

# SUBMISSION

## Submission to Treasury — ASIC Industry Funding Model Review

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28 October 2022

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Via email: ASICIFMReview@treasury.gov.au

28 October 2022

Dear Sir/Madam

**ASIC Industry Funding Model Review**

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to Treasury's review of the ASIC Industry Funding Model.

**About ASFA**

ASFA is a non-profit, non-partisan 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 \$3.3 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 17 million Australians with superannuation.

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If you have any queries or comments in relation to the content of our submission, please contact Andrew Craston on 0401 016 587 or by email [acraston@superannuation.asn.au](mailto:acraston@superannuation.asn.au).

Yours sincerely

Glen McCrea  
Deputy CEO and Chief Policy Officer

## Executive summary

ASFA supports the adequate and appropriate funding of ASIC (and the other key financial industry regulators), and considers that all regulated entities should contribute to that funding. That outcome is, in ASFA's view, far more equitable and appropriate than funding regulators solely from consolidated revenue. That said, where industry does contribute to regulators' funding, it is incumbent upon those regulators to provide genuine transparency and accountability regarding the way they determine their funding requirements and utilise their funding.

In this regard, the Treasury review (the Review) of ASIC's Industry Funding Model (IFM) presents an opportunity to improve the equity and transparency of the IFM.

ASFA considers that the design of the ASIC IFM should be consistent with the overarching principle of the Australian Government Charging Framework (the Charging Framework), that those entities that cause the need for regulation should generally pay for the cost of regulation.

In this regard, ASFA agrees with the general intent of the current methodology for apportioning levy amounts both across and within industry sub-sectors. That is, to the extent that it is practicable, to limit cross-subsidisation between entities. That said, the Review provides an opportunity to determine whether the current levy formulas reflect the appropriate mix of flat and graduated components – that adequately account for the proportions of fixed and variable costs of ASIC's regulatory efforts. Further, beyond the Review, it would be appropriate for Treasury to periodically assess levy formulas in this regard.

The key exception in the IFM to the principle of the Charging Framework relates to recovering the cost of ASIC's enforcement activities. ASFA considers the Review is an opportunity for Treasury to consider alternative funding approaches with respect to enforcement that would reduce the degree of industry cross-subsidisation. That said, ASFA acknowledges the challenges in apportioning the cost of enforcement to entities that are subject to enforcement action.

Transparency regarding the cost of ASIC's regulatory activities, and the formulas used to calculate levies, would be enhanced by improving the type/presentation of information in the annual Cost Recovery Implementation Statement (CRIS).

For ASIC's regulated entities (ASIC's key stakeholders), the most important information relates to the estimation of annual levies payable, and the drivers of changes in levy amounts from year-to-year. With respect to the former, and particularly for entities with operations across multiple sub-sectors, the required information is currently scattered throughout the CRIS. With respect to the latter, ASFA has long argued that the required information is lacking.

In this regard, ASFA recommends that the annual CRIS be accompanied by a much shorter single-point-of-reference document for regulated entities. A consolidated table would show the levy formula for each sub-sector (for the current year and the previous year). The document would also include a section that explains any significant changes to the metrics in the sub-sector levy formulas – which would be triggered if levy metrics increase by more than a threshold degree (say by 5 per cent).

## Introduction and context

Since the inception of the ASIC Industry Funding Model (IFM), ASFA has made submissions in respect of the annual Cost Recovery Implementation Statement (CRIS). In those submissions ASFA has highlighted a number of issues related to improving the equity and transparency of the IFM – all of which are relevant to the Treasury Review (the Review) of the IFM. In broad terms, these key issues relate to:

- the significant year-on-year increases in levies under the ASIC IFM (as well as levy increases in respect of other regulators)
- insufficient information in the CRIS regarding the drivers of year-on-year increases in levies
- cross-subsidisation within the IFM, particularly in respect of the recovery of ASIC's enforcement costs.

