NRMA Insurance Group - Submission to the Productivity Commission inquiry into Cost Recovery by Commonwealth Government Regulatory, Administrative and Information Agencies

Summary

- NRMA Insurance Group supports the general principle of cost recovery from regulated industries as an efficient and equitable means of funding regulatory agencies. There are, however, a number of actual or potential problems with this approach which can detract from its equity and efficiency in specific circumstances.

- NRMA Insurance Group recognises the difficulties associated with designing an efficient and equitable levy system for supervising financial institutions. Nevertheless, the existing system of cost recovery by the Australian Prudential Regulation Authority (APRA) has a number of weaknesses, the most significant of which are: the levies do not necessarily reflect the real cost of supervision; double-counting of assets; inequitable minimum and maximum levy rates; and the lack of specific charges for non-supervisory activities.

- The fact that APRA is fully funded by industry levies ignores the wider economic benefits that flow from prudential supervision. This provides a justification for at least some contribution to APRA's funding from Consolidated Revenue.

- In reviewing the APRA levy system NRMA Insurance Group supports a system where the amount of levy paid reflects the degree of supervision as this will create an incentive for sound financial management.

- APRA should also seek to develop transparent measures of supervisory costs for the industries that it regulates, and report regularly on its performance and cost levels. The reporting should be done on a six-monthly basis, which is the same as APRA requires of the companies that it supervises.

- NRMA Insurance Group is concerned that there is some possible duplication of regulatory functions between the Australian Securities and Investments Commission (ASIC) and APRA, and this is resulting in an additional cost burden on financial services providers and their customers.

- ASIC appears to be recovering more than its costs through fees and charges on industry. This is effectively a tax on industry and is resulting in higher costs to consumers and reducing the competitiveness of Australia's financial services sector.

- The proposed ASIC fee levels set out in the CLERP7 paper appear arbitrary in some areas and could lead to a further over-recovery of costs.

Introduction

The NRMA Insurance Group is the largest general insurer in Australia, with approximately 6.2 million general insurance policies issued as at 31 March 2000 and gross written premium in excess of $2.6 billion for the year ended 30 June 2000. The Group provides a full range of personal insurance products and a number of commercial insurance products. The Group also provides a wide range of other financial services products, including building society savings and loans products, superannuation, life insurance and managed investments.

Since the mid-1990's, NRMA Insurance Group has expanded its base beyond New South Wales. In 1997, it acquired the NRMA Building Society, broadening the Group's range of financial services products. In 1998, it purchased SGIO, which enabled it to extend its geographic base to Western Australia and South Australia and to extend its product lines into commercial, workers' compensation and health insurance. In 1999, NRMA Insurance Group entered into a joint venture with RACV, which significantly expanded its short-tail personal insurance business in Victoria.

The two main Commonwealth regulatory agencies that NRMA Insurance Group has dealings with are the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC). Consequently, our submission focuses on the cost recovery arrangements for these two agencies. These specific comments follow some general comments on the issue of cost recovery in the financial services sector.

General Comments on Cost Recovery

As a general principle, NRMA Insurance Group supports cost recovery by regulatory agencies through fees/charges on the regulated industry. This approach has a number of advantages, including:

- It is usually equitable because each industry pays for its own regulation. This means that industries that require relatively light regulation are not forced to pay for those that need a heavier and more costly level of regulation.

- Cost recovery through regulatory fees will also generally be economically efficient because industry is faced with the true cost of regulation.

- Regulatory fees will normally provide a stable source of revenue for the regulatory agency. This often creates more certainty than having to rely on annual budgetary funding.

While recognising these advantages of a full cost recovery system that is based on charges on the regulated industry, there are also a number of actual or potential problems with this approach. If these problems are not adequately addressed there is a risk that the advantages of a cost recovery system could be outweighed by the disadvantages. The problems that may occur with this approach are:

- Where the regulator is not subject to market discipline on its costs (or some other type of accountability over its cost levels) there is a risk that cost levels may be excessive, resulting in the charges on industry being too high. This risk is particularly likely to exist where the regulator does not face any competition in providing its regulatory service. The economic impacts of over-charging will be most severe in situations where the regulated industry faces international competition, as is the case for many types of financial services. For example, if regulatory fees for investing in managed funds are higher in Australia than overseas then Australian funds managers will have difficulty attracting investment into their funds. This is a particularly important issue given the Commonwealth Government's stated policy of positioning Australia as a global financial services centre.

- A full cost recovery system often treats all industry participants equally and does not provide incentives for the participants that require a lesser level of supervision or regulation. This will result in cross-subsidisation in that some participants within the industry will pay more than the true cost of regulating them and others will pay less than the true cost. An example of this situation is the APRA industry levies which do not necessarily reflect the cost of prudential supervision for each institution (this is discussed in more detail below).

