

SUBMISSION

Submission to Treasury —Financial Institutions Supervisory Levies methodology

September 2019

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The Treasury

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Via email: supervisorylevies@treasury.gov.au

17 September 2019

Dear Sir / Madam,

Consultation on Financial Institutions Supervisory Levies methodology

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to Treasury's Discussion Paper *Financial Institutions Supervisory Levies methodology* (Discussion Paper).

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its \$2.8 trillion in retirement savings. Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing almost 90 per cent of the 16 million Australians with superannuation.

If you have any queries or comments in relation to the content of our submission, please contact me on (03) 9225 – 4021 or by email fgalbraith@superannuation.asn.au.

Yours sincerely

Fiona Galbraith

Director, Policy

1 Table of contents

1. Introduction.....	1
2. Summary of ASFA’s positions.....	1
3. Ensuring cost incurred are justifiable.....	2
4. Accountability / Transparency of Determination of Costs.....	4
5. Financial Industry Supervision Levy Methodology.....	5
6. Discussion Paper – Consultation issues.....	7
7. Financial Assistance Funding Levy.....	10

1 Introduction

RSE licensees will pay over \$89.1 million this year in supervisory levies. This represents an increase of some \$6.8 million over the 2018 – 2019 levies.

Given that this is money which could otherwise have been attributed to member accounts, it is critical that all of the agencies who receive the levy are accountable for the costs and expenditure they incur.

In particular it is important that:

1. the costs incurred are justifiable:
 - the nature, scope and timing of activities, and the method of performing these activities, are warranted by the likelihood and consequence of the risk being regulated / supervised; and
 - the costs are reasonable
2. there is transparency and accountability with respect to the activities undertaken and the costs incurred; and
3. the supervisory levy methodology is appropriate:
 1. the nature / type of costs to be recovered from a particular industry are appropriate to be recovered by way of a levy, as opposed to being funded out of consolidated revenue;
 2. the costs are, directly or indirectly, with respect to the regulation and supervision of the relevant industry;
 3. the quantification of costs, and their allocation to the various industries, is done on an appropriate and reasonable basis, thereby ensuring that the maximum amount levied is at most equivalent to, but does not exceed, the reasonable costs incurred by the organisation which receives the levies with respect to the relevant industry; and
 4. the amount of the levy is determined on an equitable and reasonable basis after appropriate consultation.

While the Discussion Paper is focussed on the third aspect – the supervisory levy methodology – this cannot be done in isolation from considerations with respect to whether the costs are justifiable and whether there is transparency and accountability with respect to these costs.

This submission will address the issues as to the incurring of costs and whether there is adequate transparency and accountability with respect to costs, before turning to address the Discussion Paper and the consultation issues and questions asked therein.

2 Summary of ASFA positions

It is ASFA's view that

1. The levy process should be as transparent as possible, through adequate disclosure and appropriate consultation
2. APRA should publish a cost recovery policy
3. We support APRA and ASIC continuing to publish a comprehensive Cost Recovery Implementation Statement (CRIS) with respect to the financial sector levies they receive and recommend that the ATO prepare one as well
4. The ANAO should perform comprehensive audits of APRA, ASIC and the ATO's activities; expenditure and allocation of costs to industries to ensure that the functions are performed as efficiently as possible. In addition the ANAO should perform a review of the restricted /

unrestricted components of the levy calculations and whether the CRIS (if any) provide a sufficient level of detail

5. The determination of direct salary costs attributable to each levy-paying industry should not be performed on the basis of time alone but on the basis of the actual salary costs incurred
6. We agree with the conceptual basis for imposing a minimum and maximum amount with respect to the restricted, supervisory component, as a number of the costs of prudential supervision are fixed and those which are variable are not in direct proportion to fund assets
7. Care must be taken to ensure that the minimum and maximum are determined on an appropriate and equitable basis. Accordingly, there needs to be a methodology underpinning the basis upon which the minimum and maximum amounts are set each year
8. The minimum and maximums should strive to reflect the actual minimum and maximum costs of supervising entities in the relevant industries
9. Where a PST is 100% 'owned' by a superannuation fund it should be recognised that the PST will be supervised as part of the supervision of the fund and ideally the PST should not be subject to a separate levy or it should be a very small one
10. PSTs which are invested in by multiple funds should attract a specific PST levy, at a rate significantly lower than superannuation funds
11. Consideration should be given to increasing the maximum amount by a factor reflecting the percentage increase in supervision costs in the past year
12. With respect to the financial assistance levy, that the most equitable method to apportion the costs of financial assistance is to apply a percentage across the assets of funds, with no minimum / maximum.