By way of context, the CRIS for 2021-22 shows that total IFM levies in respect of superannuation trustees are expected to be 40 per cent higher than for the preceding year. For a medium-sized fund (with FUM of \$20 billion), ASFA estimates that levies for 2021-22 will be around \$370,000. An equivalent fund would have paid around \$260,000 in 2020-21. For a large fund (with FUM of \$100 billion), ASFA estimates that levies for 2021-22 will be around \$1.80 million. An equivalent fund would have paid around \$1.25 million in 2020-21.

These levy amounts relate to ASIC's regulatory activities regarding trustee obligations to consumers. In addition to the ASIC IFM levies, superannuation funds pay levies to APRA and other regulators via the Financial Institutions Supervisory Levies. For 2022-23, ASFA estimates that combined levies are likely to be in the order of \$150 million. This would represent an increase of around 150 per cent since 2013-14.

For superannuation funds, levies are typically funded through administration fees charged to members' accounts. For a representative member (balance of \$50,000), ASFA estimates that the amount payable with respect to combined levies would be around \$6. Given that combined levies have increased by around 150 per cent since 2013-14, the equivalent amount payable for a representative member would have been less than \$3 (in today's dollars) in 2013-14.

The superannuation industry is facing increased scrutiny, including as a result of the *Your Future, Your Super* legislation. In particular, the performance benchmarking of MySuper products (and in time, other products) incorporates administration fees. Any increase in IFM levies, or other similar industry levies, ultimately will be borne by members – as higher fees (or indirect costs) than otherwise would be the case.

As such, ASFA considers it appropriate that a high level of scrutiny should apply with respect to the process for recovering costs from the superannuation industry, and ASIC's broader regulated population, via the IFM levies. In this regard, the Review of the IFM presents an opportunity to improve the equity and transparency of the IFM – which ultimately will benefit consumers.

## General comments

### 1. Apportioning levy amounts among ASIC's regulated population

ASFA considers that the design of the ASIC IFM should be consistent with the overarching principle of the Australian Government Charging Framework (the 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.<sup>1</sup>

#### **Apportioning levy amounts *within* industry sub-sectors**

ASFA agrees with the general intent of the current methodology for apportioning levy amounts between entities within industry sub-sectors – that is, to the extent that it is practicable, to limit cross-subsidisation between entities. ASFA also acknowledges that the design of the IFM needs to take account of the trade-off that exists between lower cross-subsidisation on the one hand, and greater administrative complexity for ASIC on the other – which ultimately is reflected in industry levies.

Broadly speaking, the main exceptions in the IFM to the principles of the Charging Framework relate to recovering the cost of ASIC's education and enforcement activities. With respect to consumer education, ASFA considers that the current approach is broadly appropriate – effectively, that each sub-sector entity is subject to a flat fee (overall, education comprises around 2 per cent of ASIC's regulatory costs). In contrast, ASFA considers that the current approach with respect to the cost recovery of enforcement activities should be reformed to reduce cross-subsidisation. This is addressed in Section 2.

Consistent with the general intent of the IFM, ASFA considers that it is appropriate for levy formulas (applied to entities) to incorporate flat and graduated components – as is currently the case. This accounts for the fact that there are fixed costs associated with any regulatory activity – that are (relatively) independent of the scale of regulated entities – and variable costs that are related to scale.

As the Discussion Paper notes, for any sub-sector, changes to the sub-sector levy formula would alter the distribution of levies among entities within that sub-sector, but not the total amount recovered from that sub-sector. That said, the Review provides an opportunity to determine whether the current levy formulas reflect the appropriate mix of flat and graduated components – such that the formulas adequately account for the proportions of fixed and variable costs of ASIC's regulatory efforts. Further, beyond the current review process, it would be appropriate for Treasury to periodically assess levy formulas in this regard.

