



# Proposed Financial Industry Levies for 2014-15

**13 June 2014**

**AIST Submission**

## AIST

**The Australian Institute of Superannuation Trustees** is a national not-for-profit organisation whose membership consists of the trustee directors and staff of industry, corporate and public-sector funds who manage the superannuation accounts of nearly two-thirds of the Australian work force.

As the principal advocate and peak representative body for the \$600 billion not-for-profit superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

AIST provides professional training, consulting services and support for trustees and fund staff to help them meet the challenges of managing superannuation funds and advancing the interests of their fund members. Each year, AIST hosts the Conference of Major Superannuation Funds (CMSF), in addition to numerous other industry conferences and events.

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## 1 Executive summary

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AIST supports a regular consultation process of the levies methodology. The process should be with representatives of the entities that pay the levies and any process to change the levies must follow due process.

AIST applauds the Government's focus on due process and calls for it to be better applied in the setting of financial industry levies.

*We have restored due process to the governmental system in Canberra. The ten day rule applies for Cabinet decisions. Cabinet submissions have to go into the Cabinet Secretariat ten days before they are discussed. Now, you might think that's just a paper work rule but if you don't get these things right, you don't get the decisions right because if people don't have time to reflect on the submission, to reflect on the decision, if the various experts don't have time to chew over all the consequences of these proposed decisions, invariably you end up getting important details wrong.*

Prime Minister, the Hon Tony Abbott MP<sup>1</sup>.

Unfortunately, the levies proposed in the Treasury/Australian Prudential Regulation Authority paper would be set in a manner that is not consistent with the policy and legislative basis for the levies; APRA is not ready to collect some of the levies if there is a change to some of the methodologies nor be fully transparent on its impact; and the levies do not provide for the fair and reasonable allocation of costs.

This is neither surprising nor unexpected. These issues are explicitly identified in the Treasury/APRA paper and Treasury's Methodology Review Response Paper of 16 April 2014, and were noted by AIST during the consultation on the levies methodology<sup>2</sup>.

The key issues are:

1. The levies should be applied in accordance with the revised Cost Recovery Guidelines (CRGs). The CRGs are under review, and will only be able to inform the 2015-16 levies determination process.
2. The CRGs require a Cost Recovery Impact Statement (CRIS). The updated APRA CRIS has not been released and so cannot be used to provide transparency on how their regulatory activity is recovered through the levies process.

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<sup>1</sup> Abbott, A. (2013). *Address to the Western Australian Liberal State Council, Perth*. [speech] 9 November 2013: Western Australian Liberal State Council, Perth. Available at: <http://tinyurl.com/p2zwc3m> [accessed 13 June 2014].

<sup>2</sup> AIST, (2013). *Financial Industry Supervisory Levy Methodology Discussion Paper*. [pdf] Melbourne: Australian Institute of Superannuation Trustees. Available at: <http://tinyurl.com/c3zeobd> [Accessed 11 Jun. 2014]

3. The case for setting the SuperStream component on a member basis has not been made, with the APRA billing infrastructure currently unable to implement the levy on this basis in any event.

Given these issues, AIST strongly recommends that any change to the methodologies for 2014-15 be deferred until 2015-16.

AIST welcomes the chance to discuss alternative modelling proposals for the collection of levies on the financial sector but emphasise the need for stakeholders to have all of the information they need to assess the proposals, their impact and equity. The absence of this information will lead to some bizarre outcomes. For example, where a fund has under a twentieth of a percent of the total monies under administration in Australia's superannuation system yet is liable for 4.3% of the total SuperStream portion. This would not have occurred if there was more information available and greater attention was paid to due process.

AIST also submits that the costs of SuperStream implementation should not be borne entirely by APRA regulated funds. Self-Managed Superannuation Funds hold almost one-third of superannuation assets and should make a commensurate contribution to the cost of SuperStream implementation, with the SuperStream component of the APRA levy reduced accordingly.

As part of meeting the Government's transparency requirements, the cost allocation for the Superannuation Complaints Tribunal should be separately identified as it has been previously.

