POLICY

ASFA

The Voice of Super

ASFA Submission to the Productivity Commission Inquiry into Cost Recovery

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Nature and extent of cost recovery by agencies regulating or impacting on superannuation funds

History of regulatory charges

The current approach to cost recovery of regulatory costs in the superannuation sector developed for a range of legislative, administrative and historical reasons. In particular, the levy has evolved with changes in the nature and extent of the regulation of the sector.

Prior to the passage of *the Occupational Superannuation Standards Act 1987* (OSSA) the activities of superannuation funds were regulated largely through the operations of taxation law governing access to tax concessions and through the operations of general trust law provisions. No sector specific regulatory arrangements were in place, and no sector specific charges were made.

Following the passage of OSSA and the establishment of the Insurance and Superannuation Commission (ISC), regulation and supervision became more formalised and active. The introduction of award superannuation in the late 1980s, the introduction of compulsory superannuation through the Superannuation Guarantee in 1992, and the growing recognition of the importance of superannuation as a form of savings for the community and as a recipient of tax concessions led to increasing supervision and regulation. The activities of the ISC increased substantially in the early 1990s, as did the level of sector specific fees that were imposed.

In the late 1980s the only fee payed was a set fee when the ISC annual return was lodged. This was originally $30, later rising to $40. However, in 1990-91 the fee turned into a levy, and increased from the flat rate to $40 per $500,000 of fund assets or part thereof, with a maximum of $5,000. In 1991-92 the rate went to $200 per $500,000 of assets with a maximum of $14,000. The levy was imposed by the *Superannuation Supervisory Levy Act 1991* given that following the decision of the High Court in Air Caledonie v Commonwealth (1988 92 ALR 385) the assumption was made that supervisory levy is a tax and requires a taxing Act.

The Act required the ISC to consult with ASFA and the Life Insurance Federation of Australia as representatives of the industries subject to the levy. Consultation generally involved the circulation of options and background material, and the holding of meetings. The levy was intended, and did over time, recover fully the ISC's costs of supervising the superannuation industry.

Core activities of the ISC covered by the levy funding included:

- examination of annual returns
- auditing of superannuation funds,
- administration of the records of benefits received in order to determine whether they were within the Reasonable Benefit Limits,
- provision of policy advice and the management of the preparation of legislation, and
- education of the industry and community at large.

In 1992 the Government decided to establish an audit and investigation program and to expand the inquiry service of the ISC. Offices also were established in Adelaide, Brisbane, Hobart and Perth, and staff were increased in Canberra, Sydney and Melbourne. Some activities were undertaken more efficiently than others, with the costs of the unclaimed monies and lost members administration blowing out, and subsequently being made part of the responsibility of the Australian Taxation Office.

In the mid-1990s the Superannuation Complaints Tribunal (SCT) was established, and funded out of the overall ISC Budget. Expenditure on education tended to fade away, with postponement and curtailment of major campaign initiatives. A cumulative surplus of revenue over expenditure also developed, with the government not inclined to pass the benefit of this on in the form of lower levies in the future. By the end of 1997-98 the surplus had grown to around $30 million, with much of this generated by the growing number of excluded funds (self managed funds with fewer than 5 members). That surplus was not transferred or otherwise taken into account in the financial arrangements of the new regulatory bodies established in 1998 following consideration of the findings of the Financial System Inquiry (Wallis Committee).

Impact of the Wallis Committee recommendations

Following the consideration of the Wallis Committee recommendations in regard to the reform of the regulation of the financial system, the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC) were established. These organisations took over the role of the ISC, with about 90% of the ISC staff going to APRA. APRA prudentially regulates Approved Deposit Institutions, life and general insurance companies and superannuation entities. Disclosure issues and consumer protection are largely the responsibility of ASIC.

ASFA at the time endorsed the Financial System Inquiry's recommendation 104 that stated that regulatory agencies should reflect their costs. The recommendation said that:

"*The regulatory agencies should collect from the financial entities which they regulate enough revenue to fund themselves, but not more.* As far as practicable, the regulatory agencies should charge each financial entity for direct service provided, and levy sectors of industry to meet the general costs of their regulation."

Further the Financial System Inquiry's Recommendation 107 stated that APRA and ASIC should be funded off-budget. The Recommendation stated:

"From the perspective of financial regulation, it is preferable that the APRC (APRA) and CFSC (ASIC) operate off-budget.

If they are funded through the Commonwealth Government budget, they should have their funding levels determined by reference to policies for financial system regulation rather than to targets for the overall budgetary balance"

ASFA also endorsed the Financial System Inquiry's recommendation 105 that regulatory agencies should set their charges, subject to approval by the Treasurer. The recommendation stated:

"Fees and charges imposed to recover costs of the financial regulatory agencies should be determined by the agencies subject to approval by the Treasurer."

ASFA also suggested that the proposed arrangement require APRA to consult with the superannuation sector on levies to be set.

The translation of the Wallis recommendations into legislation was not altogether satisfactory from ASFA's point of view. Levies are set under the Superannuation Supervisory Levy Imposition Act 1998, with equivalent arrangements applying to other entities regulated by APRA. These levies are paid into consolidated revenue as they are technically considered to be taxes, but under a standing appropriation in Section 50 of the Australian Prudential Regulation Authority Act 1998 are made available to APRA.

More accurately, the amount made available to APRA is the balance remaining after the Treasurer has determined by way of a disallowable instrument how much is to go to ASIC or any other government agency for consumer protection and market integrity functions associated with prudentially regulated industries. This potentially allows some part of the levies raised from the superannuation sector to be used for other purposes, as typically the amount allocated to agencies such as ASIC or the Australian Taxation Office (ATO) forms only a small part of the overall expenditures of those organisations. This opens up the possibility of superannuation levies cross subsidising other activities of those organisations as there is no hypothecation of the sums allocated. As well, the Act does not require any consultation with the sector, although the second reading speech indicated that this would the usual practice.

The Australian Taxation Office was given the responsibility for the supervision of self managed superannuation funds (formerly known as excluded funds). Around $1.5 million of the former ISC budget was transferred to the ATO, about $9 a year for each self-managed fund. The levy was also reduced from the minimum $200 to a flat rate $45 for such funds. Even at this reduced rate the government continued to make a significant profit from the levies on such funds.

Not all excluded funds became ATO supervised self-managed funds, with up to 10,000 excluded funds becoming what are known as Small APRA Funds (SAFs) which have an Approved Trustee which undertakes the day-to-day management of the fund. Some organisations specialise in offering such trustee services, with one Approved Trustee responsible for the operations of over 6,000 such funds. Around $1.8 million is collected from this trustee for the funds for which it is responsible. This is more than is paid by each of the major banks or the largest of the superannuation and insurance providers. ASFA on a number of occasions has pointed to the implications of the difference in levies for self managed funds and SAFs for both equity and economic efficiency.

The levy rates set for non-excluded superannuation funds in 1998-99 under the new arrangements was a minimum of $200, a rate of 0.04% of assets, and a maximum of $39,000. The total amount of to be recovered from the superannuation sector was $30.8 million. ASIC was provided with $4.4 million for consumer protection and market integrity functions related to superannuation (including $1.55 million for the Superannuation Complaints Tribunal), and the ATO received $2.4 million for its activities associated with unclaimed monies and lost members. Formerly, these expenditures formed part of the overall ATO budget and were not paid out of levies. A further $2.7 million was allocated to a four year program of recovering the establishment costs of APRA. These latter costs were never precisely specified, but appeared to include costs of staff redundancies, and costs of establishing offices in Sydney and reducing activities in Canberra.

In 1999-00 APRA sought to recover a total of $29.7 million, with $20.4 for APRA operating expenses, $1.6 million for establishment costs, $5.3 million for ASIC (with $1.6 million of this for the SCT), and $2.4 million for the ATO. The levy structure applied was a minimum of $300, a rate of 0.04% of assets, and a maximum of $41,000.

In 2000-01 APRA is seeking to recover a total of $26.4 million, made up of $15.8 million for APRA, $2.0 million for establishment costs, $6.3 million for ASIC (with $2.6 million of this for the SCT), and $2.4 million for the ATO. The levy structure that applies is a minimum of $300, a rate of 0.02% and a maximum of $46,000. The latter maximum was altered at a late stage in the "consultation" process from $41,000 in order to provide the increase in funding for the SCT of $1 million.

The rationale and justification for the levies

The case for prudential supervision and other regulatory control of superannuation funds is clear. As indicated in Box 1, there are a number of characteristics of superannuation that justify this treatment. Similar considerations have also led to insurance companies and authorised deposit-taking institutions being the subject of supervision. This has applied in many other jurisdictions in addition to Australia.

Box 1: Special characteristics of superannuation
ASFA argues that there is a clear need for greater investor protection to be set out for the regulation of superannuation than for many other financial instruments in that:

- it is compulsory;
- it is a long term investment;
- most of the investors are financially unsophisticated;
- it performs a key role in the government's retirement income policy;
- it is the biggest asset of most Australians apart from the family home. The value of total assets in the superannuation system currently is $477 billion. The number of superannuation accounts is now 20 million, which represents approximately 8 million members; and
- it provides much needed capital for Australia's economy. Currently superannuation funds hold nearly $180 billion in Australian equities. Shareholdings by superannuation funds account for around a quarter of the market capitalisation on the Australian Stock Exchange.

While the rationale for prudential regulation is clear, it is more difficult to precisely identify who are the beneficiaries of the regulatory regime. There are both public benefits as well as benefits to the entities regulated and their members/customers.

When the levy was first introduced, the user pays nature of the arrangement was not subject to conjecture. The then ISC in its circular No 24 stated that the Government believed that it was fair that superannuation funds, and indirectly their members, should bear the full cost of supervising their access to taxation concessions, rather than having that cost borne by the general body of taxpayers.

The Senate Select Committee on Superannuation in its May 1993 report "Super Supervisory Levy" gave attention to that assertion in the light of evidence available at that time, including the nature of the then functions of the ISC. The ISC conducted a range of activities, including annual return processing, audit of funds, administration of reasonable benefit limit (RBL) system, advisings and enquiries, policy advice and development of legislation, and education.

A number of submissions to that enquiry suggested that as Australia approached universal superannuation coverage there was a case for meeting the costs of the ISC from consolidated revenue. This was not endorsed by the Senate Select Committee, but the Committee did recommend that the costs of administering the RBL system not be recouped through the supervisory levy. The Committee also believed that there was some question as to the appropriateness of the levy recouping the policy and legislation costs.

In a refrain that still has currency, the Committee also pointed to problems with the consultation process, namely, the timing of the consultations, the lack of information provided and the nature of the "consultation". There were perceptions that the ISC entered the consultation process with a pre-determined view of the levy as opposed to trying to achieve a genuine consensus.

Rationale for levies to cover the funding of APRA, and certain of the costs of ASIC and the ATO

APRA

Some of the activities of the former ISC which appeared to be more related to benefits to the public generally rather than just to superannuation funds and their members have been either discontinued or transferred to other agencies. APRA has no responsibilities in regard to the operation of the lost members register, unclaimed monies, or reasonable benefit limits. The public education function appears to have been largely abandoned, although some of these responsibilities could be seen to be undertaken by ASIC. Policy advising and preparation of legislation has also become a function of the Department of the Treasury.

The statistical function of the former ISC also has been downgraded, with the ISC Statistical Bulletin, which included in each issue a number of articles analysing the statistics and research on specific parts of the sector, being replaced by tables of statistics published on the Internet. The publication timetable has also become erratic due to the loss of the staff formerly responsible.

The core activities of APRA in regard to superannuation, as indicated in the APRA 1999 Annual Report, are:

- the licensing of operators of public offer superannuation funds,
- requiring trustees to meet appropriate governance standards,
- requiring trustees to have an investment management strategy,
- conducting periodic on-site reviews of funds and consultations with trustees,
- encouraging trustees to correct non-compliance or unsound practices, including taking of enforcement action, and
- liaising with industry organisations and specialists to keep abreast of market developments and communicate regulatory changes and concerns.

It is arguable that each of these activities provide benefits to superannuation funds and/or fund members and as such are appropriately funded from levy proceeds rather than from consolidated revenue. However, a number of the activities help support public confidence in the operation of the compulsory superannuation system and in the overall stability of an important part of the Australian financial system. While it is arguable that this provides grounds for a level of financial support by taxpayers generally, ASFA is not pursuing this suggestion. However, it should be noted that the population of superannuation fund members and the population of personal taxpayers is very similar given that compulsory superannuation covers the vast bulk of employees, and tax concessions for superannuation encourage involvement in the system by the self employed.

There are some activities of APRA in regard to its engagement in international organisations and in providing training and technical assistance to financial regulators in emerging economies, particularly in the Asia/Pacific region, which arguably should be funded out of consolidated revenue rather than industry levies. All of these activities may well be worthy, but the case for the financial sector to fund them is not clear.

The case for financing the applicable APRA costs through a levy arrangement largely hinges on the costs of supervision varying with the number of superannuation funds. If an additional superannuation funds comes into operation, then there are additional costs for APRA in the form of processing annual returns and in conducting audit, review and consultation activities. In this context the levy arrangements can be seen as providing price signals for the operators of superannuation funds. However, it should be noted that the levies being paid by individual funds are not normally of such a magnitude as to drive a decision whether to start up a new fund or amalgamate or discontinue an existing fund.

ASFA is aware that similar levy arrangements apply in other countries such as the United Kingdom where superannuation and pension funds are the subject of regulation. The levies generally take the form of a combination of a fixed fee and a variable fee based on the assets under managements and/or the number of members.

ASIC

One difficulty in evaluating whether activities of ASIC should be funded by way of the levy arrangements is that very little information is provided by ASIC on the nature of its superannuation related activities outside the operation of the Superannuation Complaints Tribunal. The ASIC 1999-2000 Annual Report provides very little evidence of significant activity in regard to superannuation apart from a compliance review of superannuation member statements.