- A system of full cost recovery through industry based regulatory charges may not allow for the wider economic benefits that flow from a well regulated industry. For example, all Australian consumers and businesses benefit from a stable financial system in which all financial services providers are required to meet minimum prudential and consumer protection standards. These standards enhance consumer and business confidence in the financial system and thus improve the efficiency of the overall system and attract additional savings for investment. Due to the existence of these wider economic benefits from regulation in the financial sector there is a strong argument for funding at least part of the cost of prudential supervision and consumer protection from general budgetary revenue rather than from industry levies or charges.

- Industry charges can often involve significant collection costs, both for the agency collecting the charges and for industry. This provides a further justification for at least partly funding the agency from Consolidated Revenue.

Cost Recovery by Specific Agencies

In addition to the above general comments, NRMA Insurance Group has a number of more specific comments on cost recovery by the Commonwealth regulatory agencies that it deals with.

Australian Prudential Regulation Authority (APRA)

As a diversified financial institution NRMA Insurance Group pays four separate APRA supervisory levies - general insurance supervision levy, life insurance supervision levy, authorised deposit taking institutions supervision levy and superannuation supervision levy.

The amount of levy paid in each category is based on a percentage of assets, subject to minimum and maximum levy amounts. The percentage rates and maximum and minimum rates are set annually based on the estimated amount of revenue needed to cover the cost of supervising each entity. The system is designed to ensure that APRA fully recovers from industry the costs of prudential supervision.

In 1999 the total levy payment by the NRMA Insurance Group was approximately $430,000. For the general insurance category the Group pays the maximum levy, which was $75,000 in 1999/2000 and has increased to $100,000 in 2000/01.

While acknowledging that, as APRA claimed at the recent review of its activities by the House of Representatives Standing Committee on Economics, Finance and Public Administration, 'it is virtually impossible to come up with a formula for calculating levy rates for cost recovery ... that will satisfy everybody every year'[1], NRMA Insurance Group offers the following comments about the existing levy system.

- **Wider economic benefits from prudential regulation:** As noted earlier there is a strong case for not funding prudential supervision entirely from industry levies. In view of the significant wider economic benefits that flow from a stable and secure financial system, a proportion of APRA's funding should come from Consolidated Revenue.

- **Lack of transparency in costs:** As noted in the report by the Australian National Audit Office (ANAO) on Commonwealth non-primary industry levies[2], APRA has difficulties in differentiating between program costs and administration costs. The report notes that agency reporting arrangements were generally not sufficiently comprehensive to provide a clear understanding of levy costs and revenue. The ANAO report also noted a lack of transparency in costs, and NRMA Insurance Group is concerned that this can result in levies being set at levels that do not accurately reflect costs.

- **Levies do not accurately reflect the amount of supervision required:** Related to the above point, the current levy system can result in cross-subsidisation between different participants within an industry. For example, two participants may have the same level of assets, and thus pay the same levy, but one may require more stringent supervision or regulation. In order to avoid this problem, NRMA Insurance Group believes that the levy imposed on each institution should be set more on a risk-based approach under which the levies depend on the degree of supervision or monitoring required. A significant advantage of this approach would be that it would provide an incentive for sound prudential management by financial institutions because those that are well-managed and require less supervision would pay lower levies.

- **Minimum levy rates:** The use of minimum levy rates also results in cross-subsidisation because the current minimum levies are unlikely to cover the costs of

[1] House of Representatives Standing Committee on Economics, Finance and Public Administration - Review of the Australian Prudential Regulation Authority: Who will guard the guardians? October 2000.

[2] Australian National Audit Office, Audit Report No.32 1999-2000, Management of Commonwealth Non-primary Industry Levies

supervision. If anything the degree of cross-subsidisation between smaller and larger institutions has probably increased in recent years because the maximum levy for general insurers has increased from $55,000 in 1998/99 to $100,000 in 2000/01, while the minimum has remained unchanged at $5,000. Furthermore, the minimum levy rate of $300 for superannuation funds is unlikely to cover the cost of surveillance and supervision.

- **Double counting of assets:** Another shortcoming of the current levy system is that it leads to a double counting of assets in some areas. This is particularly the case for superannuation as many super funds invest in policies held in Statutory Funds of life insurance companies, which may in turn invest in managed funds (according to Treasury's report on the financial sector levy review around 80 % of assets held by life companies relate to super funds). The overall effect is that more than one levy can apply to the same assets. While accepting the need for each entity to be supervised multiple counting of assets is not an equitable basis for establishing the levies.

- **Fees for elective services:** Where possible, it would be appropriate to introduce a direct user-pays system for non-supervisory elective services (e.g. licensing applications, corporate restructures). This would be a more equitable way of funding these services than through the general levies. In addition, revenue from these charges should be retained by APRA rather than being returned to Consolidated Revenue.

- **Cost recovery for conglomerates:** As noted above NRMA Insurance Group offers general and life insurance, building society products, superannuation and other financial services such as managed investments. This means that, like many other institutions, it is paying multiple APRA levies. In view of the trend towards institutions becoming conglomerates it would appear to be more appropriate to move towards a single levy structure for the overall entity. We note that APRA is intending to move towards a more common levy framework, as stated in its 1999 Industry Consultation paper, and we support this intention as it will help to improve the efficiency of prudential supervision as well as eliminate inequities that exist in current arrangements.

