediaries	\$78 000	\$130 000
60 accredited intermediaries	\$240 000	\$385 000

It is assumed that the VAS costs would be recovered from intermediaries as the industry body would be funded by participants. This means accredited intermediaries would pay a share of the scheme costs in addition to these participation costs. Table 11 summarises the average cost per accredited intermediary.

Table 11 – Average cost per intermediary, assuming 30 and 60 accredited intermediaries

	Initial costs		Ongoing costs (from year 1)
	Scheme costs (year 0)	Participation costs (year 1)	
30 intermediaries	\$7000	\$2600	\$10 000
60 intermediaries	\$3500	\$4000	\$9250

6.4 Industry-specific regulation – licensing scheme (option 4)

The licensing scheme would be established and operated by the Commonwealth and state and territory governments and all intermediaries would need to obtain a licence to operate in the industry. As discussed in section 5.4, there would be licence conditions requiring intermediaries to use a trust account in accordance with legislative requirements when holding client funds, hold professional indemnity insurance and disclose conflicts of interest.

The costs and benefits of a licensing scheme are presented in Table 12, along with the stakeholders impacted and issues and constraints. More detailed cost estimates are provided in section 6.4.1.

The introduction of a licensing scheme is likely to reduce the number of intermediaries operating in water markets as the cost of compliance for some intermediaries is likely to exceed the benefits from continuing to provide water market intermediary services. If full cost recovery is pursued, the costs are likely to be prohibitive for the majority of intermediaries (estimated average costs per intermediary are presented in table 15). The costs of compliance may also act as a barrier for potential intermediaries to enter the industry. Intermediaries who facilitate a small number of transactions per year are most likely not to become licensed because the initial compliance costs may exceed the profit available from only a few transactions. There is the potential for disproportionately higher impacts in regional areas which have specific local trading arrangements and market information. Intermediaries operating in these regions may only facilitate a few trades per year and their exit from the industry may increase transaction costs for participants and impact trading activity in these markets. It is possible that in some regions higher demand for intermediary services due to reduced risk of misconduct could encourage new entrants and increase competition.

The impact on the quantity of intermediary services is less clear. There may be a reduction in demand where the additional costs result in higher prices for intermediary services. There may be an increase in demand for intermediary services as clients become increasingly confident that the risk of misconduct by intermediaries has fallen. If water market participants factor the risk of misconduct into decisions then a reduction in this risk would be expected to shift demand. The overall effect is difficult to predict, although the high cost of the scheme and the fact that water market participants have continued to use intermediary services under current risk levels indicate there may be greater likelihood of reduced demand for intermediary services.

Overall the higher costs and potential reduction in competition between intermediaries may increase transaction costs and reduce the efficiency of water markets.

Question 19: *If a licensing scheme were implemented, what remaining concerns would you have about intermediary misconduct?*

6.4.1 Breakdown of costs for option 4

PwC (2011) provided indicative cost estimates for three schemes requiring the use of trust accounts, professional indemnity insurance, and disclosure of conflicts of interest however none of the schemes considered by the PwC align with the licensing scheme under consideration in the draft RIS. The PwC estimates have been adapted to the parameters of this scheme (for example, staff costs are used but assumptions about how many staff are required have been changed).

It is estimated that the costs of establishing and administering a licensing scheme would be largely independent of the number of licensed intermediaries. For example, the costs of developing legislation would be incurred if there were 30 intermediaries or 100. The estimated scheme costs are outlined in Table 13.

It is assumed that existing Commonwealth, state and territory departments or agencies would develop and administer the licensing scheme. Agreement would need to be reached about the distribution of roles and responsibilities.

The number of water market intermediaries operating in each jurisdiction would be an important determinant of compliance costs. The expected compliance cost per intermediary is outlined in Attachment B. The estimated cost for an intermediary to hold a licence, establish, use and audit a trust account, hold professional indemnity insurance, and disclose conflicts of interest is about \$5000 initially with ongoing costs of about \$8500 per year (including \$100 to hold a licence).

The total compliance costs for the licensing scheme are presented in Table 14. It is assumed that 5 intermediaries already use trust accounts, hold professional indemnity insurance and disclose conflicts of interest so the additional cost for them would be about \$100 per year to hold a licence. It is also assumed that approximately 20 intermediaries undertake some of these actions and the additional cost for them would be half of the initial and ongoing costs of these activities, plus about \$100 per year to hold a licence.