The findings of that review were of some concern, mainly in that they showed that the ASIC officers had not had a good knowledge of the sector or of the legislative requirements. For instance, funds were condemned by way of an ASIC media release for failure to report on matters they were not required to report on, or which where not relevant to their fund. Other funds were criticised for reporting practices that had received specific written approval from the ISC and which were designed to make reporting more meaningful for members.

ASIC was involved in the previous financial year in the preparation of some general information booklets for members of superannuation funds. In 1999-00 there is little evidence of public education activities by ASIC in regard to superannuation, and during that year ASIC withdrew from a joint ASIC and ASFA project designed to test consumer comprehension of various member disclosure documents.

Consumer protection and market integrity functions are sometimes funded out of consolidated revenue and sometimes from sector specific levy arrangements. ASFA has no strong objection to funding such functions by government agencies relating to superannuation from levies rather general taxation. The main difficulty that ASFA has had with the funding arrangements for ASIC is the very poor accountability for the amounts of levy proceeds that are involved. As well, there is a question of overlap in functions between APRA and ASIC. For instance, ASIC is concerned with some basic prudential issues such as the Net Tangible Asset backing of certain financial providers. Policy proposals by ASIC also indicate the likelihood that it will require APRA regulated superannuation funds to also obtain a license from ASIC in order to undertake certain core functions of such funds.

Apart from the funding for the SCT, in recent years ASIC has received between $3 million and $4 million a year for supposed consumer protection and market integrity functions. This has reduced the account balances of members of superannuation funds by more than $10 million in aggregate over a three year period. In comparison, the aggregate losses from superannuation funds due to fraud over the 8 year period to 1996 was $17 million, with much of this reimbursed by entities involved in the administration or marketing of superannuation products. In other words, the funding arrangements for ASIC are taking far more out of superannuation funds each year than do any fraudulent activities ASIC is attempting to prevent!

In regard to the operations of the SCT, ASFA has no objection to them being funded by way of an industry levy. Such funding arrangements are not uncommon for dispute resolution mechanisms for specific sectors, although it should be noted that other more formal dispute resolution mechanisms such as the Federal and State courts receive considerable subsidies and are only on a very partial user pays basis. There are significant public benefits from dispute resolution in the sector that are wider than the specific interests of the parties to a dispute. In this context it should be noted that around a quarter of the cases of the SCT relate to disputes concerning the distribution of death benefits. These disputes are basically between competing beneficiaries rather than being a dispute between a claimant and a superannuation fund. Such disputes when relating to the distribution of estates rather than superannuation are generally dealt with by the Courts having regard to provisions of laws relating to Testators Family Maintenance.

ATO

The rationale for the operation of the lost members register being funded from industry levies is not clear. These activities by the ATO were funded out of consolidated revenue prior to the establishment of APRA and the new levy arrangements. As well, it is not clear that the ATO devotes this level of resources to the operation of the register. ASFA understands that the figure of $2.3 million per annum is based on an initial ATO assessment of costs prior to the register coming into operation. This amount appears to have been derived from what it would cost to handle 160,000 phone inquiries and 80,000 written applications, but actual inquiries appear to be around one-fifth of that level.

At a cost to the sector of about $50 an inquiry and about $250 for each person matched with a fund balance there appears to be scope for greater efficiency if this is what it actually costs the ATO, or lower levies to reflect actual costs. The amount allocated to this function implies that each staff members deals with fewer than five inquiries each working day. It is probable that the ATO activities are much more efficient than this, and that the amount allocated to the ATO should be substantially reduced. In this context it should be noted that recent initiatives by the ATO are based on funds directly interrogating the database and/or providing details of new fund members by way of data interchange. These are relatively low cost methods for the ATO as well as being more effective than member initiated inquiries.

The case for funding the lost member register activities out of consolidated revenue is also strengthened by the fact that the Commonwealth benefits from significant levels of payments made by employers and the subsequent issue of Superannuation Guarantee vouchers. A significant proportion of such vouchers are not claimed for some time, and some will never be claimed. This results in a financial benefit for the Commonwealth.

In ASFA's opinion, the industry should not be required to pay for any activities related to the operation of the Superannuation Guarantee, the keeping of registers of complying funds, the taxation of funds or individuals, or public education campaigns conducted by the Government through the ATO.

Levies or charges for specific services provided

Section 51 of the APRA Act 1998 provides a capacity for APRA to charge directly for services. To date, this capacity has been used for only a few relatively minor services, with the vast bulk of revenue coming from the levies.

Whether greater use of this capacity should be made was considered in the course of the Review of the Financial Sector Levies that was conducted in late 1999 by the Treasury and APRA. A copy of the review discussion paper, ASFA's submission, and the report of the review are attached. The Australian National Audit Office (ANAO) Audit Report No 32: Management of Commonwealth Non-Primary Industry Levies found that APRA was unable to accurately capture the administrative costs associated with the particular levies, and had significantly overcharged and undercharged on particular levies. It was in response to such concerns that the APRA/Treasury review was established.

ASFA in its submission endorsed the general principle of relating levies and charges to the intensity of supervision and the use of services provided by the regulators. This general principle is broadly applied in the current levy structure given the linking of levies to the size of financial entities, with rates and minimum and maximum levies varying with type of entity in order to reflect the different supervisory costs for different types of entity. ASFA also supports the charging of fees for activities which do not form part of the customary activity of superannuation funds, such as the issuing of certain licenses or other special services provided by the regulators.

However, ASFA is opposed to linking a substantial part of the recovery of regulatory costs to specific interactions between financial entities and the regulator. Much of the contact between the regulators and entities is either on a regular basis (such as the receipt and processing of annual and other returns) or is on a random basis determined by the regulator (such as fund visits and reviews), according to their assessment of risk to the member or consumer. First priority has to be given to ensuring confidence in the system as a whole. It would be unreasonable to apply user charges to such activities.

Where an entity is encountering difficulties or there are management deficiencies, applying a substantial charge to cover the costs of regulatory intervention could worsen the situation of the entity concerned. Resistance would also be raised as to the priority/need for particular audits.

Depositors or fund members would end up bearing the incidence of any such payments to the regulator, which would hardly be a desirable outcome. Even worse, such charges could tip an entity over the dividing line between satisfactory operation and insolvency.

ASFA also would oppose any introduction of user charges for services such as the complaints mechanism provided by the Superannuation Complaints Tribunal.

A large part of the business of the SCT is establishing whether a complainant is totally and permanently incapacitated, and in balancing the relative claims of dependants after a member has died. Applying user charges to superannuation funds alone in regard to the resolution of such complaints is not appropriate. Equally, requiring members pursuing the resolution of matters through the SCT to pay fees would be unreasonable. ASFA strongly considers that given the compulsory nature of superannuation for the vast bulk of Australian employees the preferred method for funding complaints resolution should be through industry levies.

However, ASFA would have no objection to the regulators making greater use of charges in circumstances such as the issuing of an initial licence, or when approval is sought for a merger or reconstruction of a financial entity. Care would need to be taken that the level of charges set did not unduly discourage financial restructuring of entities.

The Report of the Treasury/APRA review recommended that APRA develop by 1 July 2000 a fee structure that provided for the imposition of charge for extraordinary or special projects that require a major allocation of resources. The review team considered that this would be unlikely to provide a significant proportion of revenue necessary to fund the total cost of supervision.

ASFA would be concerned if certain routine activities by ASIC, such as the issue of a license to conduct the business of a superannuation fund or the receipt of consumer disclosure documents, resulted in substantial lodgement fees being required. Certain ASIC discussion papers suggested that this could be the intended or unintended result of proposals for new consumer disclosure arrangements and licensing of financial intermediaries, although substantial fees for lodgement of disclosure documents now appears less likely. At the very least, if ASIC generates significant revenue form such sources its share of APRA levies would need to be decreased accordingly.

The structure of the levy

There are currently three degrees of freedom in setting levies in the financial sector: a maximum, a minimum, and a percentage of assets. There also is a maximum levy set by legislation of $1 million for each category of levy administered by APRA.

APRA and Treasury have shown a clear preference to move towards more uniform levy rates, particularly in regard to the percentage of assets rate, and have also canvassed the possibility of setting levy rates on the basis of the overall activities of a financial services group. This was the thrust of the discussion paper released last year in the context of the review of financial sector levies. However, as indicated in ASFA's submission to the review, the diverse nature of the sector both in the size and number of participants in the various sectors and the differences in governing legislation and supervisory practices does not make this feasible at this stage. As well, applying uniform percentage rates and an overall cap of $1 million for a financial services group would lead to a massive redistribution of the levy burden. Such a redistribution would be very hard to justify in terms of the regulatory costs involved for various organisations.

As a result of strong concerns expressed across the range of financial organisations supervised by APRA and the failure to develop an acceptable uniform levy structure, the review led to only relatively minor changes to the overall levy structure. However, as indicated in evidence by APRA to the Review of the Australian Prudential Regulation Authority undertaken by the House of Representatives Standing Committee on Economics, Finance and Public Administration, APRA is not comfortable with the current levy structure. This is because APRA's organisational structure is not based on a sectoral basis, and because there is a growing number of conglomerate entities. APRA has indicated that when the effectiveness of the changes recommended in the Wallis Report is reviewed in 2003 it hopes that the whole framework will be looked at afresh with a move to single levy across all industry groups.

However, in its October 2000 report, the House of Representatives Committee, while seeing some merit in the concept of a single levy system, observed at paragraph 2.37 that APRA must continue to work on methods for measuring the actual costs of supervising the individual entities to ensure that each entity is appropriately levied.

ASFA endorses that comment. Whatever the merits of moving to a uniform levy structure at some time in the future, what is needed now is better accounting of the costs of various activities and improved accountability. Clearly it will be a number of years at least before any changes in legislative arrangements and/or market developments will support uniform levies raised on the basis of financial conglomerates.

Improving accountability

Past consultation on the costs of regulation for various sectors has been on a very tight timetable, and with only limited information being made available on the relevant costs of the ATO and ASIC.

In ASFA's view, apart from the activities of the Superannuation Complaints Tribunal there is no clear or demonstrated link between the funds to be recovered and the actual level of ASIC activities in relation to superannuation. The figure for total recoveries is set in a top down manner, with no other breakdown of services/activities provided to each sector.

ASFA considers that a much higher level of accountability should be delivered by ASIC in regard to how the various amounts are spent. ASIC is attempting to play a leading role in encouraging and requiring business organisation to improve their corporate governance and accountability to stakeholders. ASIC also is seeking improved standards for disclosure of fees and charges in the financial sector. It could set an example in these areas by improving its accountability for levies collected from superannuation and other financial sector participants, and in better disclosing the nature of the charges that it is making.

Specifically, the consultative process should be improved by requiring earlier and more complete disclosure of relevant information, including the basis for estimating the relevant costs of ASIC and the ATO. In ASFA's view it is not sufficient to allocate an arbitrarily set amount by a crude measure of activity or a set percentage of overall expenditure where no analysis of actual costs has been undertaken. There needs to be a much clearer connection between relevant activities of ASIC and ATO and the levy recoveries that are set for these activities.

ASFA appreciates that it is not necessarily easy for ASIC and APRA to provide accounting information on superannuation related activities given that their organisational structures are based on types of activity and whether an organisation is a specialised financial institution or a financial conglomerate offering a range of financial services. However, it should not be beyond the capability of modern accounting systems and periodic surveys to generate more information on costs than is currently provided.

ASFA was heartened to some extent by the assurance from the Minister for Financial Services and Regulation in a letter to ASFA dated 24 August 1999 that it is very important for industry groups to understand where the revenue from levies is directed. He indicated that he would be requesting that both ASIC and the ATO provide additional information on their expenditure as part of the next financial year's levy consultation process. The need for the regulators to provide more specific cost activity information was also endorsed by the review of the financial sector levies.

However, if anything the amount of information provided and the quality of the consultation process declined in regard to the setting of the 2000-2001 levies. Treasury did not consider that any information paper, meeting or discussions was required given that the review of the levy structure had been undertaken in late 1999. Some cursory discussion of levy options was undertaken over the telephone with individual industry organisations.

Subsequently the Treasury wrote proposing a further increase in the maximum levy for superannuation funds (from $41,000 to $46,000) to generate an additional $1 million for the SCT. A copy of the Treasury letter and the response by ASFA to the Minister for Financial Services and Regulation is attached. As is evident from the correspondence, ASFA is very disappointed with a process which does not decrease the levies when an agency has funding reduced, but subsequently increases the levy when there is a need to increase funding in order to deal with a backlog of cases.

In recent years policy and legislative functions relating to superannuation have become centralised in Treasury, with APRA's role almost exclusively devoted to operational matters. While the sector is no longer required to fund policy and legislative functions by way of the levy, the sector is basically getting what it has paid for in this area. ASFA would support a higher level of resources and effort being devoted to superannuation policy matters, including consultation in regard to the setting of the levy, even if this resulted in some increase in the costs attributable to the sector and to be recovered by way of the levy.

ASFA Submission to the Review of Financial Sector Levies

August 1999

EXECUTIVE SUMMARY

ASFA welcomes the opportunity to contribute to the review of financial sector levies. The review provides the sector with a means for bringing about efficient, equitable and durable funding mechanisms now and into the future.

ASFA considers that the levy structure can be improved. Methods for calculating the value of assets to which the levy applies need attention as well. ASFA also has suggestions for changes to the consultative process undertaken each year prior to the levy rates being set. More specifically, ASFA makes the following observations and recommendations:

Sectoral approach and diversified groups

- There is a case for continuing a sectoral approach to some degree for levies, at least until regulatory and reporting requirements for different financial entities are made more uniform.
- Caution is needed in adjusting the levy structure given the wide diversity of types of financial institution and marked differences in asset levels.
- If APRA can demonstrate that the establishment of the Diversified Institutions Division reduces its operating costs substantially then it would be appropriate to pass such cost reductions onto financial organisations that include more than one supervised entity.