ASFA does not consider that the structure of levy formulas, nor the justification for that structure, is particularly complicated (as flagged in the Discussion Paper).

#### **Apportioning levy amounts *across* industry sub-sectors**

ASFA considers that the intent of the methodology for apportioning levies across sub-sectors is broadly appropriate. The current approach seeks to apportion levies between sub-sectors according to the quantum of regulatory effort. In this regard, ASIC's regulated population is divided into 52 separate sub-sectors (such as superannuation trustees sub-sector), with the entities within each sub-sector exhibiting similar features.

Each of the options presented in the Discussion Paper for potential changes to the structure of the IFM suggest some form/degree of consolidation of the current sub-sectors, which would reduce the number of separate 'sectors' to which a levy formula would directly apply. The levy formulas that would apply to entities within new, consolidated 'sectors' would be broadly similar to the current formulas – that is, a mix of flat and

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<sup>1</sup> Australian Government 2015, *Australian Government Charging Framework*.

graduated components. The Discussion Paper puts forward these options as a way to reduce the complexity of the IFM for ASIC's regulated population.

ASFA does not consider that such changes are necessary, nor desirable.

Firstly, ASFA does not consider that the IFM is overly complex. As noted in the previous section, the structure of sub-sector levy formulas is not particularly complicated. In addition, for those entities with operations in more than one sub-sector, the requirement that separate sub-sector levy amounts need to be combined to determine an overall levy amount is also relatively easy to understand. The more relevant issue is that the current structure of the CRIS makes it difficult for entities to determine the full set of levy formula that apply to their operations, and to estimate the expected levies payable. Proposed changes to the CRIS in this regard are in Section 3.

Secondly, as noted above, ASIC's regulated population is divided into 52 separate sub-sectors – with the entities within each sub-sector exhibiting similar features. For each sub-sector, the calculation of levies is based on an appropriate mix of flat and graduated components, with the latter incorporating a measure of scale that is particular to that sub-sector. Given this, any consolidation will necessarily increase the degree of cross-subsidisation within the IFM.

Overall, ASFA considers that the perceived complexity of the IFM can be addressed by improving the presentation of information in the CRIS, rather than by altering the IFM – which would lead to greater cross-subsidisation in the IFM.

## Recommendation

- ASFA recommends that the core principle guiding the design of the IFM should remain – that those entities that cause the need for regulation should generally pay for the cost of regulation.
- In this regard, to limit cross-subsidisation in the IFM (as far as is practicable), ASFA recommends that the current methodology for apportioning levies across and between sub-sectors should remain broadly unchanged.
- ASFA recommends that the cost recovery of enforcement activities should be reformed to reduce the degree of cross- subsidisation.
- ASFA recommends that levy formulas should be periodically reviewed to determine whether the current mix of flat/graduated components adequately account for the proportions of fixed and variable costs of ASIC's regulatory efforts.

## 2. Cost recovery of ASIC's enforcement activities

Around 60 per cent of the cost of ASIC's regulatory activities relate to enforcement. For 2021-22, the most recent CRIS estimates that ASIC's total direct enforcement costs are \$110 million. In addition, a pro-rata allocation of ASIC's indirect costs to enforcement is in the order of \$70 million. Thus, total costs related to enforcement for 2021-22 are estimated to be around \$180 million, out of a total of \$312 million.<sup>2</sup>

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<sup>2</sup> ASIC 2022, *Cost Recovery Implementation Statement: ASIC industry funding model (2021–22)*.