It is assumed that intermediaries would face both the initial and ongoing costs in the first year of the scheme.

Table 12 – Key costs and benefits of a licensing scheme (option 4)

	Description	Extent	Stakeholders impacted	Issues and constraints
Licensing scheme costs	Costs associated with establishing and administering the licensing scheme.	Initial costs estimate of about \$2.86 million and ongoing cost estimate of about \$895 000 per year (see table 12). Possible additional administrative costs if cost recovery is pursued.	Commonwealth, state and territory governments Shift to intermediaries and clients under cost recovery arrangements.	Resourcing Precise roles for Commonwealth, state and territory legislation, including consideration of extent of Commonwealth constitutional powers.
Costs to comply with the scheme	Cost for an intermediary to: <ul style="list-style-type: none"> • hold a licence; • establish, use and audit a trust account; • hold professional indemnity insurance; and • disclose conflicts of interest. 	Depends how many intermediaries decide to become licensed and continue operating (see table 13). Assuming 30 intermediaries, initial total cost of about \$78 000, ongoing total cost of about \$130 000 per year. Assuming 50 intermediaries, initial total cost of about \$185 000 and ongoing total cost of about \$300 000 per year. Assuming 80 intermediaries, initial total cost of about \$344 000 and ongoing total cost of about \$560 000 per year.	Intermediaries It is expected that intermediaries would pass on at least some of the costs to clients through increased prices for intermediary services (or increased percentage for commissions).	Financial constraints For ease of analysis the cost estimates are based on an assumption that all intermediaries bear the same compliance costs. In reality some intermediaries will face higher costs (for example professional indemnity insurance premiums are likely to vary across intermediaries).
Reduction in risk and concerns	Concerns about misconduct addressed through mandatory positive obligations to prevent negative impacts on clients and government oversight of compliance. Specifying steps to establish, manage and audit trust accounts would reduce the risk of loss in the case of insolvency and bankruptcy, theft or fraud and misconduct. Requiring professional indemnity insurance would reduce the risk that intermediaries cannot compensate affected parties in the case of civil action. Requiring conflict of interest disclosure would ensure market participants are informed of a key factor determining service quality.	All intermediaries subject to requirements. Civil penalties and government monitoring creates additional compliance incentives. Risk of loss of client funds in the case of insolvency and bankruptcy substantially removed. Some reduction in other risks.	Water market participants and intermediaries	Effectiveness of monitoring and enforcement. As noted in section 3, it is not clear that there is a large benefit available from reducing these risks in terms of changed behaviour of water market participants.

Table 13 - Licensing scheme costs

Activity	Resources	Initial	Ongoing
Develop legislation	Policy and legal officers to develop legislative arrangements and undertake consultation (Commonwealth \$635 000, states and territories \$1.9 million)	\$2 535 000	\$0
Set up administrative policies and procedures	Policy and IT officers to develop compliance, enforcement and communication policy, develop the licensing register and prepare website	\$330 000	\$0
Scheme administration	Officer to manage licensing and the licensing register	\$0	\$80 000
Monitoring and enforcement	Officer to coordinate monitoring across jurisdictions and public reporting (\$80 000) Resourcing to monitor and enforce licensed intermediaries and conduct checks for unlicensed intermediaries (\$635 000) Legal advice (in the event non-compliance is identified) (\$100 000)	\$0	\$815 000
Total cost		\$2 865 000	\$895 000

Table 14 - Total compliance costs, assuming 30, 50 and 80 licensed intermediaries

	Total initial cost	Total ongoing cost
30 licensed intermediaries	\$78 000	\$130 000
50 licensed intermediaries	\$185 000	\$300 000
80 licensed intermediaries	\$344 000	\$560 000

Although no cost recovery arrangements have been discussed, it is assumed that some of the licensing costs would be recovered from intermediaries. This means accredited intermediaries would pay a share of the scheme costs in addition to participation costs. Table 15 summarises the average cost per licensed intermediary, assuming all scheme costs are recovered.