Entities deserving special attention

- There is a strong case for a reduction in the levy payable by the small number of non public offer PSTs used as an administrative device by corporate superannuation funds.
- Small APRA Funds (SAFs) which make use of an Approved Trustee should pay a flat rate levy which falls between the minimum for a regulated superannuation fund and the levy applying to self managed funds supervised by the ATO.

Reporting and payment timetables

- Placing other financial entities on a payment cycle for levies similar to that for superannuation funds should not cause major cash flow problems for the regulators. In contrast requiring superannuation funds to pay levies based on a 31 March asset valuation would cause considerable compliance costs and burdens for funds with little or no benefit for government.

User pays charges

- There would be considerable problems with basing a substantial part of payments by regulated entities on the extent of interaction with the regulators. Payments based on intervention required to aid an institution experiencing difficulties would place that financial institution under further fiscal stress. As well, any payments based on the number of complaints processed by a body such as the SCT would disadvantage superannuation funds given that it is difficult to avoid disputes between competing claimants for a death benefit. Preference should be given to ensuring confidence in the industry as a whole rather than increasing reliance on direct user pay charges. The latter would be likely to result in additional questions from financial institutions

and responses from the regulator as to the need/priority of particular audits.

Improving consultation and accountability

- Past consultation on the costs of regulation for various sectors has been on a very tight timetable, and with only limited information being made available on the relevant costs of the ATO and ASIC. The consultative process should be improved by requiring earlier and more complete disclosure of relevant information, including the basis for estimating the relevant costs of ASIC and the ATO.

The present sectoral approach to cost recovery

Reasons for a sectoral approach

The current sectoral approach to cost recovery of regulatory costs developed for a range of legislative, administrative and historical reasons. Different regulatory provisions, procedures and requirements have applied to different financial services and providers, regulators have set up regulatory structures with staff and other resources dedicated to particular sectors, and in the past different regulators have dealt with different financial providers.

Changing structure of financial regulation

These sectoral divisions are beginning to break down. Procedures and requirements are becoming more uniform across financial products, and will become more so as evidenced by a number of CLERP initiatives. APRA and ASIC have responsibilities across the full gamut of financial organisations, and now have structured their staff and resources in ways other than strict institutional divides.

As well, the way many major providers supply financial services has changed. Major financial institutions now market a wide range of financial services rather than specialist financial institutions providing just one or a few types of services to customers. These changes in the market structure obviously have influenced the 23 August 1999 organisational changes to APRA.

That said, there are reasons for continuing a sectoral approach to levies for the time being, at least to some degree. Differences between financial products remain important, with regulatory and reporting requirements varying by product and type of financial products.

Why sectoral factors are still relevant

The different regulatory and reporting requirements are not due to mere historical reasons nor are they arbitrary constructs. In many instances the nature of the product and of its customers requires different treatment. In some instances there is a need to segregate assets in order to provide greater security to the customers involved. As a result, while assets and entities may fall in some way within what is categorised as a diversified institution by APRA, there is not uniform ownership or control of such assets. Developing a legislative formula which add up such assets for levy purposes would be a challenge.

For instance, there are activities, such as superannuation, which have to be provided by a trust based fund or through a virtual fund with an Approved Trustee within a life company. Superannuation assets may be managed by a financial institution, and the fund may be administered and sold by a financial institution, but they are not assets of that financial institution available to meet claims by other creditors. The separate entity of the superannuation fund forms part of the prudential protection available to the fund members.

The existence of additional entities within a diversified institution means that a greater amount of supervisory activity is needed. The Approved Trustee owes duties to the fund members rather than the owners of the associated financial institution. The fact that the assets of the Approved Trustee are loosely within a diversified institution group increases the need for prudential supervision, rather than leading to a reduction in supervisory costs.

Other products can only be supplied by financial institutions which meet specified capital adequacy and other requirements. Activities rather than overall institutions are licensed.

If an entity had one single licence for all its financial sector activities and was subject to just one set of reporting and prudential requirements, there would be a strong case for uniform levy arrangements with the rate based on the total assets of the entity. However, the reality is that the separate activities are subject to different requirements under different pieces of legislation.

The consolidation of regulators has not been mirrored by a consolidation of legislative provisions. Should the regulatory framework be transformed then consideration would need to be given to a complete revamp of the levy arrangements

Intensity of supervision is related to type of activity, not total assets

The intensity of the supervision varies with type of activity, and with the level of risk that the financial promises made will not be met. These risks are not uniform across categories of financial products, nor is the level of risk borne by the contributor or investor. For instance, the prudential issues involved in regulating a general insurer with assets between $1 million and $5 million with some hundreds of customers are far different from supervising a corporate superannuation scheme funded and backed by an employer with only a score of members. For the insurer with assets of less than $5 million a levy of $5,000 might well reflect actual regulatory costs, while for a corporate superannuation scheme it would be far in excess of actual costs.

In the absence of uniform regulation and prudential standards, differences in levy levels and structures should be expected and are supportable.

As well, there are limits on the rate of change, which is possible in the rate of levies. The maximum levy for large superannuation funds has already risen from $14,000 to $39,000. An increase in the maximum to, say, a six figure levy for a superannuation fund would be hard to justify and sustain in the market. No information has been provided by APRA which would justify a substantial increase in the maximum levy for superannuation funds.

If the levy structure review is truly a zero sum exercise, then reducing the levy paid by the larger financial institutions such as banks means that other smaller financial institutions (including relatively large superannuation funds) will have to pay more. Applying greater uniformity in maximum levies might provide some benefit for a few banks, but it would be very costly for other regulated entities, including the larger superannuation funds.

Implications of diversity in asset levels across regulated financial entities

As indicated by Appendix 1 and 2 to this submission, there are considerable differences between the levy structures currently applying to different financial providers, and there are very different market structures and asset distributions across the financial sector. For instance, banks account for some 60 per cent of the total assets of the regulated entities, but for only 1 per cent of the entities.

Prudential issues regarding large banks can involve matters of systemic stability that are not relevant to, say, a superannuation fund or life insurer. The major banks can and should pay levies which reflect the benefits of this provision of systemic stability.

However, over time and especially if prudential supervision costs are contained or reduced, it may be both possible and desirable to move to a more uniform levy structure, at least in terms of the rate in terms of percentage of assets. Such a move would be assisted by the introduction of more uniform licensing and prudential supervision requirements that might flow out of the Corporate Law Economic Reform Proposals (CLERP). Currently, superannuation funds have the highest rate in terms of assets, at 0.04 per cent. It also is not a coincidence that the minimum levy for superannuation funds is the lowest for supervised entities.

Restructuring the levy rate applying to superannuation funds

If the minimum levy for superannuation funds were increased from the current level and/or greater efficiencies were achieved in the prudential supervision of superannuation funds, there would be a strong case for reducing the levy rate applying to the asset level of the superannuation funds. The wide disparity in asset levels for financial institutions illustrated in Appendix 2 may make it difficult to move to one common rate for the financial sector, even in the long run. However, for supervised entities apart from ADIs the long term goal might be to achieve a common rate of the order of 0.02 or 0.03 per cent of assets. However, this could be achieved over time within the existing legislative framework. Legislating for uniform rates would be likely to require large (upwards) adjustments to maximum levy rates for superannuation funds in the short term in the absence of any cost reductions on the part of the regulators. This cannot be justified for these operators.

In summary, developing one levy structure which deals efficiently and equitably with numerous and small superannuation funds, friendly societies, credit unions and general insurers, and with a few large banks, major deposit takers, and life insurers has some theoretical attractions but very large practical difficulties. Care would need to be taken in addressing current problems in the levy structure to avoid the introduction of new inequities. That said, improvements to the current system of levies are both feasible and desirable.

Application of a levy on each licensed or authorised entity and suppliers active in more than one sector

As indicated in Appendix 3, it is not uncommon for a financial services supplier to be active, indeed dominant, in a range of financial supplies. APRA has indicated that its Diversified Institutions Division will, inter alia, be responsible for approximately 275 licensed entities corresponding to about 50 groups.

In addition to financial conglomerates, there can be instances where a licensed entity controls and makes use of another financial entity. For instance, APRA has indicated that in June 1997 around 5 per cent of Pooled Superannuation Trusts (PSTs), amounting to approximately 10 in number, were used by corporate superannuation funds within corporate employer groups as a means to efficiently combine the investments of a number of superannuation funds of individual employers. The existence of more than one corporate fund may follow a takeover or the closure of a scheme to new members.

Implications of investing assets through a PST or Approved Trustee

To the extent that common ownership or control reduces the aggregate cost of regulating financial entities within a group, then it would be reasonable for this to be taken into account in a levy structure. However, it is not clear how significant such cost savings for the regulators. While activities may be carried on within a financial provider group, usually there will be a range of entities involved with different capital structures, and a range of activities which have to meet prudential requirements which vary between activities. Potential conflicts of interest can arise when an Approved Trustee representing the interests of fund members has to negotiate with the financial sector entity in the group which provides administration and investment management services. Review of one entity will not be sufficient to assure compliance with regulatory requirements across all the entities within the group.

ASFA considers that if APRA can demonstrate that the establishment of the Diversified Institutions Division reduces its operating costs then these cost reductions could be passed onto financial organisations which include more than one licensed entity. ASFA would not support raising the levy on specialised and/or smaller financial sector institutions in order to fund reductions in the levy payable by large financial sector groups.

Revenue implications of pooling assets for levy purposes

On the basis of the current levy structure, and assuming that the maximum levy was of the order of $1 million, applying the levy to the aggregate assets of a group instead of to the components of the group would reduce the levy payable by some groups by over $500,000 (made up of $280,000 no longer payable for life insurance, $75,000 for general insurance, 5 times $41,000 for superannuation funds and PSTs in the group, and $18,500 for an RSA). With such savings applying to between 5 and 10 groups there would be a major hole in the levy revenues. This would have to be covered by reduced expenditures by APRA and ASIC or by increased levies on other entities. ASFA would have no objection to APRA and ASIC achieving greater efficiencies and reducing costs, these are real equity and efficiency problems if a substantial reduction in levies on large entities are funded by an increase in levies on smaller entities.

- **A conjunction of a maximum levy and using the total assets of a financial services group also would give an unfair competitive advantage to larger providers and would disadvantage smaller operators.** This would occur because banking and life insurance activities of major groups would be sufficient to generate the maximum levy. In effect, no levy would be incurred by their superannuation and general insurance activities, or by any building society activities within the group.

Potential adjustments to the levy structure

As noted above ASFA would not oppose some adjustment of levies payable by financial service providers who will be supervised by the Diversified Institutions division of APRA where this is justified on the basis of actual reductions in supervisory costs compared to current levels. A mechanism for achieving a reduction in the total levies paid by a financial sector group would be for the legislation to permit the Treasurer to make a determination allowing a specified discount on the levies payable by a financial sector group (as defined in regulations).

PSTs used as an administrative device

There is a strong case for a reduction in the levy payable in regard to the small number of PSTs used as an administrative device for the investment of funds from a number of corporate superannuation funds under the control of one employer sponsor.

While the PST in such instances is a separate entity requiring some supervisory attention in its own right, the amount of work for the regulator will be limited given the close links and common control with the relevant corporate superannuation funds. Potential conflicts of interest do not arise in regard to such PSTs to the extent that they might for other PSTs given that the employer sponsor ultimately stands behind the solvency of the scheme.

A mechanism for achieving this adjustment to the levy could be to have a special determination in regard to privately owned, non-public offer PSTs.

The impact on total revenue would be small given that there are only 10 or so of these. No reduction should apply to the bulk of PSTs controlled by banks, fund managers and life offices over and above the possible discount canvassed above that might flow from future APRA operating cost reductions.

Superannuation assets invested in life policies

It could also be argued that where assets of a superannuation fund are invested entirely in life insurance policies these assets are in some way double counted in levy calculations for both the superannuation fund and the life office. However, ASFA is not convinced by such arguments. Supervision of the superannuation fund is still required, and no less supervisory effort would be involved in regard to the life insurer as a result of a superannuation fund or funds being policy holders.

Around 80 per cent of the business of life companies is related to superannuation, and to carve out such assets would mean that the remaining 20 per cent of business would be taken to have extremely high regulatory costs. The application of minimum and maximum levies to life insurers also would make the carving out of such assets largely ineffective in influencing levies paid by life insurers.

Small APRA Regulated Funds

Another area where there is scope for an adjustment to the levy that would otherwise be payable relates to former excluded superannuation funds which for whatever reason remain under the supervision of APRA. Such funds will be required to make use of an Approved Trustee. There could be some thousands of such funds, at least initially. Their prudential supervision will largely revolve around examination of the practices and procedures of the relatively few Approved Trustees responsible for their operation.

While it is reasonable to have a levy charged for each such fund, their circumstances are different to other regulated superannuation funds in that they will require less individual attention. Prudential considerations also will differ given that these small funds will have fewer than 5 members. Regard also has to be given to the fact that very low levies apply to self managed funds (currently the levy is $45).

Accordingly ASFA suggests that Small APRA Funds (SAFs) which make use of an Approved Trustee pay a flat rate levy which falls between the minimum charged for regulated superannuation funds and the levy applying to Self Managed Funds under the supervision of the Australian Taxation Office.

Timing of payments for superannuation relative to other sectors

Levies for financial entities (with the exception of superannuation funds) are generally payable on 1 July of each year based on asset valuations at the preceding 31 March. These arrangements in most instances do not involve any valuation difficulties given that the entities in almost all cases are required to provide quarterly returns to APRA.

ASFA would have no objection to other financial entities being placed on a similar payment cycle to that applying to superannuation funds.

This would involve some delay in the receipt of levies, but this should not be a major cash flow issue for the Commonwealth or APRA. If there was a cash flow problem it could be addressed by a carryover of funds from the previous year or an advance from the Department of Finance.

ASFA would have strong objections to superannuation funds being required to make a payment shortly after 1 July based on a 31 March asset valuation.

