

File Name: 2017/13

30 May 2017

Manager
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Dear Mr McAuliffe

ASIC Cost Recovery Levy Regulations

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission on the draft *ASIC Supervisory Cost Recovery Levy Regulations 2017*.

About ASFA

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system so people can live in retirement with increasing prosperity. We focus on the issues that affect the entire superannuation system. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider membership, represent over 90 per cent of the 14 million Australians with superannuation.

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If you have any queries regarding the contents of our submission, please contact Andrew Craston on (02) 8079 0817 or by email acraston@superannuation.asn.au, or me on (02) 8079 0808 or by email gmccrea@superannuation.asn.au.

Yours sincerely



Glen McCrea
Chief Policy Officer

1. Executive Summary

ASFA considers that ASIC has a crucial role as a conduct and disclosure regulator in maintaining confidence in superannuation and the financial system more broadly.

As such, ASFA supports the adequate and appropriate funding of ASIC. Further, ASFA considers that all regulated entities should contribute to that funding. This is more equitable and appropriate than funding ASIC solely from consolidated revenue.

However, the ASIC industry funding model will recover the cost of almost all ASIC's regulatory activities.^{1 2} ASFA considers that the scope of the funding model is too broad, and has expressed these concerns in previous submissions. In particular, ASFA considers that some of ASIC's regulatory activities cannot be directly attributed to identifiable industry recipients and so should not be incorporated in the levy.

With respect to the superannuation sector, the ASIC levies (which are set out in the draft regulations) will impose a high cost burden on the superannuation industry. For a medium-sized fund, the figures in Treasury's Proposals Paper (of November 2016) suggest that base-line levies will be in the order of \$60,000 per year. Many funds will be subject to additional levies. The ASIC levies will be ultimately borne by fund members and will be reflected in members' retirement incomes.

As such, ASFA considers that it is incumbent on ASIC to be more accountable for its regulation of the superannuation industry (and the broader financial system). To this end, ASIC needs to demonstrate that the levies are set and spent appropriately and it is improving the efficiency of its regulatory effort – including by minimising the impact of regulation on the regulated population. These issues are addressed in more detail in this submission.

ASFA also has some concerns with particular sections of the draft regulations. These include sections that relate to the levy calculation for superannuation trustees.

Although ASFA's comments largely relate to superannuation trustees, which is a sub-sector of ASIC's sector category *Investment management, superannuation and related services*, many of these issues are relevant to ASIC's broader regulated population.

Cost burden on funds

The ASIC levies will impose a high cost burden on superannuation funds.

Treasury's Proposals Paper suggests that total annual levies with respect to the regulation of superannuation trustees will be in the order of \$8.5 million³ (ASFA notes that the superannuation industry already partially funds ASIC's regulatory activities via the APRA levy, so the net increase in levies payable by the industry would be less than this figure).⁴

¹ Recovered costs will exclude the costs of ASIC's registry business and the litigation costs for criminal matters that ASIC refers to the Commonwealth Director of Public Prosecutions.

² ASFA understands that ASIC's regulatory activities will continue to be funded through direct appropriation from the Commonwealth Budget, with appropriations offset by the levies and fees charged to industry.

³ This is ASIC's estimate for the expected cost of regulatory activity (with respect to superannuation trustees) for 2016–17.

⁴ Although it is difficult to determine the industry-level quantum from publically available data, ASFA has estimated that 'baseline' ASIC levies from the superannuation industry are around \$3.5 million. This excludes

Smaller funds will bear a disproportionately high burden due to the minimum levy on trustees. ASFA acknowledges that there is a fixed cost of regulating trustees. However, there is not sufficient information (in the Proposals Paper or elsewhere) to determine whether the minimum levy is appropriate.

Many funds will be subject to levies in addition to the trustee levy. Operators of investor directed portfolio services (IDPS) will be subject to a levy, irrespective of the trustee levy, and providers of financial advice services also will attract levies. With respect to the former, double counting of regulatory effort could occur where different authorisations apply to the same pool of assets. ASFA should look to refine its methodology after the funding model has been implemented (one year after implementation would be appropriate).

ASIC's transparency and accountability

Given the increase in industry funding, ASIC needs to demonstrate to its regulated population that the levies are set and spent appropriately, and that ASIC is improving its regulatory efficiency (see Sections 2 and 3 for more details).