Table 15 – Average cost per intermediary, assuming 30, 50 and 80 licensed intermediaries

	Initial costs		Ongoing costs (from year 1)
	Scheme costs (year 0)	Participation costs (year 1)	
30 intermediaries	\$95 500	\$2600	\$34 100
50 intermediaries	\$57 300	\$3700	\$23 900
80 intermediaries	\$35 800	\$4300	\$18 100

6.5 Summary

Assessment and comparison of the net benefit of each option is difficult because the benefits are not practically quantifiable. Table 16 provides a high level summary of the costs and benefits (in terms of reduction in the risk of misconduct and stakeholder concerns). In calculating the present value of the cost of each option it is assumed that the initial scheme costs occur before the scheme commences and the initial participation or compliance costs occur in the first year the scheme operates (for example, in the first year intermediaries would bear the cost of opening the account as well as using and auditing it).

It is likely that the cost of establishing and maintaining a licensing scheme (option 4) exceed the benefits associated with addressing stakeholder concerns and reducing risk of misconduct. If full cost recovery is pursued, the cost is likely to be prohibitive for the majority of intermediaries to continue operating. Further, a VAS has the potential to provide similar benefits at a lower cost if an existing industry body is used.

It is unclear whether there would be a net benefit from options 2 and 3.

Under option 2, the impact on individual intermediaries is limited to the costs of taking actions to reduce the risk of misconduct (such as using a trust account and holding professional indemnity insurance). Under option 3, accredited intermediaries would share the additional cost of establishing and running the VAS. The benefit to intermediaries and water market participants from greater confidence that the risk of misconduct has been reduced may outweigh these additional costs.

Question 20: *For each option, do you consider the available benefit would exceed the cost?*

Table 16 - Comparative assessment of regulatory options

	Option 1 – Status Quo	Option 2 – Publication of additional guidelines	Option 3 – Voluntary Accreditation Scheme (assuming existing industry body)	Option 4 – Licensing Scheme
Present value of total costs over 10 years (7% discount rate)	\$0	\$828 000 (25 intermediaries adhere to guidelines) to \$1.1 million (30 intermediaries adhere to guidelines)	\$2.4 million (30 accredited intermediaries) to \$4.3 million (60 accredited intermediaries)	\$10.1 million (30 licensed intermediaries), \$11.4 million (50 licensed intermediaries), and \$13.4 million (80 licensed intermediaries)
Risk of misconduct	No change	Partially reduced	Partially to substantially reduced	Substantially reduced
Stakeholder concerns	Not addressed	Marginally addressed	Partially to substantially addressed	Substantially addressed
Overview	No cost, no benefit. General regulation continues to apply to intermediaries.	Low cost, voluntary, no monitoring of best practice. Minimal indirect impacts on water market.	Mid cost, voluntary to become accredited, benefits and costs depend on level of participation in scheme. Some potential impacts on water market. Improved efficiency from lower risk of misconduct. Higher transaction costs and potentially reduced competition.	High cost, mandatory, most risk and concerns addressed. Likely to be impacts on water market. High cost may lead to exit of some intermediaries.

7 Consultation

The purpose of the consultation process is to seek the views of stakeholders on possible regulation of intermediaries. This will ensure that governments, regulated businesses and relevant stakeholders have a common understanding of the problem, the objectives and the costs and benefits of the options under consideration. Preliminary consultation with stakeholders was undertaken during 2011 to inform the development of regulatory options to address stakeholder concerns.

Stakeholders are encouraged to comment on the draft RIS. All comments and submissions received will be considered by the Department and a consultation statement will be included in the final RIS. The final RIS will contain a recommended option and a strategy for implementation.

A final decision about an appropriate governance regime for water market intermediaries is expected in 2013.

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Attachment A – Summary list of questions

Section 2 - Context

- Question 1 In your experience how many brokers are operating in Australian water markets? p. 6
- Question 2 Are you aware of other water exchanges operating in Australian water markets? p. 6
- Question 3 In your experience does the number of intermediaries operating in Australian water markets change year to year? p. 7

Section 3 – Statement of the problem

- Question 4 Do you consider that there has been any intermediary misconduct? If so, what is the nature of this misconduct? Do you consider it to be widespread? What is the basis for this view? p. 10
- Question 5 Do you consider intermediary misconduct is likely to increase in future? What is the basis for this view? p. 10
- Question 6 Do you have any concerns in relation to intermediaries holding client funds? If so, what is the nature of this concern? p. 11
- Question 7 Do you have any concerns in relation to the conduct of intermediaries when providing services? If so, what is the nature of this concern? p. 15