Overall conclusion

Given the lack of transparency about the process and the length of time since the initial parameters were set, there should be a thorough review of the levy determination process performed. The basis on which the levies are determined, including the underlying methodology utilised, should be reviewed by an independent party.

3 Ensuring costs incurred are justifiable

3.1 Moral Hazard

The most significant aspect of agencies being funded primarily by levies is that it represents a form of moral hazard, in that the agencies have a vested interest in increasing the levies with relatively little accountability while the parties providing the funding (industry) have no control over the resourcing decisions made by the agencies. This extends to the type, and in particular the scope, of activities engaged in by the agency and the quantum, and nature, of the resources used.

Good practice with respect to funding involves the application of rigour, including necessitating such activities as the performance of a cost / benefit analysis and the preparation of a business case, which thereby imposes a fiscal discipline on the parties concerned. If costs can simply be recovered by the imposition of a levy the agencies are relatively unconstrained as to the activities they undertake, the approach they adopt and the scope and size of any project they perform conduct and, accordingly, the costs they incur.

3.2 The Supervisory Levy Imposition Bills

The Explanatory Memorandum to the various Supervisory Levy Imposition Bills in 1998, in the Regulatory Impact Statement in Chapter 3, state as follows (emphasis added):

“3.4 The aim is to establish an administratively simple and uniform funding scheme, reflecting the principles of equity, efficiency and competitive neutrality, that is the scheme will not create a relative cost disadvantage to any one category of institution covered.

3.5 The FSI recommended that regulatory agencies’ charges should reflect their costs ... and advised that, in the interests of equity and efficiency, the costs of financial regulation should be borne by those who benefit from it and that the agencies should not overcharge.

.....

*3.7 Furthermore, [not imposing a charge on financial institutions] would be a basic departure from the approach adopted to date and **would not satisfy the principle of efficiency since there is no link between the intensity of supervision and the cost of providing it.** Other considerations include that it **might reduce the incentive for the industry to seek to have supervision carried out in a cost effective manner,** and would subject the agency to the uncertainty associated with direct funding from the Commonwealth budget.*

.....

*3.10 ... “Levy on financial institution] may also tend to **encourage the institutions paying the levy to act as a constraint on empire building or other excessive cost increases on the part of the regulator”.***

The corollaries to the first two highlighted statements are that:

- imposing a charge on financial institutions would satisfy the principle of efficiency since there would be a link between the intensity of supervision and the cost of providing it; and
- imposing a levy might increase the incentive for the industry to seek to have supervision carried out in a cost effective manner

while the consequence of the third statement is that: -

- a levy on a financial institution may also tend to encourage the institutions paying the levy to act as a constraint on empire building or other excessive cost increases on the part of the regulator.

It can be argued that the extent to which the industry is able to: -

- affect / influence the intensity of supervision (given that it is prudential supervision)
- seek to have supervision carried out in a cost effective manner; or
- act as a constraint on empire building or other excessive cost increases on the part of the regulator

realistically is limited in practice.

Notwithstanding this, it is ASFA’s view the levy process should aspire to make this as achievable as possible through adequate disclosure and appropriate consultation.

It is ASFA’s view that the levy process should be as transparent as possible, through adequate disclosure and appropriate consultation.

There needs to be effective oversight, checks and balances, and controls to ensure that the activities performed, the resourcing utilised and the resultant costs incurred are appropriate and reasonable. Currently there is little in the way of transparency and accountability.

As such, the industry holds concerns about the absence of information with respect to the costs being recovered by the levies.

4 Accountability / Transparency of Determination of Costs

4.1 Department of Finance and Deregulation Guidelines

The Government first established a formal cost recovery policy in December 2002 to improve the consistency, transparency and accountability of cost recovery arrangements and promote the efficient use of resources. The Government reissued the Australian Government Cost Recovery Guidelines ('CRG's), administered by the Department of Finance under the Australian Government Charging Framework, in July 2014.

These Guidelines, amongst other things, stipulate that entities which receive at least some of their funding by means of the imposition of 'cost recovery' levies should develop and publish policies with respect to cost recovery and periodically publish a CRIS.

4.2 Regulatory agencies in practice

APRA

ASFA supports the publication of a CRIS by APRA with respect to the financial sector levies it receives.