- Transparency and accountability are critical features of any industry funding model. There are a number of mechanisms in place (or in train) that should improve ASIC's accountability and transparency, however some of these could be strengthened.
- ASIC needs to improve its transparency and accountability regarding enforcement, particularly given ASIC's relatively heavy reliance on enforcement as a regulatory tool. ASIC should have to demonstrate that its mix of regulatory tools is appropriate.
- ASIC should work to improve its regulatory efficiency – by cooperating with other regulators to exploit regulatory synergies, and minimising the impact of regulation on the regulated population.

Some concerns with the draft regulations

ASFA has some concerns with particular sections of the draft regulations (see Section 4 for more details).

Section 5: Amounts not included in regulatory costs

As ASFA has noted in its previous submissions, a number of ASIC's regulatory activities do not relate to industry activity. ASFA considers that the cost of such activities should not be funded by industry, but instead should be funded from consolidated revenue.

In principle, ASFA considers that it would be more equitable to fund enforcement activities (and discretionary surveillance activities) from consolidated revenue rather than from industry levies. However, if enforcement activities are to be cost-recovered, ASFA considers that it is crucial that ASIC improve its transparency and accountability regarding enforcement (as noted above).

Section 34: Superannuation trustees

On balance, ASFA considers that the FUM-based levy calculation for superannuation trustees is broadly appropriate. However, ASIC should look to refine its methodology after the funding model

levies to fund the Superannuation Complaints Tribunal (The Treasury and the Australian Prudential Regulation Authority 2015, *Financial Industry: Levies for 2015-16* and ASIC, *Annual Report 2015-16*).

has been implemented (one year after implementation would be appropriate). A revised methodology could incorporate a risk-based element that would reduce the degree of cross-subsidisation among entities and lead to a more equitable allocation of regulatory costs.

As noted above, ASFA also has concerns with the calculation of the minimum trustee levy, and the potential for the double counting of regulatory effort with respect to investor directed portfolio services.

2. ASIC's transparency and accountability

Regardless of the ultimate scope of the funding model, it will need to incorporate a robust transparency and accountability framework to give ASIC's regulated population confidence that levies are set and spent appropriately.

Mechanisms to improve ASIC's transparency and accountability

There are a number of mechanisms in place (or in train) that should improve ASIC's accountability and transparency, and should lead to more efficient regulation and a more equitable distribution of the cost of regulation among ASIC's regulated population. However, ASFA considers that some of these mechanisms could be strengthened.

Recommendations of the Capability Review of ASIC

The 2015 Capability Review of ASIC noted that ASIC's transparency and accountability needed to improve. As such, the Review made a number of recommendations in order to enhance ASIC's transparency and accountability (the Review included recommendations for ASIC and for Government). The key recommendations in the context of the industry funding model include improvements to ASIC's strategy-setting process (which helps ASIC to determine where it should focus its regulatory effort), better communication of ASIC's strategy to its regulated population and more transparent reporting of ASIC's regulatory performance. ASIC's implementation plan shows that it has implemented these recommendations.⁵

ASFA considers that Government should review, after an appropriate period, whether ASIC has successfully implemented the recommendations and the degree to which the changes have improved ASIC's transparency and accountability.

The Regulator Performance Framework

Under the Government's Regulator Performance Framework, ASIC has established a set of self-assessment indicators. ASFA supports the objective of the framework – to encourage regulators to undertake their functions in a way that minimises the impact on regulated entities.

However, ASFA considers that ASIC's performance metrics need refinement, and has provided feedback to ASIC in this regard. This issue is addressed in more detail Section 3.

⁵ ASIC 2016, *ASIC Capability Review – ASIC's Implementation Plan*.

ASIC to justify its enforcement focus

ASFA considers that ASIC needs to improve its transparency and accountability regarding enforcement, particularly given ASIC's relatively heavy reliance on enforcement as a regulatory tool. Around 50% of total levies collected from ASIC's regulated population will fund enforcement.⁶

The ASIC Capability Review did not make any specific recommendations about ASIC's enforcement focus, but did note that ASIC's resource allocation to enforcement far exceeds that of peer regulators, and stated that a better-balanced approach – emphasising the full scope and use of ASIC's regulatory toolkit – would be more appropriate.⁷

ASIC's strong enforcement focus magnifies the problems of cross-subsidisation of enforcement activities. ASIC's enforcement activities involve ASIC ensuring compliance with the law in specific instances – that is, ensuring that regulated entities undertake prescribed conduct and/or cease prohibited conduct. However, under the industry funding model all regulated entities will bear the cost of enforcement activities.