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## 2 Consultation issues

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### 2.1 Background and context

One of the OECD principles of financial consumer protection says that there should be responsible business conduct by financial services providers, drawing the nexus between consumer behaviour and increased transparency:

*The principle of responsible business conduct is important in order to ensure that financial services providers and authorised agents act fairly, honestly, professionally and with due skill, care and diligence when dealing with consumers. Duty of care is necessary in addition to improved transparency because consumers have bounded rationality and therefore cannot be expected to always make decisions that are in their own best interest<sup>3</sup>.*

We note that transparency was a key pillar of the election of the Government. Prior to the election, the Government, when they were in opposition, wrote this with respect to productivity and regulation<sup>4</sup>:

*Under Labor's own rules, government departments and agencies are required to prepare Regulation Impact Statements for regulatory proposals that are "likely to have a regulatory impact on business or the not-for-profit sector, unless that impact is of a minor or machinery nature and does not substantially alter existing arrangements.*

At the time the levies methodology was under review in May 2013, AIST wrote that we supported the aims of the CRG – to ensure “consistency, transparency, and accountability, and the promotion of the efficient allocation of resources”. We consider this to be vital to the financial sector generally, but more specifically to the superannuation sector, which represents key public policy with regards to retirement savings. The trustee-beneficiary nature of superannuation requires transparency. Ultimately, Government levies are drawn from members’ accounts.

We considered that<sup>5</sup>:

Lack of consistency, transparency and accountability arise from two key issues:

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<sup>3</sup> Chapman, M. (2013). *The G20/OECD High-Level Principles on Financial Consumer Protection*. [presentation] Geneva: Organisation for Economic Co-operation and Development.

<sup>4</sup> Liberal Party of Australia, (2014). *Boosting Productivity and Reducing Regulation*. [online] Available at: <http://tinyurl.com/onm6lxz> [Accessed 12 Jun. 2014].

<sup>5</sup> AIST, (2013). *Financial Industry Supervisory Levy Methodology Discussion Paper*. [pdf] Melbourne: Australian Institute of Superannuation Trustees. Available at: <http://tinyurl.com/c3zeobd> [Accessed 11 Jun. 2014], p.4.

1. The Cost Recovery Guidelines have not been applied to either the existing levy structure or to the *Proposed Financial Industry Levies for 2012-13*.
2. The Cost Recovery Guidelines themselves are also under review (while noting AIST's support for its basic tenets).

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

We additionally noted that the lack of transparency around levies means that it is difficult to scrutinise the methodology itself as to whether this is appropriate or reasonable.

AIST considers that in this environment, the industry cannot seriously entertain the possibility of change to the existing methodology.

## 2.2 Particular issues arising from lack of application of CRG

The underlying principle of cost recovery is that agencies can set charges to recover all costs of a product or service where it is efficient and efficient to do so, where the beneficiaries are a narrow and identifiable group, and where charging is consistent with government policy objectives. The CRG require – among other things – that APRA recovers only those costs that are integral to prudential regulation and are the minimum necessary to deliver services and that the industry is consulted about the levy methodology and its application.

In our submission of May last year, we noted that:

The overall lack of transparency as to what items fall into each “pot” of the levy – restricted (supervisory) or unrestricted (systemic) – makes it difficult for the superannuation industry to determine whether the principles of the CRG have been applied to the composition of the levy. Examples include:

1. The lack of preparation of a CRIS means that there is an associated lack of rigor regarding whether the costs are appropriate and reasonable.
2. Whether the levies include what the CRG describes in key principle 7 as an agency's “basic information product set” – which are not cost recoverable. For example, the *Financial Industry Supervisory Levy Methodology Discussion Paper* (April 2013) notes in 4.1 that APRA publications and statistical data collection are included.
3. There is little or no explanation which communicates the rationale for the setting of the current parameters (eg. the percentage rate or the minimum and maximum thresholds).

The lack of transparency of process is exacerbated by AIST's belief that, with the exception of the SuperStream levy, costs attributable to regulators including APRA are unlikely to reduce over time.

We note that closer attention has been paid in this paper to the SuperStream portion of the levies. Nevertheless, we are unable to offer an opinion in the absence of a CRIS.