- This is broadly consistent with data in the recently published *Effectiveness and Capability Review of the Australian Securities and Investments Commission (2022 ASIC Capability Review)*. While this document reports that ASIC’s direct enforcement costs were \$141 million in 2021-22, this figure also includes the cost of a portion of ASIC’s licensing functions.<sup>3</sup>

The proportion of ASIC’s costs related to enforcement has increased over time – it was around 50 per cent at the time of the 2015 ASIC Capability Review. The 2015 Capability Review also noted that ASIC’s resource allocation to enforcement – at that time – far exceeded that of peer regulators.<sup>4</sup>

As noted in the previous section, the cost of ASIC’s enforcement activities is the key exception in the IFM to the principles of the Charging Framework. The cost of enforcement action with respect to entities within a particular sub-sector(s) is apportioned across all the entities in that sub-sector(s). Indeed, of the total levies associated with activities that are, by design, cross-subsidised (and so recovered via statutory levies), around 90 per cent are related to enforcement – in particular, levies to recover annual appropriations from the Commonwealth to ASIC’s Enforcement Special Account (ESA).<sup>5</sup>

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 IFM all regulated entities bear the cost of enforcement activities (in particular, for the cost recovery of ASIC’s ESA). Ultimately, groups of entities (within a sub-sector or multiple sub-sectors) pay for enforcement action taken by ASIC against a relatively small number of individual entities.

The Discussion Paper puts forward a justification for cross-subsidisation of enforcement costs – that ASIC’s enforcement action helps maintain trust and integrity in the financial system and promotes general consumer confidence, and that this benefits the whole regulated population. However, the simple fact is that entities that are *not* engaging conduct for which enforcement action is warranted are paying for the cost of enforcement action with respect to other entities that are engaging in such conduct.

Given this, ASFA considers that the current approach with respect to the cost recovery of enforcement activities should be reformed to reduce the degree of cross-subsidisation. ASFA considers the Review is an opportunity for Treasury to consider alternative approaches.

### **Cross-subsidisation of enforcement**

ASFA agrees that the recovery of enforcement costs solely from entities subject to enforcement activity would introduce additional complexity into the IFM. However, whether the additional administrative cost of a targeted approach would ‘outweigh the benefits’ is an empirical question.

It is most certainly the case that apportioning the cost of enforcement to entities that are subject to enforcement action would incur a greater administrative cost for ASIC than the current approach (that is, apportioning costs across the regulated population via levies), and that the additional administrative cost would be reflected in a higher total levies than otherwise would be the case. However, for entities not subject to enforcement action, it is difficult to envisage that any pro-rata increase in levies due to higher administrative costs would be greater than the accompanying reduction in levies due to lower apportioned enforcement costs.

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<sup>3</sup> The Financial Regulator Assessment Authority 2022, *Effectiveness and Capability Review of the ASIC*, p.9.

<sup>4</sup> The Australian Government the Treasury 2015, *Fit for the future: A capability review of ASIC*, p.11.

<sup>5</sup> ASIC 2022, Cost Recovery Implementation Statement: ASIC industry funding model (2021–22).

ASFA acknowledges the challenges in apportioning the cost of enforcement to entities that are subject to enforcement action.

- ASIC undertakes a broad range of enforcement activities in any year – including investigations, administrative actions, civil actions and criminal actions.
- Separate enforcement actions may involve multiple entities/individuals, across different sub-sectors.
- Enforcement actions commenced in a particular financial year may not be concluded until a subsequent financial year (for criminal actions, the average time to complete an investigation and reach a court decision is around 40 months).
- Stages of a particular matter may involve different enforcement activities – say from investigation to civil/criminal litigation.

That said, the Review is an opportunity to consider a shift from cross-subsidisation (the current approach), to more targeted cost recovery.

Any application of a more targeted approach would reduce the degree of cross-subsidisation in the IFM. It would also help address other issues with the IFM that are a consequence of the current settings. In previous submissions, ASFA has highlighted the fact that there can be considerable variation between estimated and actual levies for sub-sectors, and that there can be considerable volatility in actual levies from year to year. The Discussion Paper notes that in both cases, enforcement costs (and high-cost enforcement action in particular) are the major contributor.