Many and perhaps the bulk of superannuation funds prepare a formal asset valuation no more frequently than annually on their balance date. Superannuation funds are not required to submit quarterly returns. 31 March would be a balance date for very few superannuation funds, and to require a valuation at that date would involve accounting and other costs far in excess of any cash flow advantages for the Commonwealth.

A relatively minor difference in timing of levy payments also gives no effective competitive advantage to superannuation funds. This is reinforced by the fact that superannuation funds are not competing with other regulated entities in regard to the bulk of their business, and the impact of any timing effect is so small that it has no measurable impact on the fees and charges made for superannuation.

ASFA has also previously suggested ways of reducing the burden on some funds of producing a 30 June asset valuation. One way would be to allow the use of the balance date for each fund. In most cases this is 30 June, but for a variety of other dates apply to a minority of funds.

If it is considered essential that levies be struck for all superannuation funds on assets at 30 June, we suggest that funds who do not balance on 30 June have the option of using their last audited accounts adjusted by a specified percentage between the fund's balance date and 30 June.

Differentiating levies and charges according to the intensity of supervision and use of services provided by the regulators

ASFA endorses the general principle of relating levies and charges to the intensity of supervision and the use of services provided by the regulators. This general principle is broadly applied in the current levy structure given the linking of levies to the size of financial entities, with rates and minimum and maximum levies varying with type of entity in order to reflect the different supervisory costs for different types of entity. ASFA also supports the charging of fees for activities such as the issuing of licenses or other special services provided by the regulators.

However, ASFA would be opposed to linking a substantial part of the recovery of regulatory costs to specific interactions between financial entities and the regulator.

Much of the contact between the regulators and entities is either on a regular basis (such as the receipt and processing of annual and other returns) or is on a random basis determined by the regulator (such as fund visits and reviews), according to their assessment of risk to the member or consumer. First priority has to be given to ensuring confidence in the system as a whole. It would be unreasonable to apply user charges to such activities.

Where an entity is encountering difficulties or there are management deficiencies, applying a substantial charge to cover the costs of regulatory intervention could worsen the situation of the entity concerned. Resistance would also be raised as to the priority/need for particular audits.

Depositors or fund members would end up bearing the incidence of any such payments to the regulator, which would hardly be a desirable outcome. Even worse, such charges could tip an entity over the dividing line between satisfactory operation and insolvency.

ASFA also would oppose any introduction of user charges for services such as the complaints mechanism provided by the Superannuation Complaints Tribunal.

A large part of the business of the SCT is establishing whether a complainant is totally and permanently incapacitated, and in balancing the relative claims of dependants after a member has died. Applying user charges to the resolution of such complaints is not appropriate. ASFA strongly considers that given the compulsory nature of superannuation for the vast bulk of Australian employees the preferred method for funding complaints resolution should be through industry levies.

However, ASFA would have no objection to the regulators making greater use of charges in circumstances such as the issuing of an initial licence, or when approval is sought for a merger or reconstruction of a financial entity.

Care would need to be taken that the level of charges set did not unduly discourage financial restructuring of entities.

. Improving accountability

Past consultation on the costs of regulation for various sectors has been on a very tight timetable, and with only limited information being made available on the relevant costs of the ATO and ASIC.

In ASFA's view, apart from the activities of the Superannuation Complaints Tribunal there is no clear or demonstrated link between the funds to be recovered and the actual level of ASIC activities in relation to superannuation. The figure for total recoveries is set in a top down manner, with no other breakdown of services/activities provided to each sector.

ASFA considers that a much higher level of accountability should be delivered by ASIC in regard to how the various amounts are spent. ASIC is attempting to play a leading role in encouraging and requiring business organisation to improve their corporate governance and accountability to stakeholders. ASIC also is seeking improved standards for disclosure of fees and charges in the financial sector. It could set an example in these areas by improving its accountability for levies collected from superannuation and other financial sector participants, and in better disclosing the nature of the charges that it is making.

Specifically, the consultative process should be improved by requiring earlier and more complete disclosure of relevant information, including the basis for estimating the relevant costs of ASIC and the ATO. In ASFA's view it is not sufficient to allocate an arbitrarily set amount by a crude measure of activity or a set percentage of overall expenditure where no analysis of actual costs has been undertaken. There needs to be a much clearer connection between relevant activities of ASIC and ATO and the levy recoveries that are set for these activities.

In this regard ASFA is heartened by the assurance from the Minister for Financial Services and Regulation in a letter to ASFA dated 24 August 1999 that it is very important for industry groups to understand where the revenue from levies is directed, and that he will be requesting that both ASIC and the ATO provide additional information on their expenditure as part of next financial year's levy consultation process.

Appendix 1: Levies applying in 1999-2000

The Australian Prudential Regulation Authority (APRA) and relevant functions of the Australian Securities and Investment Commission (ASIC) together with the costs of the Australian Taxation Office (ATO) in regard to the Lost Members Register and unclaimed superannuation monies are funded by the financial sector on a full cost recovery basis. The funding comes from two sources: a sharing of funds raised by levies imposed on all institutions that are regulated, and income from fees and charges related to the cost of providing specific services or processing specific applications. Currently almost all of the revenue comes from the levies.

The share of the levy money going to ASIC is determined by the Treasurer, formally through a Treasurer determination under Part 5 of the *Australian Prudential Regulation Act 1998*. In essence the levy goes into consolidated revenue, and then is appropriated out again to APRA and ASIC. The Government does not make a profit out of the levy, except possibly to the extent that levies directed to ASIC might exceed relevant ASIC costs.

The Treasurer determinations on the levy and on ASIC funding are disallowable instruments for the purposes of Section 46A of the *Acts Interpretation Act 1901*. This means that while a levy determination can be made and take effect from the date that the Treasurer makes the determination without any need for consideration by either House of the Parliament, a determination needs to be tabled and is subject to disallowance.

There is no legislated provision for consultation with the industry, but the Explanatory Memorandum for the legislation indicated that "In the preparation of specific levy rates it is intended to consult with the Department of Finance and Administration, the affected regulators and key industry bodies". The table below sets out the levies applying to funds that submit annual returns in 1999-2000.

	Type of Fund					
	Non Excluded Super funds	**Self managed super fund**	**RSA**	**Life insurers & Friendly societies**	**General insurers**	**ADI**
% of Assets	0.04	Flat rate	0.04	0.02	0.02	0.013
Minimum	$300	$45	$5 000	$500	$5 000	$500
Maximum	$41 000		$18 500	$280 000	$75 000	$1 000 000
Levy Raised	$27.37m(a)	$8.1m	$69,000	$8.33m	$4.78m	$25.98m

(a) This amount is likely to be an underestimate given likely growth in asset levels. Future levy collections from APRA regulated funds are also likely to rise because as many as 10,000 former excluded funds may become small APRA regulated funds. However, the number of such funds is unknown at this stage, with the number in the long term likely to be sensitive to the levy rate and minimum and other costs of falling under APRA supervision.

Appendix 2: Structure of prudentially supervised entities, June 1998

Assets ($)	Life	General Insurers	Super funds(a)	PSTs (b)	RSAs	Friendly Societies	Building Societies	Credit Unions	Banks
<1m	0	1	1,826	21	2	17		12	
1-5m	0	13	1,248	39	3	15		27	
5-10m	2	15	506	26		7		29	
10-20m	1	19	370	18	3	8		39	
20-50m	3	15	342	22	0	13	3	46	
50-100m	4	27	146	19	0	4	1	31	
100-250m	4	29	145	18	0	1	5	26	2
250-500m	3	15	67	15	0	5	3	17	2
500-1,000m	5	11	45	6	0	2	3	7	9
1-5b	13	16	44	4	0	2	5		24
5-10b	4	1	4		0				6
10-20b	3	0	0		0				4
20+b	1	0	0		0				5
Total	**43**	**162**	**4,743**	**188**	**8**	**74**	**20**	**234**	**52**

(a) Non-excluded (prudentially supervised) funds from 1997-98 annual reports lodged with APRA.
(b) As at June 1997.

Appendix 3: Ownership in the financial services market

Life Insurance Companies (ranking) by Net Premiums	**Banks** (ranking) by Total Assets	**Fund Managers** (ranking) by Total Funds under Management	**Investment Advisors/ Financial Planners** (ranking) by Networks of Proper Authority Holders
AMP (1)	N/A	AMP Investments (1)	AMP Financial Planning (2)
Westpac Life (3)	Westpac (3)	Westpac Investment Management (8)	Westpac Banking Corp (1)
Commonwealth Life (5)	Commonwealth (2)	Commonwealth Financial Services (4)	Commonwealth Investment (16)
National Australia Financial Management (9)	National Australia (1)	National Asset Management (22)	
ANZ Life (10)	ANZ (4)	ANZ Funds Management (11)	ANZ Banking Corp (15)
Bankers Trust (16)	Bankers Trust Australia (13)	BT Australia Group (2)	Bankers Trust Australia (4) BT Securities (7) BT Funds Managem't (9)
Macquarie Life (13)	Macquarie (15)	Macquarie Investment Management (9)	Macquarie Investment Management (2)
Lend Lease (4)	N/A	Lend Lease (3)	MLC Limited (6) Lend Lease Financial Planning (18)
Mercantile Mutual (22)	N/A	MercMut Investment Management (10)	RetireInvest (17)
Colonial (8)	Colonial State Bank (7)	Colonial Investments (19)	N/A
Insurance Directions Feb. 1998, p. 11	*RBA Bulletin Apr. 98 S14*	*Australian Investment Managers Association 31 Dec. 1997*	*ASCOT Database, Jun. 1997*

Source: ISC Bulletin, March Quarter, 1998

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REPORT ON THE FINANCIAL SECTOR LEVY REVIEW

The purpose of the levy review was to evaluate the current levy arrangements ability to provide an efficient, equitable and durable funding mechanism for the supervision of prudentially regulated institutions consistent with the principles included in the Financial System Inquiry recommendations[1].

The Treasury and APRA undertook the review. Industry groups have been consulted throughout the review[2] and will continue to be consulted further prior to implementation of levies for the 2000-01 financial year.

Summary of Recommendations

The key recommendations are set out below, with a more detailed discussion of the recommendations provided in the following sections.

1. Continue to impose levies on a sectoral basis.

2. Retain concepts of minimum and maximum amounts payable.

3. Charge small APRA superannuation funds (SAFs) the same rate as other prudentially regulated superannuation funds recognising the importance of these financial institutions receiving an appropriate level of prudential regulation.

4. Maintain the existing timing of collection of levy payments.

5. That the 'double counting' of assets for the purposes of calculating the levy payable is not inconsistent with the goal of collecting revenue from the relevant financial sector to fund the costs of regulating that sector.

6. Do not merge the levy imposed on providers of Retirements Savings Accounts (RSAs) with the levy imposed on the Authorised Deposit-taking Institution (ADI) sector at this time.

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1 This is consistent with Recommendation 104 of the Financial System Inquiry that "... regulatory agencies should charge each financial entity for direct services provided, and levy sectors of industry to meet the general costs of their regulation." pg 532

2 The following table is a list of financial sector industry groups consulted by the review team:

- Investment and Financial Services Association
- Australian Association of Permanent Building Societies
- Insurance Council of Australia
- Association of Superannuation Funds of Australia Limited
- Australian Bankers Association
- Credit Union Services Corporation (Australia) Limited
- International Banks and Securities Association of Australia
- Australian Institute of Superannuation Trustees

7. Rebate up to $1 million of over collection of levies to industry in order to provide for stability in the levy rates determined by the Treasurer.

8. Recognising the lower level of demand placed on the regulator by foreign bank branches provide for a concessional levy on foreign bank branches.

9. Provide a concession to a small number of Pooled Superannuation Trusts (PSTs) used as an administrative device for the investment of funds from a number of corporate superannuation funds under the control of one employer sponsor.

10. APRA to introduce fees/charges for non-supervisory elective services.

11. The regulators are to provide more detailed specific activity cost information to assist with setting levies more reflective of the costs of supervision.

12. Undertake a review of the levies framework in around 2003 to consider the extent of convergence amongst sectors and whether a group based model would be more appropriate.

Having regard to the above the review team recommends no legislative amendments need occur at this time since all significant changes emanating from the levy review can be accommodated within current legislation.

Discussion of Recommendations

1. Continue to impose levies on a sectoral basis.

The review team considered whether levies should continue to be imposed on a sectoral basis or to move to a conglomerate or group-wide basis.

The current sectoral model provides for the cost associated with supervising a particular sector to be closely matched with levies received from that sector. The sectoral approach is appropriate while the majority of financial institutions are still mono-line service providers, rather than conglomerate institutions.

A group-based model would provide for a single levy to be imposed across all the assets held by the group. This approach recognises convergence in the industry whereby institutions are becoming more like multiple service providers across financial sectors. It is also consistent with recent changes to APRA's approach to supervision. The APRA Board is strongly of the view that there should eventually be a group-based levy with a uniform rate across most institutions.

Industry argued that a move to a group-based model at this stage would be premature. Although a number of large financial conglomerates dominate the Australian market there are still a vast number of mono-line providers that provide specific products, such as superannuation and insurance. Accordingly, the review team does not propose any change to the sectoral approach at this time. Recognising that this situation might change the review team recommended that APRA continue to monitor this issue and that it be a specific consideration during the review scheduled for 2003 (see recommendation 12).

2. Retain concepts of minimum and maximum amounts payable.

The amount payable by each entity is currently subject to both a minimum and maximum amount. These concepts have generally been supported on the basis that there is a certain minimum cost incurred in regulating even the smallest institutions, and that beyond a certain size there is only a marginal or no increase in the cost of regulating an institution.

Industry did not reach a consensus on the appropriate basis for levies - some supported a pure cost basis while others preferred a broader basis that recognised risk and a perception of 'public benefit' from supervision.

Industry groups generally argued that the minimum amount payable should equal the cost of supervising these entities, however there was no consensus in industry views. Entities paying above the minimum tended to assume that minimum amounts (of around $300-$500) were too low and were less than the true minimum cost of supervision, whereas other industry groups argued the minimums were too high.