We further note relevant comments made by the Treasurer, the Hon. Joe Hockey MP, who made the following points about government expenditure<sup>6</sup>:

*Since coming to office, we have carefully and methodically looked at all areas of Government spending... Australians are always prepared to make a reasonable contribution if they know their money is not wasted.*

AIST considers that the same reasoning that would apply to the Government or ordinary Australians is very much applicable to entities in the financial sector as well: The rationale and methodology for the levies is unclear, and Australians will foot the bill for these costs.

Financial sector levies are substantial and are eventually charged to the pockets of working Australians. At this point – without the CRG being applied, we do not know the composition of the levies or whether they are being raised fairly. We do not even know, as explained above, whether the levies contain an agency's "basic information set" costs, which aren't recoverable.

AIST also points to comments made in the discussion paper of November 2013, *Better regulation and governance, enhanced transparency and improved competition in superannuation*. The then Assistant Treasurer, Senator the Hon Arthur Sinodinos AO wrote in the forward to this discussion paper, that<sup>7</sup>:

*The Abbott Government is committed to ...enhancing transparency in the superannuation system...*

*[The Government is] committed to improving the quality of information available to superannuation fund members and employers, which helps them to make informed decisions ... A more informed market will lead to greater competition, consequently delivering increased value to consumers...*

*The Government is keen to ensure that superannuation regulation maximises benefits to members while minimising disruption and compliance costs to the sector.*

We consider that, given the quantum of the levies to be charged to the sector, information that must be provided about the levy composition must be critically benchmarked against the costs of the levy itself.

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<sup>6</sup> Hockey, J. (2014). *Budget speech 2014-15 delivered on 13 May 2014 on the Second Reading of the Appropriation Bill (No. 1) 2014*. [speech] 13 May 2014: House of Representatives, Parliament House, Canberra. Available at: <http://tinyurl.com/lg8yf9c> [accessed 13 June 2014].

<sup>7</sup> Sinodinos, A. (2014). 'Forward'. In: The Treasury, *Better regulation and governance, enhanced transparency and improved competition in superannuation*. [discussion paper] Canberra: The Treasury, p.5.

Superannuation funds and their members need to know what they are receiving from the application of funds received by the regulators through the levying process.

Given the lack of transparency and accountability regarding either the imposition or breakdown of the levies, AIST recommends that there be no parameter change to the levy until such time as the CRG has been reviewed and that a Cost Recovery Impact Statement (CRIS) regarding the levies has been drafted together with a suitable consultation process. This method would have no financial impact on the Government.

Further to this, AIST would happily participate in the consultation process for the review of the CRG.

## 2.3 The use of Cost Recovery Impact Statements (CRIS)

We note that the Government has been committed to supporting the use of Regulatory Impact Statements, which AIST notes are conceptually comparable to CRISs.

In their document, *Boosting Productivity and Reducing Regulation*<sup>8</sup>, prepared whilst in opposition, the Government noted the need for RISs to be undertaken, and committed to requiring these for all Cabinet submissions. Commentary outlined the low rate of compliance that the then Government had met with respect to RIS and exemptions granted by the then Prime Minister.

The document explained that:

*Failure to require a regulatory impact statement was done in order to avoid subjecting these policies to a rigorous regulatory impact analysis, which the Coalition believes would in all likelihood have indicated that the costs of implementing the policy exceeded the benefits.*

The issuance of CRIS is designed to outline quantifiable areas where costs are weighed against benefits. AIST points out that the use of CRIS is immediately compatible with Government policy.

In 2013, the Australian National Audit Office (ANAO) undertook a review<sup>9</sup> of the way that financial industry levies were determined and collected by APRA and Treasury. A finding from this report was that allocations from the Commonwealth Budget to APRA are largely recovered from the entities that APRA regulates.

