

## Submission to the Australian National Audit Office with respect to APRA levies

**21 December 2012**

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## About ASFA

ASFA is the peak policy, research and advocacy body for Australia's superannuation industry. It is a not-for-profit, sector-neutral, and non-party political national organisation whose aim is to advance effective retirement outcomes for members of funds through research, advocacy and the development of policy and industry best practice.

ASFA's focus is on whole of system issues and its core strategies are aimed at encouraging industry best practice, advocating for a system that plays a productive role in the Australian economy and ensuring the industry delivers on its primary purpose of delivering decent retirement incomes.

Our membership - which includes superannuation funds from the corporate, industry, retail and public sectors, and, through its service provider membership, self-managed and small APRA funds - represents over 90 per cent of Australians with superannuation.

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Should you have any queries regarding the contents of this submission, please do not hesitate to contact me on (03) 9225 - 4021 or 0431 490 240 or [fgalbraith@superannuation.asn.au](mailto:fgalbraith@superannuation.asn.au).

Yours sincerely

Fiona Galbraith  
Acting General Manager, Policy & Industry Practice

## **INTRODUCTION**

RSE licensees will pay over \$180 million this year to APRA in supervisory levies. This represents an increase of some \$134 million over the 2011 – 2012 levy.

Significantly, 67% of the 2012 – 2013 levy is attributable to the new SuperStream component of the levy.

Given that this is money which could otherwise have been attributed to member accounts, it is important that

- APRA and the other agencies are accountable for the costs and expenditure they incur, in particular that: -
  - the costs they incur are justifiable (i.e. the nature, scope and timing of activities, and the method of performing these activities, are warranted by the risk being regulated \ supervised);
  - the costs are reasonable;
  - the costs are, directly or indirectly, with respect to the regulation and supervision of the relevant industry;
- 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;
- 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 APRA, and the other government agencies who receive the levies (ASIC, ATO & DHS), with respect to the relevant industry; and
- APRA determines the amount of the levy on an equitable and reasonable basis and consults appropriately.

### **A) ACCOUNTABILITY \ TRANSPARENCY OF DETERMINATION OF COSTS AND LEVY**

#### **1) Moral Hazard**

The most significant aspect of agencies being primarily funded by levies is that it represents a form of moral hazard, in that the party which is providing the funding (industry) has no control over the resourcing decisions made by the agency. 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.

As such, there is little in the way of 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.

The usual process with respect to funding has a rigour about it, which necessitates having to perform a cost \ benefit analysis and prepare a business case, thereby imposing a fiscal discipline on the party concerned. If costs can simply be recovered by the imposition of a levy the agency is relatively unconstrained as to the approach it can take, the scope and size of any project \ activity and accordingly the costs it incurs.

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

The Explanatory Memorandum to the various Supervisory Levy Imposition Bills in 1998, in the Regulatory Impact Statement in Chapter 3, stated 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;
- imposing a levy might increase the incentive for the industry to seek to have supervision carried out in a cost effective manner;

while 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.

While 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 may be relatively limited in practice, nevertheless the levy process should aspire to make this as achievable as possible through adequate disclosure and appropriate consultation.

## **2) 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. To this end, the Government reissued the Australian Government Cost Recovery Guidelines ("Guidelines") in July 2005, which are administered by the Department of Finance and Deregulation ("DFD").

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, in excess of \$5 million per annum, should: -

- develop and publish policies with respect to cost recovery; and
- periodically publish a "Cost Recovery Impact Statement" (CRIS).

We note that the DFD is currently reviewing the guidelines. ASFA made a submission to this review, which can be found on our web-site.

## **3) Compliance with DFD Guidelines**

### **a) APRA**

#### **i) Publication of policy with respect to cost recovery**

It does not appear as though APRA has published a policy with respect to cost recovery. Given that APRA is largely funded through levies, and has been for some years, this is extremely disappointing, to say the least.