The ANAO regularly should perform a comprehensive audit of

- APRA's activities, expenditure and allocation of resources and costs to industries and to the restricted / unrestricted components of the levy calculations
- the CRIS, including whether it is sufficiently detailed.

ASIC

Of particular importance with respect to ASIC is that:

- as functionally superannuation is part of wealth management – it is critical to ensure that superannuation funds only pay levies with respect to consumer protection within superannuation and not with respect to other wealth management sectors, such as managed investments and financial advisers
- as neither
 - self-managed super funds; nor
 - financial advisers / financial planners

pay levies - it is important to distinguish activities undertaken with respect to these as they should not be funded by levies paid by regulated superannuation funds.

A CRIS produced by ASIC should ensure that functions performed with respect to: -

- regulated superannuation funds
- managed investment schemes
- self managed superannuation funds
- financial advisers

are identified separately, with only the first category subject to a superannuation levy.

ATO

Given the amount of levy paid by the superannuation industry to the ATO it would be ideal if the ATO were to prepare a CRIS.

5 Financial Industry Supervisory Levy Methodology

It is critical to ensure that only appropriate \ relevant costs are recovered through levies and that they are recovered on an equitable basis.

5.1 General principles – quantification / attribution of costs to industries

In a cost recovery regime it is critical that costs are accurately quantified and allocated appropriately.

There are two main aspects to this:

- capturing direct costs accurately; and
- allocating indirect costs on an appropriate basis.

5.1.1 Direct costs - the salary cost with respect to each industry

In our view the direct cost for each industry should be determined by:

- ascertaining the time spent by each 'front office' and 'middle office' employee during the financial year on activities directly related to each of the levy paying industries
- multiplying the time spent on each industry by the mean (for that year) of the total cost of employment for that employee.

In ASFA's view determination of salary costs should not be performed based on time alone, which does not reflect the actual salary costs incurred. The actual costs incurred will vary depending on the relative seniority of the staff concerned and whether overtime is payable. Allocation based on time does not necessarily reflect the costs incurred.

If overtime is payable then any direct salary cost calculation should utilise the total time spent on activities for a particular industry, loaded to reflect the applicable overtime rate. If overtime is not payable then any direct salary cost calculation should be determined based solely on the 'standard' units of time (e.g. 7.5 hours per day) for which the employee is remunerated, irrespective of the time actually spent.

The direct salary cost of each employee with respect to each industry would then be totalled, to determine the total direct salary cost for each industry. This would represent the direct cost component to be borne by that industry.

ASFA submits that the determination of direct salary costs attributable to each levy-paying industry should not be performed based on time alone but on the actual salary costs incurred.

5.1.2 Indirect costs

It is unclear the basis upon which the amount of indirect costs with respect to 'back office' support functions has been determined.

ASFA's view is that the indirect costs of regulating the superannuation industry could be determined by one of three possible methods:

- allocating indirect costs on a pro-rata 'per capita' basis (i.e. on the basis of 'head count') ('Head Count Model');
- apportioning indirect costs on the basis of the proportion that the industry's direct salary costs bears to the total agency's relevant costs ('Salary Proportioning Model'); or
- full activity based costing.

1. Head Count Model

Under this model the indirect expenditure of the agency would be allocated based on the number of employees with respect to whom all, or the majority, of their time is spent with respect to each industry. Given the nature of indirect costs, allocating them on a 'per capita' basis (ignoring, for example, if an employee is part-time or the salary of the employee) frequently produces an equitable outcome.

A number of indirect costs, such as HR / Finance / IT / rental / workspace etc, are more fixed in nature than variable. As such, these costs tend to relate more to the number of employees and not necessarily to the number of hours that each employee works or their salary level.

2. Salary Proportioning Model

Another possible costing model would allocated indirect costs based on applying the proportion represented by each industry's total direct salary costs against the total relevant costs of that agency.

Firstly, the direct salary costs for each industry would be totalled and the relative proportion of each industry determined. The proportion of each industry's direct salary costs would be applied against the total relevant agency cost to determine the quantum of costs to be borne by each industry.

3. Activity based costing

A final alternative would be activity based costing.

In addition to establishing the cost basis for levies, this method may have the further advantage of documenting both the types of activities engaged in, and the amount of time spent on, each activity. In that this could in turn facilitate analysis of the nature, scope and timing of the activities engaged in by the agency, such information could potentially assist both the government, the agency and the industry in assessing whether the agency was allocating and utilising resources efficiently and delivering on its public policy outcomes in an effective manner.