More targeted recovery of enforcement costs – in reducing volatility of levies payable – would be preferable to alternative options presented in the paper to address that volatility. Each of the alternative options presented in the Discussion Paper incorporate a greater degree of cross-subsidisation in the broader IFM than is currently the case. ASFA does not consider that this is desirable.

### **Transparency of enforcement**

ASIC's reliance on enforcement as a regulatory tool, and the associated impact on industry funding and levies, justifies a greater degree of transparency (than is currently the case), regarding the effectiveness of ASIC's enforcement activities.

The 2022 ASIC Capability Review finds that while ASIC produces and publishes some metrics related to its enforcement activities, these offer limited insight into ASIC's effectiveness and capability. The Capability Review notes that currently published data on the number of enforcement actions and the quantum of pecuniary penalties imposed do not measure whether the regulator's enforcement strategy is appropriately targeted.<sup>6</sup>

The Capability Review recommends that metrics be developed to better allow for assessment of ASIC's effectiveness and capability – which, for enforcement, could include indicators of whether ASIC's enforcement actions deter future misconduct. ASFA agrees with this approach.

Crucial to the transparency of ASIC's regulatory activities is the manner in which metrics/indicators are presented and published. As is the case with the CRIS (see Section 3), while ASIC publishes a large quantum of information and data regarding its regulatory activities, in many cases the information/data is not presented in a form that ASIC's regulated entities can readily use.

When developed, ASFA considers that ASIC should provide a set of targeted, relevant metrics (with respect to its range of regulatory activities) at the same time as its revised CRIS documents (see Section 3). Together

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<sup>6</sup> The Financial Regulator Assessment Authority 2022, *Effectiveness and Capability Review of the ASIC*, p.9.



this would enable regulated entities to better understand the quantum of, and any changes to, their levies, as well as the effectiveness and efficiency of ASIC's regulatory activities.

### Recommendation

- ASFA recommends that Treasury consider alternative funding approaches with respect to enforcement that would reduce the degree of cross subsidisation. Any application of a more targeted approach would also help address the general volatility in levies on the broader regulated population from year to year.
- ASFA recommends greater transparency regarding the effectiveness of ASIC's enforcement activities in particular. When developed, ASIC should publish a set of targeted, relevant metrics with respect to its range of regulatory activities at the same time as its CRIS documents.

## 3. Transparency of the IFM

### The purpose of the CRIS

The Discussion Paper notes that the annual CRIS is the key means for providing information about the IFM to ASIC's regulated population. The CRIS is less useful as a means for consulting ASIC's regulated population on the IFM. This reflects the fact that the IFM is an ex-post cost recovery model – levy amounts, and the allocation of regulatory costs to sub-sectors, are based on the regulatory effort that ASIC has expended. As such, there is little capacity for changing IFM settings in response to stakeholder feedback via the annual CRIS. This has been ASFA's experience in making submissions to the CRIS process since the inception of the IFM.

In this regard, ASFA agrees with the proposed role for future annual CRIS documents – that the CRIS should focus on transparency rather than consultation. With respect to consultation on the IFM, ASFA considers that less frequent, but more substantive consultation on the IFM's settings should be undertaken jointly by ASIC and Treasury.

### Information presented in the CRIS

The Discussion Paper notes that ASIC receives conflicting feedback regarding the type, and detail of information that should be included in the CRIS – while some stakeholders consider that the CRIS is too complex, lengthy and difficult to navigate, other stakeholders consider that the CRIS should contain more granular information on ASIC's activities and costs (to help stakeholders understand the drivers of changes in levy amounts from year to year). ASFA has argued this latter point in previous submissions regarding annual CRIS documents.

Improvements to the presentation of information in the CRIS would help address the apparent conflicting feedback from stakeholders.

It is worth noting that the relevance (to stakeholders) of the various types/forms of information contained in the CRIS will differ across stakeholders. While the detailed breakdown of regulatory costs for each sub-sector is useful for policy advocacy purposes (including by ASFA), for ASIC's regulated population, the most relevant information is contained in the summary tables of estimated industry funding levies. In particular, the summary tables contain the information required for entities to estimate annual levies payable.