Some industry groups also suggested that the maximum amount payable should either be raised significantly or even abolished - stating that there is no cap on the size of the risk associated with any entity, therefore, the amount payable should not be capped. Others did not accept this view as it would lead to the situation where the revenue raised from large institutions would be likely to far exceed the costs of supervision involved.

In light of the lack of industry agreement on this issue, and consistent with industry views for no change on the sectoral approach, we recommend that no legislative amendments occur at this time.

However, the review has recommended that APRA look at ways of producing detailed specific activity cost information, which should assist with setting levies in the future in a way that better reflects the costs of supervision (see recommendation 11).

During the review one industry group raised the proposal of charging graduated levies, where different sized entities within each sector could be levied at a rate according to asset levels. The proposal did not appear to receive widespread industry support. APRA also supported it as a possible measure to provide greater flexibility at a later time but were not proposing that it be adopted now. Accordingly, it is not recommended that graduated levies be pursued at this time, although it could be reconsidered if it gains stronger industry support during the review scheduled for 2003 (see recommendation 12).

Overall, the arrangements for minimums and maximums will be reassessed on their appropriateness in the 2003 levy review. The review team recognised that the industry was undergoing substantial change with a number of actual and potential mergers both in Australia and overseas, the review team requested that APRA monitor this situation to ensure that industry consolidation did not result in an inequitable distribution of the burden of the cost of regulation. APRA are to report to the Minister on this issue on a regular basis prior to the scheduled review (see recommendation 12).

3. Charge small APRA superannuation funds (SAFs) the same rate as other prudentially regulated superannuation funds recognising the importance of these financial institutions receiving an appropriate level of prudential regulation.

The Government's response to the recommendations of the Financial System Inquiry provides that the regulation of small superannuation funds be transferred to the ATO. These legislative changes are to ensure that the members of self-managed funds are able to protect their own interests while being subject to minimal prudential regulation.

Some small funds will remain under the supervision of APRA because they make use of an approved trustee. APRA has suggested that the number of SAFs remaining under their supervision following the ATO transfer could be in the vicinity of between 9,000 and 14,000 funds.

The review discussion paper canvassed the possibility of setting the levy for SAFs somewhere between the $45 fee for small super funds regulated by the ATO and the general $300 minimum levy fee set by APRA for super funds. This proposal reflected the likelihood that SAFs would receive less supervision than larger funds regulated by APRA.

The alternative arrangement is to charge all superannuation funds regulated by APRA, including SAFs, the same minimum. A single minimum within the sector would be consistent with greater uniformity in the levy arrangements, and would permit some adjustment to the other parameters applying to the sector. In particular, the levy rate applying to the superannuation can be reduced from 0.04 per cent to 0.02 per cent from 2000-01. Accordingly, it is recommended that all superannuation funds regulated by APRA be charged the same minimum levy of $300 for 2000-01.

4. Maintain the existing timing of collection of levy payments.

Under the current legislation, levies are calculated and payable by all industries at the same date, apart from the superannuation industry. The levy on the superannuation sector is based on assets as at 30 June while the levy on all other sectors has been based on 31 March assets. The levy is due from all sectors on 1 July, apart for the superannuation sector which is due 6 weeks after the lodgment of an annual return that relates to the previous financial year (under section 36 of the *Superannuation Industry (Supervision) Act 1993*).

In practice this means that all industries other than the superannuation industry pay their levies in advance, while super industry levies are generally received in the second half of the financial year (from November through to March).

The review team considered the issue of whether the levy on all sectors should be calculated based on assets at the same date and whether the levy should be payable on the same date. This would improve equity between sectors.

The superannuation industry opposed changes to timing for superannuation funds because if super funds were required to pay levies based on 31 March assets there would be considerable compliance costs on the sector.

The alternative proposal of bringing other industries into line with the super industry would cause considerable cash flow problems for the regulators. APRA does not have significant financial reserves and relies on receiving revenue at the beginning of the financial year.

While the most consistent approach would be for all industries to pay their levies at the beginning of the financial year based on assets at the same date, this would place a potential burden on super funds if they are required to calculate their levies on the basis of a date other than 30 June.

The majority of super funds regulated by APRA will be required to lodge their annual returns sooner from 1 July 2000. From this time the prescribed period for lodgment of annual returns will be reduced from six months to four months from balancing date. To some extent this will bring super funds closer in line with the time that levies are due from all other sectors.

Accordingly it is recommended there be no change to the current structure of the timing of the calculation and payment of levies.

5. That the 'double counting' of assets for the purposes of calculating the levy payable is not inconsistent with the goal of collecting revenue from the relevant financial sector to fund the costs of regulating that sector.

The current levy on each entity is calculated as a per cent of assets under management. As some financial sector entities invest in other such entities, some assets are therefore counted twice.

The most significant double counting occurs in super funds that invest in policies held in statutory funds of life insurance companies. Around 80 per cent of the investment assets held by life companies relate to superannuation funds. However, it is unclear whether all the assets come from supervised funds. The review team understands there would be significant costs associated with distinguishing assets in this manner. In any case, if these assets were carved out of the calculation, the remaining life businesses would be charged extremely high regulatory costs.

The majority of industry groups either did not consider this a significant issue or defended the current double counting of assets. Many industry groups argued that even if a super fund invests in life policies, the super fund must still be supervised and no less supervision would be involved in regard to the life insurer.

On the basis of the above, we consider that the costs of trying to address this concern are unwarranted.

6. Do not merge the levy imposed on providers of RSAs with the levy imposed on the ADI sector at this time.

A levy is currently imposed on the providers of RSAs. This levy is imposed on a very small number of institutions (less than 20) to recover revenue of around $0.1 million. As each provider is an ADI it would be possible to recoup this revenue from within the ADI sector. That is, the levy calculated on the ADI would also take into account assets held by any associated RSA provider.

Whilst merging these levies did receive broad industry support it would require legislative amendments. Given the nature of the amendments required and the quantum of the deficiency in the legislation and with no legislative change likely to be required outside of this proposal the review team felt it would be difficult to proceed with legislative change at this time.

7. Rebate up to $1 million of overcollection of levies to industry in order to provide for stability in the levy rates determined by the Treasurer.

The issue of returning overcollection of levies from previous years was not raised with industry as part of the review. The policy to date has been to reduce the levies determined the following year and this policy is clearly understood and supported by industry.

Overcollection of levies can occur for the following reasons:

- levies are set before accurate data is available on institution's assets;
- levies may be collected from prior periods due to late lodgement; and
- the cost of operating APRA may be lower than budgeted.

The issue of over/under collection is most relevant to the superannuation industry where levies are paid mid-way through the financial year, making it difficult to estimate any overcollection before determining the levies in May.

One approach would be for overcollection of levies to be returned to industry by a rebate. For example, the process for the coming financial year for the super industry would be as follows:

Proposed rebate process for super industry

July 1999 – June 2000	Some overcollection of levies based on rates as determined by the Treasurer in May 1999.
May 2000	The budget papers are published including expected revenue/expenses associated with APRA. The Treasurer determines the levies payable in 2000-01. The amount of overcollection may or may not be taken into account when setting the rates. (Note that it is difficult to estimate the revenue collected from the super industry at this time.)
August 2000	APRA has more accurate data on overcollection for 1999-00 financial year associated with the super industry. APRA provides for a waiver (or rebate) of part of the levy determined by the Treasurer for 2000-01 (eg. 5%) based on a more accurate calculation of overcollection for 1999-00.
November 2000	Institutions pay levies for 2000-01 according to Treasurer's determination and any waiver determined by APRA. The levy notice for 2000-01 will show the amount waived (ie. rebate for levies which were over collected in 1999-00).

The primary advantage of a rebate system is that the rates determined by the Treasurer may be more stable and predictable over time, rather than fluctuating with any previous over/under collection. (Note that the actual amount paid by entities will continue to fluctuate between years although this fluctuation will be due to the amount that APRA deems to be an appropriate rebate.)

The review team supports the principle of returning overcollection of levies by way of a rebate, subject to the following parameters:

- the levy rates set by the Treasurer should continue to be the major determinant in the amount of levy paid by entities;
- the total amount of overcollection returned to any sector by way of a rebate should be no greater than $1 million in any year, with any remaining overcollection returned to the sector through lower levies determined by the Treasurer the following year; and
- generally, rebates should only apply to the superannuation industry.

The review team has received legal advice from the Attorney General's department indicating that rebates may be given to industry within the current legislation (see below).

8. Recognising the lower level of demand placed on the regulator by foreign bank branches provide for a concessional levy on foreign bank branches.

The *Authorised Deposit-taking Institutions Supervisory Levy Imposition Act 1998* provides for a levy to be imposed on all ADIs, including domestic banks, foreign banks, building societies and credit unions. These institutions are all currently levied at the same rate of 0.013 per cent of assets. Some industry groups are concerned that the current sectoral approach does not recognise that certain institutions may not be subject to the same level of supervision as others within a sector.

For example, foreign bank branches (FBBs) do not receive the same level of supervision as other ADIs because they are precluded from accepting retail deposits and do not have to satisfy the capital adequacy requirements placed on subsidiaries. Further, the home country supervisor has primary responsibility for prudentially supervising foreign banks and their branches. Several industry groups suggested that the levy framework should take into account the lighter level of supervision of these entities relative to domestic ADIs.

A particular concern of industry during the review was the fact that a number of foreign banks currently pay a levy on their foreign subsidiary bank assets and pay a further levy on the assets of their FBB. These foreign banks have ended up paying a combined levy similar in amount to large domestic ADIs.

While other financial institutions with more than one regulated entity – such as domestic conglomerates providing lending, insurance and superannuation services - pay more than one levy, the review team recognises that FBBs are supervised less intensively than domestic ADIs. On that basis, it is recommended that a concessional levy be provided for FBBs relative to other ADIs, with FBBs levied at a percentage rate one half of the rate applied to other ADIs, and with the maximum payable lowered to $0.5 million (or half the maximum for other ADIs). Both the percentage rate and reduced upper limit can be accommodated by the current levy framework without legislative amendment.

9. Provide a concession to a small number of Pooled Superannuation Trusts (PSTs) used as an administrative device for the investment of funds from a number of corporate superannuation funds under the control of one employer sponsor.

PSTs are a distinct group of superannuation entities, which operate under the *Superannuation Industry (Supervision) Act 1993*. PSTs can be used only for the investment of assets of regulated superannuation entities and form part of the managed wholesale pooled funds market. PSTs provide a means to pool the assets of a number of smaller superannuation funds to improve efficiency and achieve a diversity of investments.

The Association of Superannuation Funds of Australia (ASFA) has identified a special group of PSTs that are administrative entities used for pooling investment funds from a number of corporate superannuation funds who are under the control of one employer sponsor. These PSTs typically arise where a company has taken over or merged with other companies and has employees in a number of corporate superannuation funds controlled by the employer. There are often legal impediments preventing the merging of these funds (eg because they have differing benefit structures), so in order to achieve efficiencies the funds assets are directed into a single PST for management and investment purposes.

ASFA considers there is a case for reducing the levy payable for these PSTs because they are under one employer and require lower cost regulation than others. We recommend that no general concession be provided for PSTs but that some concession should be provided to the special category of PSTs identified by ASFA. ASFA have undertaken to assist in the identification of these funds to ensure that the concession on levies is limited. We understand they number about 12.

The Australian Government Solicitor has advised Treasury that section 12 of the *Financial Institutions Supervisory Levies Collection Act 1998* will enable APRA to provide the concessions to the small number of applicable PSTs.

10. APRA to introduce fees/charges for non-supervisory elective services.

The Financial System Inquiry recommended that fees and charges should be imposed to assist in recovering the cost of supervision. Section 51 of the *Australian Prudential Regulation Authority Act 1998* provides for APRA to charge directly for services.

Industry indicated strong support for a user pays system for non-supervisory elective services. Fees could be charged for discrete services such as licensing applications, corporate restructures and mergers. Industry agreed that the charges should clearly accrue to the particular institutions receiving the benefits of the service.

This approach is consistent with the practice adopted by the Financial Services Authority (FSA) in the United Kingdom which charges fees for processing an application that requires corporate authorisation. For example, the FSA charges £25,000 to process an application for a banking licence.

The review team has not considered what level of fees would be appropriate, however industry generally opposed a user pays system to the extent that any entity would be required to meet precise estimates of the actual costs of supervision. In this respect the submissions supported a levy to be the primary source of revenue.[3]

Some industry groups were concerned that a flat fee may impact more significantly on smaller institutions.

We recommend that APRA develop by 1 July 2000 a fee structure that provides for the imposition of charges for extraordinary or special projects that require a major allocation of resources. The review team notes that it is unlikely such a fee structure would provide a significant proportion of revenue necessary to fund the total cost of supervision.

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[3] This is consistent with Recommendation 104 of the Financial System Inquiry that "... regulatory agencies should charge each financial entity for direct services provided, and levy sectors of industry to meet the general costs of their regulation." pg 532

11. The regulators are to provide more detailed specific activity cost information to assist with setting levies more reflective of the costs of supervision.

Industry groups considered that the data available on the costs of supervision was inadequate and there was a need for better data on both APRA's and ASIC's costs to ensure that levies could be set in a way that is more reflective of the costs of supervision.

At the roundtable discussion APRA agreed to consider whether further information could be obtained on supervisory costs and supervisory activities relating to particular categories of institutions. This is expected to take six to nine months to compile.

ASIC is also to provide more detailed information on their supervisory costs as industry groups have not been satisfied with data on how ASIC's funding allocation is spent or their justification of increases in supervisory costs. (Consumer protection functions by ASIC account for around 17 per cent or $11.6 million of total supervisory costs.) Should you approve this recommendation steps will be taken to ensure that the $11.6 million appropriated to ASIC is fully explained in ASIC's annual financial statements.

The review team notes that APRA and ASIC will provide more detailed specific activity cost information to assist in setting levies in a way that is more reflective of the costs of supervision.