Having said that, given that: -

- the majority of APRA's costs are salary and wages (we believe about 80%)
- the majority of APRA staff are allocated to a particular industry, with relatively few performing 'corporate' functions;
- the demands of each industry on 'corporate' services are likely to be broadly in proportion to the number of staff who in are engaged in regulating that industry; and
- the costs of developing, maintaining and utilising an activity based costing system can be considerable

it would appear that any benefits at the margins might be outweighed by the costs.

ASFA submits that consideration should be given to the appropriate method for allocating indirect costs. In ASFA's view a 'head count' model may be appropriate.

6 Discussion Paper – consultation issues

In ASFA's view the basis for the determination of the amount of the levy should strive to achieve equity both between different industries and between entities of different sizes.

With respect to the financial industry supervisory levy, ASFA has some concerns with respect to both:

- the legislative formula for the determination of the levy; and
- the basis upon which the levy percentages and the minimum and maximum levy amounts have been determined in practice.

Question 1 – Is the current levy base appropriate for each industry sector?

The levy base appears to be appropriate.

Question 2 – Not applicable

Question 3 – What changes would stakeholders find useful to the annual levies consultation process?

There are a number of areas which could be reviewed, as follows:

1 Cost Recovery Impact Statements (CRIS)

ASFA is concerned that APRA publishes its Cost Recovery Impact Statement (CRIS) after the consultation process. This should be altered so that APRA produces its CRIS prior to the consultation.

We also consider that, in order to demonstrate consistency, transparency and accountability of cost recovered activities; promote the efficient allocation of resources and ensure compliance with the Cost Recovery Guidelines, the CRIS should contain more detailed information with respect to expenditure and should be audited by the ANAO.

The CRIS prepared by ASIC should distinguish between

- regulated superannuation funds
- managed investment schemes
- self managed superannuation funds
- financial advisers

The ATO should prepare a CRIS with respect to levy amounts collected from the superannuation industry.

2 Framework - restricted and unrestricted levy components and minimum and maximum

The levies framework consists of two components, based on:

- cost of supervision (restricted component)
- system impact (unrestricted component).

ASFA agrees with the conceptual basis for imposing a minimum and maximum amount with respect to the restricted, supervisory component, as a number of the costs of prudential supervision are fixed and those which are variable are not in direct proportion to fund assets.

The process for determining the amount of the restricted and unrestricted component and for setting the minimum and maximum, however, must ensure that that costs are allocated appropriately and that the rates for both components and the minimum and maximum for the restricted component are determined on an equitable basis.

In particular, ASFA is concerned that it appears as though the apportionment between the components is based on time alone and not salary costs. The actual costs will vary depending on the relative seniority of the staff concerned and whether overtime is payable.

The levy is intended to recover the financial costs APRA incurs in undertaking supervisory work relating to the institutions being levied. Allocation based on time does not necessarily reflect actual costs incurred.

3 Recovery of costs from each industry sector and minimisation of cross-subsidies across sectors

In ASFA's view the methodology does not, in and of itself, ensure this – what is critical is the allocation of costs and the determination of the restricted and unrestricted components and minimum and maximum amounts on an appropriate basis.

ASFA agrees with the conceptual basis for making the distinction between the two types of activities. A minimum and maximum with respect to the restricted component relating to supervision makes sense – a number of the costs of prudential supervision are fixed and those which are variable are not in direct proportion to fund assets.

Care must be taken, however, to ensure that the annual adjustments to the minimum and maximum parameters with respect to the restricted levy component should be determined on an appropriate and equitable basis. Accordingly, there needs to be a methodology underpinning the basis upon which the minimum and maximum amounts are set each year.

The band width between the minimum and the maximum should be such that few pay the minimum and few pay the maximum. This should serve to ensure that the funding impact is equitable across those paying the levy.

ASFA is of the view that the minimum and maximums should strive to reflect the actual minimum and maximum costs of supervising the entities in the relevant industries.

4 Pooled superannuation trusts

ASFA shares the concern of some trustees of Pooled Superannuation Trusts (PSTs) with respect to the assets being used in calculating the levy for each of the investing funds including assets invested in a PST, which are used again in calculating the PSTs' levy. To the extent that this occurs it represents double counting. This results in members of funds invested in PSTs paying the levy twice – one in respect of the assets being counted towards fund assets and again in respect of the assets in the PST.