- **Regulatory overlap:** Another issue is the potential for duplication of regulation by different agencies. Both APRA and ASIC play important roles in regulating the financial services sector. There is a danger, however, that even though they co-operate closely in performing their regulatory functions there could be some duplication or overlap between the two agencies, resulting in higher regulatory costs. This will be a particularly important issue when the Financial Services Reform Bill comes into effect. For example, ASIC will be responsible for ensuring that financial services licensees maintain sufficient financial resources, but for some licence holders this could duplicate the supervisory function that is carried out by APRA.

NRMA Insurance Group is aware that the APRA levy system is to be reviewed in 2003. Consequently, we would seek the above issues to be addressed in that review and in any other earlier reviews.

Key points

- NRMA Insurance Group recognises the difficulties associated with designing an efficient and equitable levy system for supervising financial institutions. Nevertheless, the existing system of cost recovery by APRA has a number of weaknesses, the most significant of which are: the levies do not necessarily reflect the real cost of supervision; double-counting of assets; inequitable minimum and maximum levy rates; and the lack of specific charges for non-supervisory activities.

- The fact that APRA is fully funded by industry levies also ignores the wider economic benefits that flow from prudential supervision. This provides a justification for at least some contribution to APRA's funding from Consolidated Revenue.

- In reviewing the APRA levy system NRMA Insurance Group supports a system where the amount of levy paid reflects the degree of supervision as this will create an incentive for sound financial management.

- In order to ensure that the cost of APRA's regulatory activities are kept at reasonable levels, APRA should be required to provide transparent information on its costs on a regular basis e.g. every six months. In addition, performance measures should be developed and outcomes reported on regularly so as to ensure that industry is receiving value for money.

- NRMA Insurance Group is concerned that there is some possible duplication of regulatory functions between ASIC and APRA, and this is resulting in an additional cost burden on financial services providers and their customers.

Australian Securities and Investments Commission (ASIC)

ASIC collects fees from industry for a range of regulatory activities including: occupational licensing; incorporation and registration of companies; annual returns and accounts; fundraising (e.g. prospectuses); and supply of information.

As foreshadowed in the Corporate Law Economic Reform Program Paper No. 7 (CLERP7) - Simplified Lodgments and Compliance - the Commonwealth Government is proposing significant changes to both the types and levels of regulatory fees that are collected by ASIC. The proposed fees were outlined in the above paper and the Government requested comments on this issue.

Although the new regulatory fees have not been finalised the CLERP7 paper outlines the principles on which the proposed fees are based. The fees are intended to cover: the costs of ASIC; compensation payments to the States for revenue forgone as a result of the establishment of a national scheme; costs of other bodies that form part of the national companies regulation scheme (e.g. the Australian Accounting Standards Board); and related costs for bodies that perform functions arising out of the administration and regulation of the national scheme (e.g. the Federal Police).

The CLERP7 paper also notes that since 1996-97 revenue from fees has exceeded costs. These surpluses have been used to offset the deficit of $217.6m that the national scheme incurred between 1991-92 and 1995-96, and the accumulated deficit is expected to be eliminated in 2000-01. The elimination of this deficit would suggest that any further surpluses would in effect be an over recovery of the costs of regulation.

According to the 1999-2000 ASIC Annual Report the net cost of providing its regulatory services was $135.3m, approximately the same as the previous year. Revenue collected from fees and charges was $361m in 1999-2000, a 9% increase on the previous year.

While it is not possible to determine the contribution that the fees/charges make to funding other agencies involved in corporate regulation, it appears that the level of charges significantly exceeds the cost of providing the regulatory services. Furthermore, as the Investment and Financial Services Association (IFSA) has pointed out the proposed changes to fees under CLERP7 are projected to lead to a significant increase in fee revenue for ASIC and potentially an even greater over-recovery of regulatory costs.

Based on the above information, we offer the following comments on the existing and proposed funding arrangements for ASIC.

- The over-recovery of costs that appears to have occurred in recent years, and which is projected to continue, will increase the cost of financial services because the higher regulatory costs on industry will be at least partly passed on to consumers. This could impact adversely on overall savings levels in Australia.

- As discussed earlier any excess cost burden on Australian financial services providers will reduce Australia's international competitiveness in that industry. This is an important concern given the Government's policy of positioning Australia as an international financial services centre.

- As noted by IFSA in their submission on the CLERP7 consultation paper the proposed charges appear to be quite arbitrary rather than reflective of the real costs involved in the various regulatory activities. This will not only result in over-recovery of costs, but will also create inequities because some participants will pay more than the true costs and other participants may pay less.

Key points

- ASIC appears to be recovering more than its costs through fees and charges on industry. This is effectively a tax on industry and is resulting in higher costs to consumers and reducing the competitiveness of Australia's financial services sector.

- The proposed fee levels set out in the CLERP7 paper appear arbitrary in some areas and could lead to a further over-recovery of costs.