12. Undertake a review of the levies framework in around 2003 to consider the extent of convergence amongst sectors and whether a group based model would be more appropriate.

It is recommended that the levy framework should be reviewed again in around 2003. The purpose of this review would be to consider whether the extent of convergence between sectors is sufficient to warrant a move to a group-based model. Industry generally supported a further review around that time.

Industry groups were very supportive of a move to a group-based model, particularly as it would be consistent with broad trends towards convergence being observed across the financial sector. However, industry considered that the change would be premature at this time as the pace of convergence and industry rationalisation was uncertain, and it would be more appropriate if the issue could be revisited after a period of time. Accordingly, the review team recommends a review in 2003, as this would allow a significant period of time for further industry rationalisation and convergence, and it would be consistent with the timing of the review of financial sector reforms scheduled to be undertaken by the Financial Sector Advisory Council in 2003.

Conclusion

Given that all significant changes emanating from the levy review could be accommodated within current legislation, it is recommended that no legislative amendments occur at this time.

There were four key proposals industry wished to consider which would require legislative change. These were:

- whether levies would continue to be levied by sector or on some other basis. In the event there was widespread support for retaining the sectoral approach - see recommendation 2;

- the proposal to allow for a graduated levy to be charged within sectors - see recommendation 3;
- a proposal to increase the statutory maximum applicable to the ADI sector - see recommendation 2; and
- a proposal to merge the providers of RSAs with the ADI sector - see recommendation 6.

We consider that all the issues can be suitably addressed within the current levy framework without legislative change at this time.

2000-01 BUDGET AND LEVY PARAMETERS

	Current levy arrangements	1999-00 budget cost of supervision	Levies required after carry forward	2000-01 Levy arrangements (proposed)	2000-01 budget cost of supervision	Levies required after carry forward
Superannuation entities						
APRA operating expense*	min $300	$20,421,000		min $300	$15,778,112	
APRA establishment	max $41,000	$1,638,640		max $41,000	$1,973,988	
ASIC	rate 0.04%	$5,280,000		rate 0.02%	$5,280,000	
ATO		$2,353,000			$2,353,000	
		$29,692,640	$27,616,384		$25,385,100	$24,076,929
Retirement Savings Accounts						
APRA operating expense	min $5,000	$89,000		min $5,000	$52,273	
APRA establishment	max $18,500	$11,357		max $18,500	$6,527	
ASIC	rate 0.04%			rate 0.02%		
		$100,357	$111,360		$58,800	$58,800
Life Insurance & Friendly Societies						
APRA operating expense	min $500	$6,366,000		min $500	$5,919,874	
APRA establishment	max $280,000	$417,743		max $280,000	$739,226	
ASIC	rate 0.02%	$2,040,000		rate 0.02%	$2,040,000	
		$8,823,743	$8,541,483		$8,699,100	$8,699,100
General Insurance *						
APRA operating expense	min $5,000	$3,411,000		min $5,000	$3,049,236	
APRA establishment	max $75,000	$167,865		max $100,000	$380,764	
ASIC	rate 0.02%	$1,720,000		rate 0.02%	$1,720,000	
		$5,298,865	$4,847,168		$5,150,000	$5,150,000
Authorised Deposit-taking Institutions						
APRA operating expense	min $500	$19,313,000		min $500	$18,731,022	
APRA establishment costs	max $1,000,000	$3,203,878		max $1,000,000 (fbb $500,000)	$2,338,978	
ASIC	rate 0.013%	$2,560,000		rate 0.012% (fbb 0.006%)	$2,560,000	
		$25,076,878	$25,455,878		$23,630,000	$21,983,866
Non-operating Holding Companies	flat rate $10,000			flat rate $10,000		
		$30,000	$30,000		$30,000	$30,000
Financial Sector						
APRA operating expense		$49,630,000			$43,560,517	
APRA establishment		$5,439,483			$5,439,483	
ASIC		$11,600,000			$11,600,000	
ATO		$2,353,000			$2,353,000	
TOTAL		$69,022,483	$66,602,273		$62,953,000	$59,998,695

* The asset levels of general insurers has declined over 1999-00

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MEDIA RELEASE

Joe Hockey

Minister for Financial Services & Regulation

FINANCIAL SECTOR LEVIES FOR 2000-01

The Minister for Financial Services & Regulation, Joe Hockey, today announced the 2000-01 financial sector levies.

The levies cover the supervisory costs of prudentially regulated financial institutions, which include the operational costs of the Australia Prudential Regulation Authority (APRA) and the consumer protection functions of the Australian Securities and Investments Commission (ASIC) and the Australian Taxation Office (ATO).

The 2000-01 levies have been determined so that revenue collected from each industry will cover the costs of supervising that industry and to achieve the outcomes of the recent financial sector levy review.

Total levy revenue required has declined markedly from $66.6 million in 1999-00 to $61 million in 2000-01.

The levy rates and the amounts applicable to the relevant industry sectors for 2000-01 are set out in the table below.

Industry	Percentage of assets	Minimum levy	Maximum levy
Superannuation funds 2000-01	0.02%	$300	$46,000
Retirement savings account providers 2000-01	0.02%	$5,000	$18,500
Life insurers 2000-01	0.02%	$500	$280,000
General insurers 2000-01	0.02%	$5,000	$100,000
Authorised deposit-taking institutions 2000-01	0.012%	$500	$1,000,000
Foreign bank branches 2000-01	0.006%	$500	$500,000
Non-operating holding companies 2000-01	Flat rate charge of $10,000		

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"The reduced levy revenue required is evidence that the regulator have met cost efficiencies and that the cost of supervision is declining. This cost saving is being directly passed on to financial sector entities," the Minister said.

In 2000-01, the superannuation sector will receive a reduced levy rate or 0.02 per cent of assets which is half that of the rate for 1999-00. The reduced levy rate is the result of excess levy revenue collections in this sector in previous periods and the achievement of significant savings in infrastructure costs.

The maximum levy payable by superannuation entities in 2000-01 increases to $46,000 from $41,000 in 1999-00. This increase is directly attributable to the increase in funding for the Superannuation Complaints Tribunal (SCT) which plays an important part in the market integrity and consumer protection functions of the super industry.

The authorised deposit-taking institution sector receives a reduced levy rate of 0.012 per cent of assets in 2000-01 down from 0.013 per cent of assets in 1999-00. This is a direct result of excess levy revenue collection in this sector from previous periods.

Within the authorised deposit-taking institutions sector, foreign bank branches receive a concessional levy rate of 0.006 per cent of assets along with a reduced maximum levy payable of $500,000. The concession provided to foreign bank branches reflects their less intensive supervision in Australia because of the additional supervision provided by their home country supervisor and their inability to accept retail deposits.

General insurers pay a new maximum levy amount of $100,000 in 2000-01 up from $75,000 in 1999-00. The increase results from increased supervisory work being undertaken in the sector.

Financial sector levy review outcomes

The financial sector levy review was established with the aim of ensuring the current levy arrangements provided an effective, equitable and durable funding mechanism for the supervision of prudentially regulated institutions.

Industry groups have been widely consulted during the levy review and in the 2000-01 levy parameter setting process. Industry feedback was essential and contributed significantly to the outcomes.

The main outcomes from the review are:

- to continue imposing levies on a sectoral basis;
- providing the ability to rebate excess levies collected back to industrv;
- to recognise the lower level of demand placed on Australia's regulators by foreign bank branches; and
- regulators are to provide more detailed specific activity cost information to assist with the levy setting process.

June, 2000

Treasury **contact: Anthony Cussen,** 02 6263 2995
Matthew Abbott, Minister's office, 6277 7230 or 0413 076 213

REVIEW OF FINANCIAL SECTOR LEVIES TO FUND THE COST OF SUPERVISING THE FINANCIAL SECTOR

NOVEMBER 1999

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INTRODUCTION

The purpose of this paper is to facilitate a round table discussion with industry groups regarding the review of the financial sector levies. It does not represent government policy.

This review is to evaluate the current levy arrangements' ability to provide an effective funding mechanism for the supervision of prudentially regulated institutions. Recommendations will be made on any changes required to the current arrangements to ensure there is an efficient, equitable and durable funding mechanism capable of meeting needs well into the future. The detailed terms of reference for the review are set out at Attachment 1.

The levies are required to recover the operational costs of the Australian Prudential Regulation Authority (APRA) and consumer protection functions carried out by the Australian Securities and Investments Commission (ASIC) and the Australian Taxation Office (ATO). In the initial years, the levies also recover the establishment costs associated with APRA and ASIC.

Current Levy Arrangements

Under the current arrangements these costs are allocated between sectors of the financial sector. The levy on each of the sectors is set at a rate to raise sufficient revenue to meet the budgeted cost of supervising that sector for the financial year. Any excess or shortfall in levy revenue is taken into account the following financial year.

This sectoral approach to recovering levies broadly reflects recommendation 104 of the Financial Sector Inquiry (FSI): *"As far as practicable, the regulatory agencies should charge each financial entity for direct services provided, and levy sectors of industry to meet the general costs of their regulation."*

The legislative framework for the current levy arrangements was passed at the same time as a significant package of legislation relating to the recommendations of the FSI on 1 July 1998. As the starting point for each sector was so different it was not possible to move to a common architecture without disruptively large changes. Therefore, the current legislation largely mirrors the levy framework that existed under the regime of the Insurance and Superannuation Commission (ISC).

The table below summarises the existing levy arrangements.

Table of Current Sectoral Arrangements

Sector		Current	
Non excluded super	% on assets	0.04	
	minimum	$300	
	maximum	$41,000	
	levy raised ($m)	27.6	
	cost of supervision ($m)	29.7	2.1M.
Retirement savings account providers	% on assets	0.02	
	minimum	$5,000	
	maximum	$18,500	
	levy raised ($m)	0.1	
	cost of supervision ($m)	0.1	
Life insurers	% on assets	0.02	
	minimum	$500	
	maximum	$280,000	
	levy raised ($m)	8.5	
	cost of supervision ($m)	8.8	0.3m
General insurers	% on assets	0.02	
	minimum	$5,000	
	maximum	$75,000	
	levy raised ($m)	4.8	
	cost of supervision ($m)	5.3	.5m
ADIs	% on assets	0.013	
	minimum	$500	
	maximum	$1,000,000	
	levy raised ($m)	25.4	
	cost of supervision ($m)	25.4	
Foreign bank branches	% on assets	included in ADI industry	
	minimum		
	maximum		
	levy raised ($m)		
	cost of supervision ($m)		
NOHCs	flat rate charge	$10,000	
	levy raised ($m)	0.03	
	cost of supervision ($m)	0.03	
TOTAL LEVY RAISED ($m)		66.4	
TOTAL COST OF SUPERVISION ($m)		69.3	

Note: the levy raised in the current financial year took account of the carryforward from the previous financial year.

Overview of Discussion Paper

The submissions from industry which have been provided as input to the review raised a range of issues:

- Should the current sectoral approach continue or should the levy be imposed on group assets?
- If the sectoral approach continues, should an attempt be made to avoid double counting of assets for the purposes of calculating the levy?
- Should the amount payable be capped and is there a need to increase the minimum?
- Should the levy take account of the lower cost/intensity of supervision associated with some entities (e.g. foreign bank branches)?
- Should the levy on all sectors be calculated on assets at the same time with the levy due on the same date for all sectors?
- To what extent should fees and charges be imposed to recover costs associated with specific services undertaken by APRA?
- Should the levy on providers of retirement savings accounts be merged with the levy on ADIs?

This discussion paper canvasses these issues. It also presents three alternative levy models and a variety of scenarios within the three broad approaches. Many alternative scenarios could be devised, but the modelling presented provides a basis for discussion and further development of a proposed approach. Some of the scenarios involve a significant shift from the present arrangements and may not prove to be widely accepted. However, at the least, the scenarios provide a guide to the workability of different approaches. The review team has not drawn firm conclusions on the scenarios; the intention is to provide a focus for further discussion.

KEY ISSUES IDENTIFIED IN THE SUBMISSIONS

Should the current sectoral approach continue or should the levy be imposed on groups?

Considerable attention was given to whether the levy should be imposed on specific industry sectors, in light of sectoral convergence. Bancassurance or sectoral convergence means that institutions are becoming more than just mono-line service providers. Institutions are becoming broad financial service providers. For example, banks today not only offer a huge range of deposits and credit facilities, but also products and services that were not previously associated with banks, including managed funds, superannuation, insurance, financial planning advice and stock broking.

However, most industry groups tended to argue against moving to a single levy across the broader group entity. These submissions suggested that the current approach recognises the still diverse nature of institutions across sectoral categories. For example, where an insurer is part of a group that provides other products, the nature of the products and the associated risks differ substantially across the group. It was suggested that while regulatory and reporting requirements remain different across sectors, it is appropriate that levies should also vary across sectors.

One industry group argued that the sectoral distinctions are appropriate given the variations in the intensity in which different sectors are supervised. This industry group argued that if levies were imposed on a group wide basis this may erode the public perception that there are differences in the level of supervision between sectors.

Some industry groups recognised the potential advantages of a levy structure based on a single levy for an overall entity. They noted that such an approach:

- is consistent with the move towards adopting a uniform regulatory environment across the whole financial services sector; and
- would improve the efficiency of supervision arrangements through reducing the costs of collecting and administering the levy.

It should also be noted that it will become increasingly difficult to allocate costs on a sectoral basis. Until recently APRA's structure was largely an aggregation of its predecessor organisations. From August 1999 APRA has adopted a different structure so that financial institutions are supervised on the basis that they are diversified or specialised institutions, rather than on a sectoral basis.

More specifically, staff from different backgrounds have been established in teams responsible for supervising either a small number of conglomerate (or complex) groups which include ADI's, insurance companies and superannuation entities, or a larger number of stand-alone (or specialised) institutions which also come from a number of industry groups. Under this model, analysts, teams or branches can be responsible for the supervision of a range of institutions from different industry groups. Moves are also under way to implement an integrated and consistent style of supervision across the financial system.