For regulated entities, the efficacy of the information in the summary tables could be improved.

Firstly, the summary tables should be consolidated, and provided in a (short) supplementary paper to the main document (similar to, but more detailed than, the *Summary of Actual Levies* publication). Currently, there are 12 summary tables – one for each major sector of ASIC’s regulated population. Each of the summary tables is within the relevant sector-specific section of the CRIS – and so are found at different parts of the CRIS document. In the 2021-22 CRIS, the summary tables are found between pages 34 and 134. For many entities, their operations span multiple ASIC sub-sectors. For example, superannuation entities typically provide financial advice services and life insurance products.

Secondly, the information in the consolidated table should be presented in manner that would best enable an entity to determine and compare levy amounts (again, similar to, but more detailed than, the *Summary of Actual Levies* publication). For example, sub-sector-level information regarding the number of entities and total estimated levies are irrelevant. Levy formulas (including metrics) for both the current and previous years would be far more useful.

Thirdly, the supplementary paper should include a section that explains any significant changes to the metrics in the levy formulas.

- By way of context, in the 2021-22 CRIS the levy metric for superannuation trustees – which is a dollar amount per assets under management – rose from \$12.33 to \$17.85 for each \$1 million above the threshold of \$250 million (unchanged).
- There is little explanation in the CRIS for the increase (see below).

ASFA acknowledges that – as noted in the Discussion Paper – it is not feasible or appropriate for ASIC to provide highly granular ‘line-by-line’ information about its costs to stakeholders. Instead, ASFA considers that explanations for changes could be provided where a flat/graduated formula metric increases by more than a threshold amount – say by 5 per cent. One can imagine that, broadly speaking, the key reasons for a change in a levy metric would include:

- changes to government policy
- an increase in enforcement costs (although the aforementioned proposed changes to the cost recovery of enforcement activities should mean that large movements in enforcement costs would be less likely).
- an increase in indirect costs – that typically would be related to the above
- large, broad-based increases in wages for ASIC staff.

Beyond improvements to the presentation of information regarding levy formulas, ASFA considers that similar improvements should be made to information at the aggregated sub-sector level.

ASFA acknowledges that ASIC has improved its transparency around its allocation of costs, at the sub-sector level, since the inception of the IFM. The CRIS provides a break-down of ASIC’s required resources for regulating each sub-sector, by type of regulatory activity (enforcement, surveillance etc).

However, just as is the case for levy formulas, ASFA considers that the disaggregated cost data in the CRIS should be accompanied by more details of the major cost centres, particularly where there is a material change in the quantum and/or allocation of costs from year to year.

By way of example, for the superannuation trustees sub-sector, the 2021-22 CRIS shows large increases in both the cost of enforcement activities (up almost 30 per cent) and indirect costs (up almost 60 per cent). These cost increases are reflected in changes to levy formula – as noted above. There is little explanation in the CRIS for these changes. The increase in enforcement costs suggests a shift in ASIC’s regulatory focus, however there is little information in the CRIS in this regard.

In the future, ASIC should incorporate more details of major changes in regulatory costs in the CRIS (and other documentation that deals with prospective costs for a particular financial year), as well as in documentation related to cost outcomes. As proposed above in relation to levy formulas, a similar and complementary mechanism could be put in place – where explanations for changes would be provided if cost-centre aggregates rise by more than threshold amount (say by 5 per cent).

### Recommendation

- ASFA recommends that the annual CRIS be accompanied by a much shorter single-point-of-reference document for regulated entities.
  - A consolidated table would show the levy formula for each sub sector (for the current year and the previous year).
  - The document would also include a section that explains any significant changes to the metrics in the sub-sector levy formulas – where, for example, levy metrics increase by more than a threshold amount – say by 5 per cent.