Given the Capability Review's findings about ASIC's strong enforcement focus, ASIC should have to demonstrate that its mix of regulatory tools is appropriate and is achieving ASIC's regulatory objectives at least cost. This could form part of ASIC's broader performance reporting requirements via the Government's revised performance framework (which applies to all Commonwealth entities and companies).⁸

More complete public data on regulatory effort

ASIC needs to provide more detailed data on its allocation of costs. There is publically-available data on ASIC's required resources for regulating the broad sectors of its regulated population, but not for sub-sectors (including for the 'superannuation trustees' sub-sector in the *Investment management, superannuation and related services* sector). As such, the current data is not sufficiently detailed for industry to make an informed judgement about whether the allocation of regulatory effort and costs is appropriate.

ASFA acknowledges that ASIC has commenced a three-year programme to improve data on its workflows and business processes that should allow for a more detailed breakdown of ASIC's regulatory effort and the types of expenses related to those efforts.

3. ASIC's regulatory efficiency

In a cost-recovery model of regulation, the regulated population reasonably expects that the regulator is functioning in the most efficient manner – that is, the regulator is achieving its regulatory objectives at least cost.

⁶ Using data for 2016-17. The Australian Government the Treasury 2016, *Proposed Industry Funding Model for the Australian Securities and Investments Commission*.

⁷ Australian Government 2015, *Fit for Future: A Capability Review of the Australian Securities and Investments Commission*, December, page 11.

⁸ Under the *Public Governance, Performance and Accountability Act 2013*.

Recognise synergies in regulation

Within the proposed industry funding model, it is not clear whether allocations of regulatory cost take into account the extent to which some sectors or sub-sectors are already subject to primary regulation by another regulator, and the resultant regulatory synergies. A regulator's supervisory efforts would be expected to change an entities' behaviour beyond the direct area of supervision – which would reduce the required regulatory effort by other regulators.

The 'superannuation trustees' sub-sector of the *Investment management, superannuation and related services* sector is already subject to full prudential supervision by APRA, for which it incurs substantial levies (for the pooled superannuation sector, APRA levies for APRA's activities were \$30.5 million in 2016-17).

APRA's supervision of superannuation trustees includes enforcement of prudential standards that govern trustees' conduct across a wide range of areas. In contrast, ASIC's direct regulatory and supervisory responsibilities in respect of the APRA-regulated superannuation sector is effectively limited to matters and conduct related to the 'issue' of interests in superannuation funds and to disclosure.

Compliance with APRA's prudential standards has required superannuation trustees to implement robust compliance and risk frameworks. It also has led to a general improvement in standards of behaviour and professionalism – which extends across trustees' entire business operations, including into areas which fall within ASIC's supervision.

Although ASIC applies a conduct-focussed lens, as opposed to APRA's prudential approach, it cannot be denied that synergies exist and that regulatory efficiencies arise due to the prudential supervision applied to superannuation trustees. Indeed, with respect to enforcement activity, ASFA members have indicated that they are observing an increasing overlap between ASIC and APRA.

The ASIC Capability Review noted that ASIC should consider whether regulatory outcomes could be achieved by using existing regulation administered by another regulator, or other collaborative arrangements, to ensure an integrated regulatory framework and to reduce costs for regulated entities.⁹ Ultimately, greater recognition of synergies would allow Australian regulators to allocate their resources to where they are most needed, and would lead to a more efficient regulatory environment.

Account for impact of regulation

In a cost-recovery model of regulation, the regulated population reasonably expects that the regulator is functioning in a way that minimises the impact on the regulated population. This is the main objective of the Government's Regulator Performance Framework – which requires regulators to develop outcomes-based key performance indicators and to implement a process for annual externally-validated self-assessment.

⁹ Australian Government 2015, *Fit for Future: A Capability Review of the Australian Securities and Investments Commission*, December, page 160.

ASFA supports the objective of this process, but considers that ASIC's proposed performance metrics need refinement to provide a more useful gauge of regulatory impact.¹⁰

In ASFA's view, any assessment of ASIC's performance needs to better capture how well ASIC balances the intended benefits of new regulatory measures against the costs to industry. This is crucial given that despite the Government's emphasis on minimising or reducing red tape, ASFA members report that their compliance burden continues to rise.