However, the report also found that, whilst the administration is effective, consultation with stakeholders could be improved. AIST maintains that, although improvements to the consultation process are welcome,

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<sup>8</sup> Liberal Party of Australia, (2014). *Boosting Productivity and Reducing Regulation*. [online] Available at: <http://tinyurl.com/onm6lxz> [Accessed 12 Jun. 2014]

<sup>9</sup> ANAO, (2014). *Determination and Collection of Financial Industry Levies*. [pdf] Canberra: Australian National Audit Office. Available at: <http://tinyurl.com/nvm9pco> [Accessed 12 Jun. 2014]

we point out that even blue-ribbon quality consultation where transparency that is required by the CRG is not considered, will still fail to be effective consultation.

The ANAO report also found that APRA had not done a CRIS with respect to financial levies since 2006-07.

The ANAO report recommends the following areas where further analysis should be undertaken:

- Levy methodology is based on activities of staff from 4 of 5 APRA divisions and excludes many indirect costs e.g. IT. There may be cross-subsidisation between sectors.
- The methodology includes 'restricted' and 'unrestricted' components which respectively relate to prudential supervision and 'system impact and vertical equity.' ANAO comments that some activities in the unrestricted component do not always bear a close relationship to functions addressing system impact and vertical equity.
- Large levies increases bring complexities to APRA setting levies. It has been brought into question whether the methodology is appropriate for those other levies (e.g. SuperStream).

We would consider that, where these three large questions are still not yet addressed, the consideration of additional proposed methodologies should not continue, in the absence of a CRIS. We note that, in their review, ANAO noted the ability for APRA to provide more information with regards to the breakdown of components in the costs covered by the levy. Additionally, ANAO noted that APRA has not prepared a CRIS since 2006-07, but has undertaken to provide one following the levies methodology review. We maintain that this is the incorrect order and that the CRIS should be prepared prior to the review of the levies methodology review.

AIST recommends that for these reasons, the decision to change the methodology for the assessment of financial industry levies must be accompanied by a CRIS.

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## 3 Methodology considerations

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AIST would like to explain that, given the issues that we raised above concerning the absence of an updated CRG, or a CRIS, we cannot support a change to the existing methodology.

With this in mind, we present the following discussion of the levy methodologies discussed in this paper.

### 3.1 Option 1 vs Option 2

We note that that Option 2 moves all activities, with the exception of APRA's prudential supervision, to the unrestricted component. Option 2 proposes no changes to how APRA's prudential regulation is to be charged with respect to the restricted and unrestricted components.

On the other hand, Option 2 proposes that all the remaining costs be assigned to the unrestricted component of the levy.

AIST maintains that this is out of proportion with the actual cost drivers of the different areas of regulation. A good example of this is in regards to APRA themselves: There are economies of scale in regulating superannuation funds. What we mean by this, is that in the case of a large superannuation fund, the size of the fund being regulated by APRA will eventually get to the point where funds under management cease to drive the costs of prudential regulation up further. APRA's areas of regulation in 2014-15 include "governance and risk management issues, data integrity and the liquidity of superannuation funds" as explained in the paper at page 14. As we noted in our May 2013 submission, this is consistent with the original foundation for the levy collection, where it was found that<sup>10</sup>:

*In relation to the policy justification for the sectoral approach to APRA funding, the sectoral model is aimed at achieving a result which sees institutions pay in proportion to the share of the benefits that the sector receives from the system of prudential supervision. It also ensures that each sector pays for the cost that the regulator incurs in supervising that sector.*

*The use of minimum and maximum amounts reflects the view that there are certain minimum costs incurred in regulating even the smallest institutions but beyond a certain size there is no extra cost in regulating the institution. Imposing a cap also prevents larger institutions funding the costs of prudential regulation and supervision to a far greater extent than would be justified by the share of APRA's expenditure on those institutions.*

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<sup>10</sup> Dudley, S. (2005) *Financial Institutions Supervisory Levies Collection Amendment Bill 2004*. Bills Digest no. 100, 2004-05, ISSN 1328-8091. [report] Canberra: Commonwealth of Australia, p.3.

Similarly to APRA, as the size of a fund grows, the resources needed to manage these areas internally, are not going to grow beyond a critical mass.

Hence the need for a restricted component with respect to APRA's prudential component, which is maintained.