#### **ii) CRISs**

The APRA \ Treasury undated document "Proposed Financial Industry Levies for 2012 – 13" ("Consultation Paper") stated that in 2012 – 2013 APRA will merge its current levy review process with the development of what will be its initial CRIS and will continue to consult with industry on the development of the CRIS.

Given that: -

- the guidelines commenced over a decade ago;
- they indicate that a CRIS should be published whenever a review is performed, arrangements change or there is a new arrangement; and
- APRA is largely funded through levies

it is extremely disappointing that it appears as though the only CRIS which APRA may have produced is with respect to assessing the applications of entities intending it be authorised.

This is unsatisfactory, to say the least, and even more so when it members of superannuation funds who ultimately fund the payment of these levies. Given that superannuation is legislatively mandated, and not discretionary, APRA's failure to produce a single CRIS with respect to financial levies (other than applications) is totally unacceptable.

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

In particular, the imposition of the new SuperStream component in 2012 – 2013 represents a new arrangement, or a material amendment to an existing arrangement and in either case would necessitate a CRIS being prepared prior to the arrangement or change being introduced.

Given APRA's failure to produce a CRIS with respect to levies, ASFA submits that the ANAO should perform a comprehensive audit of APRA's activities, expenditure and allocation both to industries and to the restricted \ unrestricted components of the levy calculations.

We note the Consultation Paper made reference to "continue to consult" with industry but we consider there has been little consultation with industry to date, other than the annual draft determinations.

ASFA submits that consideration should be given to making the production of CRISs mandatory for agencies who receive more than \$5 million through levies, with sanctions if the CRIS is not produced or is not sufficiently detailed.

### iii) Reviews

The Consultation Paper stated that APRA has a regular review process to monitor the implementation of its financial industry levies.

APRA last performed a review of the financial sector levies in June 2009. The Review focussed largely on specific issues about the methodologies and some operational issues, as opposed to a performing a fundamental examination of the levy system.

Amongst other things the report recommended that: -

1. ***That (subject to the recommendations below) the current framework for setting financial sector levies be maintained.***
2. ***That the current reporting accountability of APRA in relation to the imposition and collection of levies generally should not be changed.*** ... However, as part of the annual consultation process, APRA will provide more detailed information on the allocation of costs and levy recovery to improve the transparency of the levy arrangements.
3. ***That the minimum and maximum restricted levy arrangements for each sector be maintained - there is sufficient capacity within existing caps to fine tune the amounts imposed.*** The statutory upper limits (which cap the maximum restricted levy amount) should continue to automatically increase annually in line with the indexation factor specified within the imposition Acts.
4. ***That the recommendation of the 2004 review that the notional ratio of the unrestricted component of levy to the total levy be between 10 per cent and 30 per cent be removed in relation to the 2009-10 and subsequent years.***
5. ***That the valuation date for ADIs, general insurers, life insurers and friendly societies and superannuation funds not be changed.***
6. ***a) That the levy date for new starters should be redefined and a new starter return be introduced.***
7. ***Total assets should remain the base for most financial sector levies, subject to Recommendation 9.*** ... The Review further recommends that a more extensive review of the valuation basis be carried out at the next review.
8. ...
9. ***That the imposition legislation be amended to provide more flexibility so that a valuation basis other than assets can be used on a case by case basis in the annual determinations.***
10. ...
11. ***That no change in levy structure should be made to the levies for regulated institutions within conglomerate groups.***
12. ***That no change should be made to the levy structure for Pooled Superannuation Trusts (PSTs).*** ... This levy category should be re-examined at the next methodological review.
13. ***That a further review of the levies framework be carried out within four years.***

#### **4) ASIC's compliance with the Guidelines**

ASIC has published cost recovery FAQs and a CRIS with respect to its 1 January 2012 to 30 June 2013 market supervision function.