Some other countries are also seeing similar developments and are to consider whether a shift from a sectoral based levy system is appropriate (see Attachment 2).

Despite the trend to convergence, however, it might be possible to use previous years' costs as a basis for estimating sectoral based costs for some time in the future. The review team notes there are good arguments in favour of both approaches and has not reached conclusions on the issue.

Should an attempt be made to avoid double counting of assets for the purposes of calculating the levy?

The current levy on each entity is calculated as a percentage of assets under management. As some financial sector entities invest in other financial sector entities, some assets are counted twice for the purpose of calculating the levy.

The most significant example of this double counting relates to super funds that invest in policies held in statutory funds of life insurance companies. Around 80 per cent of the investment assets held by life companies are related to superannuation funds. However, it is unclear whether all of these assets come from supervised funds. The review team understands that there would be significant costs associated with distinguishing assets in this manner. In any case, if these assets were carved out for the purpose of calculating the levy, the remaining life businesses would be charged extremely high regulatory costs.

The majority of industry groups either did not consider this a significant issue or defended the current double counting of assets. Several submissions recognised that even if a super fund invests in life policies, the super fund must still be supervised and no less supervision would be involved in regard to the life insurer.

On the basis of the above, the review team raises the question of whether the costs of trying to address this concern are warranted. No.

Is it appropriate to use minimums and maximums and if so, how should these amounts be determined?

As noted earlier, the amount payable by each entity is currently subject to both a minimum and maximum amount. The concepts of minimum and maximum levies are supported on the basis that there is a certain minimum cost incurred in regulating even the smallest institutions and that beyond a certain size there is only a marginal or no increase in the cost of regulating an institution.

Minimum amounts

The submissions generally argued that the minimum amount payable should equal the cost of supervising these entities. Those entities currently paying above the minimum tended to assume that minimum amounts of around $300-$500 that are currently charged are less than the true minimum cost of supervision.

Maximum amount

The bulk of submissions also suggested that the maximum amount payable should either be raised significantly or even abolished. They argued that there is no cap on the size of or risk associated with any entity, therefore, the amount payable should not be capped. Other industry groups recognised the potential impact on revenue if larger institutions merge.

The review team supports the argument that the amount payable should be related to cost of supervision. The team also recognises that this amount should have regard to an institution's capacity to pay, which must take into account the significance of individual financial institutions within the financial sector.

In relation to the minimum amount further analysis is required to ensure the minimum levies payable better reflect the minimum cost of supervision, subject to capacity to pay considerations.

Further consideration will also need to be given to the maximum amount, in light of capacity to pay, the significance of individual institutions within the financial system and the need to cover overall costs.

Should a levy imposed on a particular sector take account of the lower cost of supervising some entities within that sector?

The current sectoral approach does not distinguish between entities or groups of entities within a sector. Some industry groups are concerned that this does not recognise that the level of supervision may vary within a sector. In particular, industry groups were concerned about the levies relating to foreign bank branches, pooled superannuation trusts and self managed superannuation funds with approved trustees.

Foreign bank branches

The *Authorised Deposit-taking Institutions Supervisory Levy Imposition Act 1998* provides the legislative provisions for a levy to be imposed on all ADIs, including domestic banks, foreign banks, building societies and credit unions. These institutions are all currently levied at the same rate of 0.013 per cent of assets.

Foreign bank branches are precluded from accepting retail deposits. As a consequence, they are subject to less intense supervision by Australian supervisors than domestic ADIs. The home country supervisor has primary responsibility for prudentially supervising foreign banks and their branches. Several submissions suggested that the levy framework should take into account the lighter level of supervision of these entities relative to domestic ADIs. One industry group suggested they should be levied at one third the rate imposed on domestic ADIs, in accordance with other countries such as the United Kingdom.

The review team recognises that foreign bank branches are supervised less intensively than domestic ADIs of the same size. On that basis, the review team considers that there is a prima facie case for imposing a lower percentage levy rate on foreign bank branches relative to other ADIs.

Foreign banks are also concerned at the imposition of separate levies on their subsidiary and branch operations. (A foreign bank that wishes to maximise its competitiveness in the retail and wholesale markets tends to have both a branch and locally incorporated subsidiary.) Some industry groups have suggested that, for the purposes of calculating the levy, the assets held by the branch and subsidiary should be aggregated.

The review team appreciates this concern held by the few foreign bank branches affected and will examine whether this issue can be addressed.

Pooled superannuation trusts (PSTs)

PSTs are a distinct group of superannuation entities which operate under the *Superannuation Industry (Supervision) Act 1993*. They can be used only for the investment of assets of regulated superannuation entities and form part of the managed wholesale pooled funds market. PSTs provide a means to pool the assets of a number of smaller superannuation funds to improve efficiency and achieve a diversity of investments.

Submissions from the superannuation industry suggested that it is not clear whether the cost of supervising these institutions is lower than other superannuation funds. While activities may be carried on within a financial provider group, usually there will be a range of entities involved with different capital structures, and a range of activities which have to meet prudential requirements which vary between activities. They suggested that no reduction should apply to the bulk of PSTs controlled by banks, fund managers and life offices.

One submission suggested that there is a strong case for a reduction in the levy payable in regard to the small number of PSTs used as an administrative device for the investment of funds from a number of corporate superannuation funds under the control of one employer sponsor. It was argued that although the PST in such instances is a separate entity requiring some supervisory attention in its own right, the amount of work for the regulator will be limited given the close links and common control with the relevant corporate superannuation funds. It was also noted that potential conflicts of interest do not arise in regard to such PSTs to the extent that they might for other PSTs given that the employer sponsor ultimately stands behind the solvency of the scheme. The review team considers the general view of industry groups on this issue is worthy of consideration but notes that there are only limited cost savings in the supervision of such entities compared to other arrangements.

Small APRA Funds

Recent legislation which reflects the Government's response to recommendations of the FSI provides that the regulation of self managed superannuation funds (SMSFs) be transferred to the ATO and that all members will be trustees of these funds. These moves are to ensure that all members of self managed funds are able to protect their own interests, and allow these funds to be subject to minimal prudential regulation. Some SMSFs will remain under the supervision of APRA because they make use of an Approved Trustee. (There are currently 4933 Excluded Funds with an Approved Trustee.)

One submission argued that SMSFs which will remain under APRA supervision should pay a flat rate levy which falls between the minimum for regulated superannuation funds and the levy applying to self managed funds supervised by the ATO.

Although the regulation of these funds revolves mainly around the Approved Trustee, these funds are subject to additional oversight compared with those which are supervised by the ATO. The review team agrees that these funds should be charged a rate which falls between the minimum for regulated superannuation funds and the levy applying to self managed funds supervised by the ATO.

Should the levies be calculated and payable by all sectors at the same time?

Under the current legislation the levies are calculated and payable by all industries at the same date, apart from the superannuation industry. The levy on the superannuation sector is based on assets as at 30 June while the levy on all other sectors has previously been based on 31 March assets. The levy is due from all sectors on 1 July, apart for the superannuation sector which is due 6 weeks after the lodgment of an annual return under section 36 of the *Superannuation Industry (Supervision) Act 1993* that relates to the previous financial year.

In practice this means that all industries other than the superannuation industry pay their levies in advance while the majority of levies from the super industry are received in the second half of the financial year (from November through to March).

There is a question as to whether the levy on all sectors should be calculated based on assets at the same date and whether the levy should be due from all sectors on the same date. This would improve equity between sectors. This may also enable groups to be sent a single invoice rather than separate invoices for separate sectors of their business.

Submissions from the superannuation industry opposed any move to bring superannuation funds into line with other financial sectors. They suggested that if super funds were required to pay levies based on 31 March assets there would be considerable compliance costs on the sector.

Industry groups from the super industry suggested that other industries could be brought into line with the super industry. The review team notes, however, that this would cause considerable cash flow problems for the regulators. APRA does not have significant financial reserves and relies on receiving revenue at the beginning of the financial year.

The review team notes that the most consistent approach would be for all industries to pay their levies at the beginning of the financial year based on assets at the same date. However, the review team is also conscious of the potential burden on industry if super funds are required to calculate their levies on a date other than 30 June.

The review team notes that the majority of super funds regulated by APRA will be required to lodge their annual returns sooner from 1 July 2000. From this date the prescribed period for lodgment of annual returns will be reduced from 6 months to 4 months from balancing date. To some extent this will bring super funds closer in line with the time that levies are due from all other sectors.

To what extent should fees and charges be imposed to recover costs associated with specific services undertaken by APRA?

The recent FSI recommended that fees and charges should be imposed to assist in recovering the cost of supervision. Section 51 of the *Australian Prudential Regulation Authority Act 1998* provides for APRA to charge directly for services.

The submissions from industry indicated strong support for a user pays system for non-supervisory elective services. The submissions suggested that fees could be charged for discrete services such as licensing applications, corporate restructures and mergers. One submission stated that such fees should be imposed "on a time spent basis for any particular services that cause regulatory or supervisory involvement above an agreed benchmark". The submissions indicated that the benefits of the service being charged for should clearly accrue to the particular institution being charged.

This approach is consistent with the practice adopted by the Financial Services Authority (FSA) in the United Kingdom. The FSA charges fees for the processing of an application that requires corporate authorisation. For example, they charge 25,000 pounds sterling to process an application to carry out banking business.

The submissions generally opposed a user pays system to the extent that any entity would be required to meet precise estimates of the actual costs of supervision. In this respect the submissions indicated strong support for the broader levy to be the primary source of revenue.

The review team recommends that APRA develop a fee structure that provides for the imposition of charges for extraordinary or special projects that require a major allocation of resources. The review team notes that it is unlikely such a fee structure would provide a significant proportion of revenue necessary to fund the total cost of supervision.

Should the levy imposed on providers of retirement savings accounts be merged with the levy imposed on ADIs?

A levy is currently imposed on the industry of providers of retirement savings accounts. This levy is imposed on a very small number of institutions (less than 20) to recover revenue of around $100,000. As each of the current providers is an ADI it would be possible to recoup this revenue from within the ADI sector. There would be some administrative efficiency gains from merging the assets of these institutions with the associated ADI for the purposes of calculating the levy.

ALTERNATIVE LEVY MODELS

The review team has developed three alternative models for discussion.

These models are based on the cost of supervision for the 1999-2000 financial year. This includes APRA operating expenses of $50 million, APRA establishment costs of $5.4 million and revenue to cover the cost of the functions carried out by ASIC and the ATO of $11.6 million and $2.4 million respectively.

To ensure consistency the scenarios presented do not take into account any over or under collection of levies from the previous financial year. This has a particularly significant impact in the superannuation industry which received a carryforward of around $2 million from the previous financial year. If this carryforward was not available in the current financial year a maximum amount of around $53,500 would have been necessary to provide sufficient revenue from the sector, compared to the $41,000 maximum that was determined.

All three models address the following areas of concerns highlighted in the submissions:

- a concession to foreign bank branches;
- a levy on small APRA funds which make use of an approved trustee between the minimum for regulated superannuation funds ($45) and the levy applying to self managed funds supervised by the ATO;
- absorption of retirement savings account providers into the ADI sector for the purposes of calculating the levy;
- removal of the statutory upper limits where required; and
- adjustments to the minimum amount for illustrative purposes.

The first model is based on the current sectoral approach with minor amendments to take into account those areas of concern listed above and includes options that allow a move towards a more standardised approach across sectors.

The other two models impose levies on group assets rather the current sectoral approach. That is, the levy on a conglomerate would be calculated based on all assets under management rather than separate levies on each sector of the conglomerate's business.

The first of the group assets models imposes the same levy rate on all assets within the group. The second of these group assets models imposes different levy rates according to whether the entities are diversified or specialised.

Within these models there are a large number of possible scenarios that could be adopted. The scenarios presented are for illustrative purposes to assist with discussion.

The following table provides an overall summary of the various models and scenarios and the subsequent part of the paper provides further discussion of the different approaches.

Summary of Alternative Models and Scenarios

Sector		Current	Model 1 - Sectoral Model: Scenario 1	Scenario 2	Scenario 3
Non excluded super	% on assets	0.04	0.04	0.015	0.015
	minimum	$300	$500	$500	$500
	maximum	$41,000	$52,000	$275,000	$148,000
	levy raised ($m)	27.6	29.8	29.8	25.0
	cost of supervision ($m)	29.7	29.7	29.7	29.7
Retirement savings account providers	% on assets	0.02	merged with the ADI industry		
	minimum	$5,000			
	maximum	$18,500			
	levy raised ($m)	0.1			
	cost of supervision ($m)	0.1			
Life insurers	% on assets	0.02	0.02	0.015	0.015
	minimum	$500	$500	$500	$500
	maximum	$280,000	$325,000	$360,000	$360,000
	levy raised ($m)	8.5	8.8	8.9	8.9
	cost of supervision ($m)	8.8	8.8	8.8	8.8
General insurers	% on assets	0.02	0.02	0.015	0.015
	minimum	$5,000	$5,000	$5,000	$500
	maximum	$75,000	$120,000	$150,000	$150,000
	levy raised ($m)	4.8	5.3	5.3	5.0
	cost of supervision ($m)	5.3	5.3	5.3	5.3
ADIs	% on assets	0.013	0.013	0.015	0.015
	minimum	$500	$500	$500	$500
	maximum	$1,000,000	$1,150,000	$1,000,000	$1,500,000
	levy raised ($m)	25.4	21.2	21.0	26.1
	cost of supervision ($m)	25.4	21.5	21.5	21.5
Foreign bank branches	% on assets	included in ADI industry	0.0065	0.0075	0.0075
	minimum		$500	$500	$500
	maximum		$575,000	$500,000	$500,000
	levy raised ($m)		4.0	4.1	4.1
	cost of supervision ($m)		4.0	4.0	4.0
NOHCs	flat rate charge	$10,000	$10,000	$10,000	$10,000
	levy raised ($m)	0.03	0.03	0.03	0.03
	cost of supervision ($m)	0.03	0.03	0.03	0.03
TOTAL LEVY RAISED ($m)		56.4	69.1	69.1	69.1
TOTAL COST OF SUPERVISION ($m)		69.3	69.3	69.3	69.3

Model 2 - Group Model*	Scenario 4	Scenario 5	Scenario 6
% on assets	0.012	0.015	0.02
minimum	$500	$500	$500
maximum	$2,000,000	$1,375,000	$575,000
levy raised ($m)	69	69	69
supervisory cost ($m)	69	69	69
Analysis of levy/costs according to diversified and specialised			
Diversified Institutions			
levy raised ($m)	45	38	31
supervisory costs ($m)	28	28	28
approx. contribution of total levy raised	65%	55%	45%
Specialised Institutions			
levy raised ($m)	24	31	38
supervisory costs ($m)	41	41	41
approx. contribution of total levy raised	35%	45%	55%

* This model provides for a concession on foreign bank branches and a fee less than $500 to be imposed on small APRA funds which make use of an approved trustee.