Section 5 – Statement of options

- Question 8 Do you have reason to believe that the majority of intermediaries will take action to deal with the matters of stakeholder concern under the status quo? p. 21
- Question 9 What do you consider should be included in an industry code of conduct? p. 21
- Question 10 What existing intermediary industry bodies could be involved in the VAS? p. 23
- Question 11 What other industry bodies might be able to perform this function? p. 23
- Question 12 Do you consider there are ways in which government could be involved in the VAS? If so, what are these? p. 23

Section 6 – Preliminary impact analysis

- Question 13 When using an intermediary do you seek assurances that the intermediary: p. 25
- a) maintains an audited trust account for holding client funds;
 - b) holds professional indemnity insurance (and if so the premium and extent of coverage); and
 - c) implements arrangements to disclose conflicts of interest to clients?

Question 14	The preliminary impact analysis contains many assumptions and estimates of the costs and benefits associated with the four options. Where you consider these assumptions and estimates could be improved, please provide additional information or details of alternative suggestions.	p. 25
Question 15	Would additional information about intermediary best practice assist you when using intermediary services?	p. 27
Question 16	If additional guidance material were provided, what remaining concerns would you have about intermediary misconduct?	p. 27
Question 17	Would you be more likely to participate in water trading if you could use the services of an intermediary accredited under the VAS?	p. 30
Question 18	If a VAS were implemented, what remaining concerns would you have about intermediary misconduct?	p. 30
Question 19	If a licensing scheme were implemented, what remaining concerns would you have about intermediary misconduct?	p. 32
Question 20	For each option, do you consider the available benefit would exceed the cost?	p. 36

Attachment B – Intermediary participation and compliance costs

Intermediaries will face costs in setting up, using and auditing trust accounts, holding professional indemnity insurance and disclosing conflicts of interest. To allow for comparison between intermediaries the cost estimates associated with participation and compliance requirements are based on an assumption that all intermediaries bear the same costs. The cost estimates for each intermediary are outlined in Table B1. In reality intermediaries will face different costs (for example professional indemnity insurance premiums are likely to vary across intermediaries). These figures are indicative only and individuals may face considerably different costs in the event that any of these options are implemented.

The PwC (2011) estimate of time cost at \$54.55 per hour is used.

PwC estimated that an auditor would cost between \$200 and \$300 per hour, and audit services would be required for between half a day and two days (PwC 2011, p. 26). PwC estimated that professional indemnity insurance premiums would be approximately \$1000 for intermediaries who already had some form of professional indemnity insurance and \$4000 for first time policy holders (PwC 2011, p. 27). A midrange of both these estimates has been used.

The assumption that each intermediary facilitates approximately 145 trades per year is based on 2010-11 trade data (NWC 2011a). A total of 6786 entitlement trades and 9131 allocation trades were undertaken in 2010-11. Assuming 90 per cent of entitlement trades and 60 per cent of allocation trades were assisted by intermediaries and there are 80 intermediaries actively facilitating trades, this equates to 145 trades per intermediary per year. In reality intermediaries will undertake far more or less than 145 transactions.

Table B1 – Participation and compliance costs per intermediary

Activity		Resources	Initial	Ongoing
Trust accounts	Open account	4 hours to set up the account, costs \$54.55 per hour	\$218	\$0
	Management of transactions	145 trades per year, each requiring two transactions, costs 40 cents per transaction	\$0	\$116
		5 mins on each of 290 transactions per year, costs \$4.55 per transaction	\$0	\$1 320
	Audit	annual payment to auditor for 7.5 hours per year, costs \$250 per hour	\$0	\$1 875
Professional indemnity insurance	Obtaining policy	1 hour to obtain an insurance policy, costs \$54.55 per hour	\$55	\$0
	Payment of annual premiums	annual premium costs \$2 500	\$0	\$2 500
Disclosure of conflicts of interest	Establishment of disclosure policy and staff training	costs \$5 000	\$5 000	\$0
	Identification and treatment of disclosure for each trade	20 mins for each of the 145 trades per year to consider whether a conflict may arise and informing both parties, costs \$18.18 per trade	\$0	\$2 636
Total (option 2)			\$5 273	\$8 447
Accreditation or licence	Application for accreditation or licence	2 hours each year dealing with paperwork to become and remain accredited or licensed, costs \$54.55 per hour	\$0	\$111
Total (options 3 and 4)			\$5 273	\$8 558