#### **5) ATO's compliance with the Guidelines**

With respect to the SuperStream levy of \$467 million - little in the way of detailed information or a break-down of costs has been published.

Given the sheer magnitude of this levy – especially in light of the fact that the DFD Guidelines have a \$5 million threshold - it is reasonable for the industry to expect information with respect to the various activities being performed, the anticipated deliverables, the basis upon which expenditure has been incurred and a breakdown of past and anticipated costs. This has not been forthcoming.

ASFA submits that, not only should this detailed information be provided to the industry but that a comprehensive audit of the SuperStream costs should be performed by the ANAO.

There has been no consultation with the superannuation industry in relation to the proposed ATO expenditure on SuperStream and the precise nature and scope, and resourcing requirements, of the deliverables that the levies will be funding are yet to be published.

In particular, the imposition of the new SuperStream component would represent a new arrangement, or a material amendment to an existing arrangement, which in either case would necessitate a CRIS being prepared.

#### **6) DHS's compliance with the Guidelines**

It does not appear as though the DHS has published a cost recovery guidelines or a CRIS. Given that the vast majority of its funding will be budget funding from consolidated revenue and that it only assumes responsibility for the administration of the early release function in November 2011 this is understandable.

### **B) ENSURING ONLY APPROPRIATE COSTS ARE RECOVERED THROUGH LEVIES**

#### **1) 2012 – 2013 determination as to which costs were to be recovered**

We note that, with respect to the 2012 - 13 year, that the Consultation Paper stated that it the decision was made to recover from relevant industries costs with respect to: -

- certain ASIC and ATO market integrity and consumer protection functions (all industries but predominantly borne by superannuation);
- DHS's administration of claims for early release of superannuation benefits on compassionate grounds (superannuation only)
- SuperStream implementation (superannuation only)

whilst at the same time it was determined that costs with respect to: -

- accreditation of ADIs with sophisticated risk management systems to adopt "advanced" approaches for determining capital adequacy permitted under the Basel II framework;
- ongoing specialised supervision of accredited ADIs; and
- accreditation of general insurers with robust internal models to use these models to meet capital adequacy requirements

would not be recovered through the financial institutions supervisory levies.



It is unclear as to the basis upon which this decision was made. ASFA submits that this would appear to be inconsistent at best.

In particular: -

- at least some of the benefits of implementing SuperStream will flow to employers, payroll providers, SuperStream gateway providers, clearing houses and hubs, SMSF funds and their providers and even to government. As such, it is unclear why all of the costs should be borne by superannuation trustees;
- it is unclear why ADIs should not bear the costs of their Basel II accreditation;
- similarly, it is not apparent why general insurers should not bear the costs of their accreditation.

## **2) ATO Component**

Funding from levies collected from the superannuation industry includes a component to cover the expenses of the ATO in administering the Superannuation Lost Member Register ("LMR").

We note that, partially in response to the ANAO's 2011 report on the administration of the LMR, the ATO now undertakes costing of the LMR function. We support that this costing should take place and suggest that it be subject to continual audit and review, to ensure that the LMR function is performed as efficiently as possible.

## **3) 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 includes the SCT.

In 2012 – 2013 the ASIC component includes an amount for the continuation of work supporting the Stronger Super – MySuper initiative.

## **4) DHS Component**

A component of the levies is to fund the administration of early release of benefits on compassionate grounds.

We note that Consultation Paper indicated that the DHS and APRA will conduct a review of the early release activities with the intention of leveraging off DHS's operational scale and infrastructure to reduce future levies. ASFA welcomes this review and the intention to create efficiencies and thereby reduce costs.

## **5) SuperStream Component**

In 2012 – 2013 it was announced that the full costs of the SuperStream implementation, estimated to be some \$467 million in total, will be recovered through the superannuation industry levies from 2012 - 2013 to 2017 - 2018 inclusive.