Model 3 - Specialised and Diversified Group Model*	Scenario 7	Scenario 8	Scenario 9
Diversified Institutions			
% on assets	0.017	0.02	0.015
minimum	$500	$500	$500
maximum	$775,000	$800,000	$1,550,000
levy raised ($m)	28	31	41
supervisory costs ($m)	28	28	28
approx. contribution of total levy raised	40%	45%	60%
Specialised Institutions			
% on assets	0.022	0.02	0.02
minimum	$500	$500	$500
maximum	$775,000	$800,000	$200,000
levy raised ($m)	41	38	28
supervisory costs ($m)	41	41	41
approx. contribution of total levy raised	60%	55%	40%

* This model provides for a concession on foreign bank branches and a fee less than $500 to be imposed on small APRA funds which make use of an approved trustee.

Note: the levy raised in the current year took account of the carry forward from the previous financial year.

Model 1 – Sectoral Model

This model is based on the current sectoral approach while taking into account the primary areas of concern outlined above. This would involve only minimal legislative change to the current framework. The disadvantage of this model is that it continues to rely on the availability of accurate information relating to sectors. As mentioned, these costs are becoming increasingly difficult to calculate.

Scenario 1 leaves most percentage sectoral rates unchanged. It shows that if the minimum amount payable by super funds is increased from $300 to $500, the maximum payable by these entities could be reduced (from $53,500 if no carryforward) to $52,000. A 50 per cent concession is provided to foreign bank branches. The maximum payable by ADIs needs to be marginally increased to $1,150,000.

Scenario 2 incorporates the most of the changes mentioned above while applying the same percentage on assets across all sectors. This approach may reflect the move to a more consistent approach to regulation. The percentage rate on assets chosen (0.015 per cent) is marginally greater than that imposed on the ADI sector and significantly less than imposed on the super industry. As shown in the table below, a reduction in the percentage rate on assets necessitates significant increases in the maximum levies payable by the superannuation and insurance industries.

Scenario 3 illustrates a schema involving a uniform percentage on assets and uniform minimum for all sectors. There are differences in the maximum amount payable by each sector; the very significant increase in the maximum for the superannuation industry is tempered compared to Scenario 2. The revenue from each sector broadly reflects but does not precisely equal the cost of supervising that sector. This Scenario could represent a step towards a more consistent or group based framework.

Sector		Current	Model 1 - Sectoral Model		
			Scenario 1	Scenario 2	Scenario 3
Non excluded super	% on assets	0.04	0.04	0.015	0.015
	minimum	$300	$500	$500	$500
	maximum	$41,000	$52,000	$275,000	$148,000
	levy raised ($m)	27.6	29.8	29.8	25.0
	cost of supervision ($m)	29.7	29.7	29.7	29.7
Retirement savings account providers	% on assets	0.02	merged with the ADI industry		
	minimum	$5,000			
	maximum	$18,500			
	levy raised ($m)	0.1			
	cost of supervision ($m)	0.1			
Life insurers	% on assets	0.02	0.02	0.015	0.015
	minimum	$500	$500	$500	$500
	maximum	$280,000	$325,000	$360,000	$360,000
	levy raised ($m)	8.5	8.8	8.9	8.9
	cost of supervision ($m)	8.8	8.8	8.8	8.8
General insurers	% on assets	0.02	0.02	0.015	0.015
	minimum	$5,000	$5,000	$5,000	$500
	maximum	$75,000	$120,000	$150,000	$150,000
	levy raised ($m)	4.8	5.3	5.3	5.0
	cost of supervision ($m)	5.3	5.3	5.3	5.3
ADIs	% on assets	0.013	0.013	0.015	0.015
	minimum	$500	$500	$500	$500
	maximum	$1,000,000	$1,150,000	$1,000,000	$1,500,000
	levy raised ($m)	25.4	21.2	21.0	26.1
	cost of supervision ($m)	25.4	21.5	21.5	21.5
Foreign bank branches	% on assets	included in ADI industry	0.0065	0.0075	0.0075
	minimum		$500	$500	$500
	maximum		$575,000	$500,000	$500,000
	levy raised ($m)		4.0	4.1	4.1
	cost of supervision ($m)		4.0	4.0	4.0
NOHCs	flat rate charge	$10,000	$10,000	$10,000	$10,000
	levy raised ($m)	0.03	0.03	0.03	0.03
	cost of supervision ($m)	0.03	0.03	0.03	0.03
TOTAL LEVY RAISED ($m)		66.4	69.1	69.1	69.1
TOTAL COST OF SUPERVISION ($m)		69.3	69.3	69.3	69.3

Note: the levy raised in the current financial year took account of the carryforward from the previous financial year.

Model 2 – Group Model

This model provides for a single levy rate to be imposed on all assets held within a group. To some extent, this reflects changes that have been made in the manner in which APRA conducts its supervision of institutions. Although APRA will still need to undertake statistical and other analysis at the entity level, the important questions of management control and systems adequacy can be reviewed for the group as a whole. Similarly, consultations can be conducted with a group perspective in mind.

The table below presents three scenarios to demonstrate how a group based levy could be imposed.

- In **Scenario 4** a relatively low percentage levy (0.012 per cent) is modelled. Under this scenario sufficient revenue could be raised with the maximum levy set at $2 million. This amount would be payable by the 13 largest groups.

- In **Scenario 5** a percentage on assets of 0.015 is modelled. The amount payable by any single group would be $1,375,000.

- In **Scenario 6** a relatively high percentage levy of 0.02 per cent is modelled. A total of 29 groups would be required to pay the maximum levy of $875,000 under this scenario, including four large corporate super funds.

At this stage it is difficult to allocate supervisory costs between diversified and specialised institutions. APRA has not operated in this form for an entire financial year while the other regulators (ASIC and the ATO) have not formally accounted for costs in this manner. For the purposes of this analysis, the cost of supervising specialised institutions is estimated to be around 60 per cent of the total, with the cost of supervising diversified institutions accounting for the remainder. Based on these cost estimates there is some cross subsidy of specialised institutions by diversified institutions in the scenarios shown. Scenario 4 involves the greatest cross subsidy.

Model 2 - Group Model*

	Scenario 4	Scenario 5	Scenario 6
% on assets	0.012	0.015	0.02
minimum	$500	$500	$500
maximum	$2,000,000	$1,375,000	$875,000
levy raised ($m)	69	69	69
supervisory cost ($m)	69	69	69

* This model provides for a concession on foreign bank branches and a fee less than $500 to be imposed on small APRA funds which make use of an approved trustee.

Diversified Institutions			
levy raised ($m)	45	38	31
supervisory costs ($m)	28	28	28
approx. contribution of total levy raised	65%	55%	45%

Specialised Institutions			
levy raised ($m)	24	31	38
supervisory costs ($m)	41	41	41
approx. contribution of total levy raised	35%	45%	55%

Model 3 – Specialised and Diversified Group Model

This model is based on the previous group based model with the added flexibility to impose different levies on diversified and specialised institutions. This sort of approach would require some difficult decisions on criteria for classifying institutions in this manner. Under Scenarios 7 and 8 an attempt is made to collect an amount from the diversified and specialised areas broadly in line with the cost of supervising these types of institutions.

Scenario 7 presents the same minimum and maximum levy amounts for both the diversified and specialised institutions. A greater percentage on assets is required on the specialised institutions in order to raise an amount broadly similar to the cost of supervising these entities. This Scenario would impose a greater levy on large super funds and insurers than currently, while reducing the levy on large banks.

Scenario 8 presents the same percentage on assets and minimum with the maximum payable set at an amount necessary to broadly raise sufficient revenue from that group.

Under **Scenario 9** a levy is collected from diversified institutions beyond the cost of supervising these institutions. It may be argued that this approach reflects the greater capacity that these institutions have to pay.

very hard for labour aligned funds.

9 least worst.

lower max than what

New player

Model 3 - Specialised and Diversified Group Model*

	Scenario 7	Scenario 8	Scenario 9
Diversified Institutions			
% on assets	0.017	0.02	0.015
minimum	$500	$500	$500
maximum	$775,000	$800,000	$1,550,000
levy raised ($m)	28	31	41
supervisory costs ($m)	28	28	28
approx. contribution of total levy raised	40%	45%	60%

Specialised Institutions			
% on assets	0.022	0.02	0.02
minimum	$500	$500	$500
maximum	$775,000	$800,000	$200,000
levy raised ($m)	41	38	28
supervisory costs ($m)	41	41	41
approx. contribution of total levy raised	60%	55%	40%

Credit U. Super Building societies

Use step rate to keep max under control

* This model provides for a concession on foreign bank branches and a fee less than $500 to be imposed on small APRA funds which make use of an approved trustee.

ATTACHMENT 1: TERMS OF REFERENCE FOR REVIEW

Mission

The Review is required to undertake an evaluation of the current levy arrangements in terms of their ability to provide an effective funding mechanism for the supervision of prudentially regulated institutions*. Recommendations will be made on any changes that are required to the current arrangements to ensure that there is an efficient, equitable and durable funding mechanism capable of meeting needs well into the future.

Specifics

1. The Review will examine concerns expressed by institutions and industry bodies based on the operational experience with the existing arrangements. Issues that will need to be considered include:

   - the present sectoral approach to cost recovery;
   - the application of a levy on each licenced or authorised entity;
   - the position of those entities which operate in more than one sector; and
   - the different provisions regarding timing of payments for superannuation as compared with the other sectors.

2. The Review will recommend any changes to the current arrangements that might be considered necessary to provide a mechanism that meets the broad objective outlined above and is generally acceptable to stakeholders. In doing so, consideration should be given to the following factors:

   - the scope for a uniform levy arrangement, bearing in mind the changing structure of the financial sector;
   - the extent to which it is feasible to relate levy payments more closely to the level of supervision incurred; and
   - the most appropriate basis for determining relative levy shares amongst prudentially regulated institutions.

3. The Review should also have regard to the capacity for APRA and ASIC to charge directly for services.

4. The scope of the Review does not extend to making recommendations regarding the appropriateness of the operational or other costs associated with supervision.

5. In carrying out its investigations, the Review may invite submissions and hold discussions with relevant industry bodies or prudentially regulated institutions.

6. The Review will consult with the Australian Securities and Investments Commission and the Australian Taxation Office.

7. A final report is to be provided to the Minister for Financial Services and Regulation no later than 8 October 1999.

* The cost of supervision of these institutions includes the operational costs of the Australian Prudential Regulation Authority (APRA) and consumer protection functions carried out by the Australian Securities and Investments Commission (ASIC) and the Australian Taxation Office (ATO). In the initial years, the levies also recover the establishment costs associated with APRA and ASIC.

ATTACHMENT 2: INTERNATIONAL FINANCIAL SECTOR LEVY MODELS

United Kingdom

- Sectoral levy to recover all costs incurred by Financial Services Authority (FSA) and other regulatory bodies.
- Banks' annual assessment fee is based on all eligible liabilities* plus one-third of foreign currency liabilities. The charge is £54 per million of the fee base. The minimum fee is £10,000 with no maximum set. All Banks are regulated by FSA. (*Based on all deposits of Sterling).
- Foreign banks are charged at £18 per million of the fee base. Bank branches that cannot accept deposits are not charged a fee. The minimum fee is £10,000 with no maximum.
- Insurance companies are levied at flat rates based on total insurance premium revenue falling within revenue 'bands'. The lowest band fee is £1,000 for premium revenue of between £0.50 million to £2.0 million. Regulated by the Insurance Directorate of HM Treasury.
- Fund management, unit trust groups, occupational pension funds, merchant banks and clearing banks and venture capitalists are self-regulated by the Investment Management Regulatory Authority (IMRO). There is a minimum annual tariff of £2,355 with no maximum. Fees are established on the basis of £2,355 plus a percentage for 'funds managed', plus a percentage for 'advice given'.
- Largest annual fee paid by any UK financial institution is £4.9 million.
- British government is attempting to consolidate the FSA, the Insurance Directorate of HM Treasury, the Investment Management Regulatory Authority (IMRO), Building Societies Commission, Friendly Societies Commission, Personal Investment Authority and the Securities and Futures Authority under the umbrella of the FSA by October 2001 at the earliest. Once consolidated, the FSA will look towards a more standardised levy base.

Canada

- Sectoral levy to recover all costs related to regulation by the Office of Superintendent of Financial Institutions (OSFI).
- Minimum assessment fee of $10,000 on banks, foreign banks, trust and loan companies, and applicable cooperative credit associations **plus** a percentage based on assets held in previous fiscal year.
- Minimum assessment fee of $10,000 on Life, Property and General insurers **plus** a percentage based on net premiums received during the preceding fiscal year.
- OSFI's annual budget is approximately $46 million. Banks, trust and loan companies contribute 39 per cent, life insurers and fraternal benefit societies provide 26 per cent, property insurers provide 20 per cent, cooperative credit associations provide 1 per cent and 'others' provide 8 per cent.
- OSFI are considering moving towards a 'group assessment' model in 2001-02.