Further, indicators should better account for the time needed for industry to implement new regulatory requirements, and the need for all stakeholders to have sufficient clarity around the interpretation and operation of those requirements before commencing implementation. With respect to ASIC's recent regulatory initiatives, ASFA members raised the example of changes to fee and cost disclosure.

4. Comments on particular sections of the draft regulations

Section 5: Amounts not included in regulatory costs

The ASIC industry funding model will recover the cost of all ASIC's regulatory activities – except for the costs of ASIC's registry business and the litigation costs for criminal matters that ASIC refers to the Commonwealth Director of Public Prosecutions.

In previous submissions, ASFA has stated that, as a general principle, cost-recovery from industry should be limited to regulatory activities where identifiable industry recipients have created demand for those activities. This is consistent with the Australian Government's Charging Framework. In particular, the Framework's equity principle states that *where specific demand for a government activity is created by identifiable individuals or groups they should be charged for it*.¹¹

ASFA considers that a number of ASIC's activities cannot be directly attributed to identifiable industry recipients, and so should not be cost-recovered from industry. These include:

- Activities relating to ASIC's international engagement, including through participation in the International Organization of Securities Commissions
- 'Overhead' expenditures, including those relating to the capabilities, training and development of ASIC staff.

Section 34: Superannuation trustees

On balance, ASFA considers that the FUM-based levy calculation for superannuation trustees is appropriate. However, ASIC should look to refine its methodology after the funding model has been implemented (one year after implementation would be appropriate).

ASFA acknowledges that it is difficult to strike an appropriate balance between the competing requirements of simplicity, transparency and the equitable allocation of the costs of regulatory effort among the regulated population. This applies to the levy methodology for superannuation trustees, but also to the levy methodologies for other sub-sectors in the industry funding model.

¹⁰ ASFA 2016, *Regulator Performance Framework – external validation of self-assessment*.

¹¹ Australian Government 2015, *Australian Government Charging Framework*.

The proposed FUM-based calculation is relatively simple and transparent, but it is an imperfect proxy for the risk that entities pose to the broader market (and thus an imperfect proxy for required regulatory effort). In particular, it does not account for differences in the sources of risk – such as trustee conduct. For entities with the same FUM, the proposed methodology effectively means that entities that are relatively ‘low-risk’ would subsidise ASIC’s regulatory effort regarding relatively ‘high-risk’ entities.

A revised methodology could incorporate a risk-based element that would reduce the degree of cross-subsidisation among entities and lead to a more equitable allocation of regulatory costs. ASFA would be willing to assist ASIC to develop a risk-based metric for superannuation trustees.

Details of levy calculation for superannuation trustees

ASFA has some concerns with the calculation of the minimum levy payable. Although ASIC notes this reflects the fixed cost of regulating a superannuation entity, there is little information on how this is derived. Therefore, it is difficult to make a judgement as to whether the minimum levy is appropriate. The size of the minimum levy is most relevant for smaller funds. Table 1 shows ASFA’s estimates of levy per member for a set of ‘stylised’ APRA funds.

Table 1: Indicative levies for trustees

	assets (\$m)	members	total annual levy (\$)	levy per member (\$)
small fund	1,000	25,000	22,065	0.88
medium fund	10,000	250,000	66,642	0.27
large fund	50,000	1,250,000	264,762	0.21

ASFA calculations.

Double-counting of FUM

A shortcoming of the FUM-based approach is the potential for double-counting FUM when determining the regulatory effort related to discrete entities. Although ASFA’s comments relate to the proposed methodology for the *Investment management, superannuation and related services* sector, they have relevance to other sectors/sub-sectors in the industry funding model.

To apportion the costs of regulatory effort, the funding model assigns levies by function/activity. With respect to the *Investment management, superannuation and related services* sector, this includes AFS licensees with authorisations to;

- Operate as superannuation trustees and responsible entities
- Issue interests in managed investment schemes
- Operate investor directed portfolio services.

Double-counting of regulatory effort could occur where different authorisations apply to the same pool of assets. For example, for entities that have authorisations to operate as a superannuation trustee and as an operator of investor directed portfolio services (IDPS), assets of the trustee also may be assets of the IDPS.

ASFA understands that there are minimum costs associated with regulating separate authorisations. However, with reference to the above example, it is not clear that a single pool of assets subject to multiple authorisations would require the same degree of regulatory effort as separate asset pools subject to the equivalent individual authorisations. ASIC should look to refine its methodology after the funding model has been implemented (one year after implementation would be appropriate).