Interestingly, the Consultation Paper chose to indicate that the cost of the levy in 2012 - 2013 as being roughly in the order of \$4 per account, a per capita concept, while the levy is in fact determined on the basis of funds assets.



Little has been provided in the way of detail as to the SuperStream costs, other than a break-down into four only high level deliverables, broken down further into the IT and non - IT costs for each deliverable. ASFA submits that significantly more information is necessary before any kind of meaningful analysis and assessment as to the reasonableness of the costs can be made.

With respect to the SuperStream component, and especially given its magnitude, the industry is extremely disappointed that there was no consultation and that little information has been disclosed. ASFA submits that the ATO should undertake a comprehensive costing of the SuperStream initiative and that it should be subject to audit by the ANAO and ongoing review, to ensure that SuperStream is designed and implemented as efficiently as possible.

### **C) QUANTIFICATION AND ATTRIBUTION TO RELEVANT INDUSTRIES\COMPONENTS**

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

There are three main aspects to this: -

- capturing direct costs accurately;
- allocating indirect costs on an appropriate basis; and
- attributing costs to the restricted and unrestricted components appropriately.

#### **1) Direct costs**

##### **a) Determine the direct salaries cost with respect to each industry**

In our view this should be determined by: -

- ascertaining the time spent by each employee during the financial year on activities directly related to each of the regulated \ supervised industries;
- multiplying the time spent on each industry by the mean (for that year) of the total cost of employment for that employee.

##### **b) Determine the total direct salary cost for each industry**

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

##### **c) Treatment of overtime**

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.

#### **2) Indirect costs**

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.

#### **a) Head Count Model**

Under this model the indirect expenditure of the agency would be allocated on the basis of 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 the most 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.

#### **b) Salary Proportioning Model**

Another possible costing model would allocated indirect costs on the basis of 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.

#### **c) 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 activities engaged in by the agency, such information could potentially assist both the government 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 in are engaged in regulating that industry;
- the costs of developing, maintaining and utilising an activity based costing system can be considerable

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

### **3) Allocation to restricted and unrestricted components**

A matter of general concern to ASFA with respect to the use of the components is that it appears as though the apportionment between the components may be on the basis of time alone and may not reflect direct salary costs. Actual costs will vary depending on the relative seniority of the staff concerned and whether overtime is payable.

If this is the case then ASFA is concerned that only time is used and not costs. We consider that the apportionment should occur based on salary costs incurred, not time spent.

A second area of concern is the apparent apportionment of non-supervision costs into the restricted component. Given the underlying policy rationale for the two components, and the imposition of minimums and maximums on the restricted component, the inclusion of non-supervision costs in the restricted component is inappropriate and leads to a distortion in the impact of the levy and inequitable outcomes.

Specifically with respect to the 2012 - 2013 year, ASFA is concerned that the maximum cap on the restricted component was increased to accommodate the SuperStream levy. As the SuperStream levy in no way relates to supervision, it should have been allocated to the unrestricted component.

### **4) Smoothing of supervision costs using a four year moving average**

Little detail appears available with respect to the underlying rationale or methodology for this, however, on the face of it this would appear to be a reasonable approach to adopt.

## **D) BASIS ON WHICH VARIOUS LEVIES ARE CALCULATED**

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

### **1) Supervisory levy**

With respect to the APRA 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, minimum and maximum levy amounts have been determined.

#### **a) The legislative formula**

##### **i) Use of value of assets as the basis for levy**

The legislative basis for determining the quantum of the levy payable by each RSE licensee has been the level of assets of the RSE. While historically this was considered to be the most appropriate basis, recent thinking is that a mix of assets and per capita (i.e. number of members) may yield a more equitable outcome.

## **ii) Restricted and unrestricted components**

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 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 costs are allocated appropriately and that the minimum and maximum for the restricted component and the rates for both components are determined on an equitable basis.

## **iii) Maximum and minimum levy amounts**

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.