Sub-section 7(4A) of the *Superannuation Supervisory Levy Imposition Act 1998* (pursuant to which the annual Determination is made) provides that a determination may make different provision for different classes of superannuation entity. PSTs are not 'regulated superannuation funds' but are a superannuation entities.

The need for this is especially pronounced in the case where the levy is used to fund costs other than those of APRA – in particular the costs of other agencies i.e. ASIC and the ATO. A PST should not to have retail investors (ASIC) and does not necessitate the involvement of the ATO through SuperStream, the LMR and early release.

5 Determination of agency components

ATO Component

ASFA supports that the costing of the various ATO functions should take place and suggest that it be subject to continual audit and review, to ensure that the functions are performed as efficiently as possible.

ASIC Component

A component of the levies is to cover ASIC expenditure with respect to consumer protection, regulatory and enforcement activities relating to financial products. ASIC funding currently includes the Superannuation Complaints Tribunal (SCT).

Costs with respect to functions performed relating to:

- regulated superannuation funds
- the SCT
- self-managed superannuation funds
- managed investment schemes; and
- financial advice

are not separately identified.

Future CRIS prepared by ASIC should identify the costs with respect to the different functions separately.

ATO component

Ideally the ATO should prepare a CRIS with respect to the costs it recovers from the superannuation industry.

6 Allocation to restricted and unrestricted components

In ASFA's view the basis for the determination of the amount of the levy should strive to achieve equity between industries and between entities of different sizes within those industries. We have some concerns about the transparency of the underlying rationale and methodology employed to allocate amounts to the restricted and unrestricted components and to determine the minimum and maximum amounts in any given year.

A matter of general concern to ASFA with respect to the use of the restricted and unrestricted components is that it appears as though the apportionment between the components may have been on the basis of time alone and may not reflect direct salary costs. The actual costs will vary depending on the relative seniority of the staff concerned and whether overtime is payable. We consider that the apportionment should occur based on costs incurred, not time spent.

7 Methodology / Rationale for determining the minimum and maximum amounts

ASFA notes that the Discussion Paper does not provide an underlying rationale or details as to the methodology which is employed to determine the minimum / maximum amounts and the percentage scales.

In order to ensure continued vertical equity, adjustments to the maximum parameters for the restricted levy component are made annually but no basis is stated for the approach taken. By way of example, the increase could be through the utilisation of an indexation factor or through increasing the minimum and maximum by the percentage increase in supervision costs.

7 Financial Assistance Funding Levy

ASFA also has concerns with respect the basis upon which the financial assistance levy is determined - in particular the inequities resulting from the imposition of a minimum and maximum levy.

When the *Superannuation (Financial Assistance Funding) Levy Act 1993* (FAF Act) was originally enacted the levy was a flat percentage applied against the assets of the superannuation funds. As a matter of policy, a method which utilises fund assets is consistent with the cost of the levy being borne as equitably as possible across the membership base of all funds.

In 2002, just prior to the first determination of a financial assistance, the FAF Act was amended to insert the ability for there to be declared a minimum and a maximum levy, purportedly to align the financial assistance funding levy with the supervisory levy. When the financial assistance funding levy has been determined there has been a minimum and a maximum amount.

A minimum and maximum with respect to the supervisory levy makes sense – a number of the costs of prudential supervision are fixed and those which are variable are not in direct proportion to fund assets.

By way of contrast – a minimum and maximum with respect to the financial assistance levy does not make any sense – it is not dealing with a scenario where there is a mix of fixed and variable costs but instead a scenario where the costs of the financial assistance levy should be borne as equitably as possible across the membership base of all funds. This can only be achieved where there is no minimum or maximum but instead the levy is a fixed percentage of funds' assets, so all members bear the cost of the levy as the same proportion of their superannuation account balance.

Alignment of the financial assistance funding levy with the supervisory levy is based on a false premise that the two levies should be recovering costs on the same basis. Imposing a minimum and maximum on a financial assistance levy means that members of large funds where the maximum is imposed are advantaged, as they will less than under a straight proportioning exercise, while members of small funds where the minimum is imposed are disadvantaged, as they will pay more than under straight proportioning.

The FAF Act should be amended to remove the ability to declare a minimum and a maximum levy, to restore those provisions of the FAF Act as they originally were enacted.

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