We do have some concerns, however, about the transparency of the underlying rationale and methodology employed to determine these amounts in any given year.

## **b) Process of determining percentage scales and minimum\maximum**

ASFA notes that the Consultation Paper failed to provide any underlying rationale or details as to the methodology which could be employed to determine the minimum \ maximum amounts and the percentage scales.

Instead, it merely provided different scenarios as to how the minimum and maximum amounts could be increased and the levy rate adjusted and presented comparisons of the impact of funds of differing asset values. The determination of the maximum was on an apparently “random” basis, with no justification as to how the proposed \$1 million, or final \$2 million, was determined. The percentage scale appears simply to have been worked out backwards to ensure that all costs are recovered.

## **i) Determination of minimum and maximum amounts**

Both the Consultation Paper and the undated final paper stated that – to ensure continued vertical equity – adjustments to the maximum parameters for the restricted levy component are made annually.

The Consultation Paper proposed increasing the maximum amount in 2012 – 2013 from \$260,000 to \$1 million to accommodate the separate SuperStream component. No basis was stated for this approach and it was not apparent, for example, why the approach was not adopted to: -

- allocate the SuperStream amount to the unrestricted component - as it has nothing to do with supervision; and
- increase the maximum amount by the same three percent indexation factor as was proposed for the other industries.

It is also not readily apparent the basis upon which the original maximum, subsequently indexed to \$260,000, was determined.

The final paper states at Page 12 as follows: -

*“Further adjustments are also made to ensure fair sharing of the levy burden in each industry by requiring those institutions that are nearing the maximum amount to continue contributing to the increased cost of supervision. The maximum amount for the superannuation levy has also increased to \$2.0 million in 2012 – 2013 to accommodate the separate SuperStream component”.*

Taking the first sentence – from this it would appear that one alternative approach to increasing the maximum by indexing by the indexation factor in the various Imposition Acts may be to increase it by the percentage increase in supervision costs.

The second sentence contains an error – the maximum amount is only with respect to the restricted component of the levy, not the total levy – and makes no reference either to: -

- why the SuperStream amount was notionally attributed to the restricted component; or
- the basis upon which they arrived at the figure of \$2 million for the new maximum.

The approach adopted in the final paper – of increasing the maximum amount of the restricted component from \$260 to \$2 million - produced the somewhat anomalous outcome whereby: -

- funds of \$50 million and \$250 million had a levy increase of 33.9%, while
- a fund of \$5 billion only had an increase of 20.7% and
- a fund of \$20 billion had an increase of 35%.

Curiously, these figures are identical to the ones on the Consultation Paper, despite the change in the maximum from \$1 million to \$2 million, which would appear to indicate that perhaps they had not been recalculated.

Most significantly of all, the increase in the maximum amount of the unrestricted component from \$260,000 to \$2 million is effectively tantamount to saying that the cost of supervising the larger superannuation funds was \$2 million. ASFA submits that this is an unsupportable proposition and is in direct contravention of any principles underpinning the concept of cost recovery.

ASFA submits that, given the lack of transparency about the process and the length of time since the initial parameters were set, that a thorough review of the levy determination process be performed. One possibility may be that the Productivity Commission review the basis on which the levies are determined, including the underlying methodology utilised.

## 2) **Financial assistance funding levy**

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

When the *Superannuation (Financial Assistance Funding) Levy Act 1993* (FA 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, or possibly number of members, is consistent with the cost of the levy being borne as equitably as possible across the membership base of all funds.

In 2002, however, and prior to any financial assistance levy having been raised, the FA Act was amended to insert the ability for there to be declared a minimum and a maximum levy, in line with the supervisory levy.

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.

With respect to the financial assistance levy, however, ASFA submits that the most equitable method to apportion the costs of financial assistance is either to apply a: -

- percentage across the assets of funds, with no minimum \ maximum; or
- fixed dollar amount with respect to each member of the fund.

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