It is the belief of AIST that economies of scale occur similarly with other areas of regulation. We recommend that these areas be more thoroughly explored in order to properly evaluate the method of assessment of the levies.

## 3.2 SuperStream

### 3.2.1 The proposed basis of calculation

In the absence of further information and justification, AIST does not support the proposal (Option 2A) to charge the SuperStream component of the levies on a per member basis.

The SuperStream reforms are intended to facilitate the introduction of e-commerce into the superannuation system. It is envisaged that the reforms will improve contributions and rollover transactions and processing. Other benefits include consolidation of accounts and better matching of lost and unclaimed accounts.

Option 2A will adversely and inequitably affect funds that have large numbers of accounts with low balances. AIST accepts that there is both a minimum and maximum (or at least plateauing level) of involvement in SuperStream that needs to be taken into account in the SuperStream levy. However, it is far too crude a measure to use a measure based solely on either number or members or funds under management.

During the course of SuperStream design and implementation, AIST repeatedly sought further information about the how the SuperStream levy is being spent, and for estimates of the financial benefits of SuperStream implementation. Other than at a high level, this information has not been provided by the ATO or Government.

AIST submits that Option 2A would be compounded by an incorrect appreciation of what constitutes a super fund "member". We consider that the intention of Option 2A is to charge on the basis of member accounts, rather than by member. Our conclusion is based on the premise that, as at 30 June 2013, the number of members in the superannuation system would be 29.9 million members, if calculated on the basis of account numbers. Yet we also know that Australia's population is around 22 million, with the working population being about half this.

We consider this to be particularly important in the aftermath of the removal of member benefit protection, where funds can charge members with low balances administration fees.

This issue is relevant to all funds with large numbers of small account balances. However, it has the most bizarre consequences when applied to super funds with very large numbers of members and very small account balances. The case study below reference such an example:

## Case study

AIST's member funds include AUSfund, which is an eligible rollover fund (ERF). According to APRA's stats as at the 30 June 2013<sup>11</sup>, AUSfund had 1.2 million members and just over \$545 million in net assets.

Expressed as a portion of the total, AUSfund note that out of the 29.9 million member accounts in the superannuation system, AUSfund would represent 4.3% of these, and therefore, would be charged 4.3% of the total cost recoupment of the portion of the levies attributable to SuperStream.

This is particularly inequitable given that AUSfund does not receive contributions, and will not receive a benefit from SuperStream contributions implementation.

Based upon the member numbers used above, as well as the proposed \$2.47 per member rate discussed in the paper, AUSfund's liability to the SuperStream levy would come to just under \$3 million dollars.

AIST does not believe that this is consistent with the intentions of the current CRG, even considering that these are under review.

AIST recommends that SuperStream activity be more appropriately measured before a proposal can be put forward with regards to how the SuperStream portion is charged.

### 3.2.2 SuperStream and the level playing field

Our other concern with relation to the SuperStream portion of the levies relates to coverage.

This was best explained in our submission of May last year, where we wrote that:

Despite a share of the superannuation market that is just under one third of the total funds under management in the superannuation industry, SMSFs are presently exempt from contributing towards the costs of SuperStream. The benefits to SMSFs are openly supported throughout the industry, as the SMSF

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<sup>11</sup> References cited use a variety of the stats available at APRA's statistics resources available at: APRA, (2014). *Superannuation fund-level publications*. [online] Australian Prudential Regulation Authority. Available at: <http://tinyurl.com/bzv76es> [Accessed 12 Jun. 2014].

Professionals Association of Australia (SPAA) explained in 2011<sup>12</sup>:

*New data transfers standards for rollovers and employer contributions, to be introduced as part of SuperStream, will benefit self-managed super funds (SMSFs), according to SMSF Professionals' Association of Australia (SPAA) technical director, Peter Burgess.*

*"Ensuring all rollovers and employer contributions must be accompanied by mandatory sets of data will eliminate the need for SMSF administrators (sic) to chase up missing data and undertake time consuming reconciliation processes," he added.*

Indeed, our submission to the Parliamentary Committee on Corporations and Financial Services of February<sup>13</sup> of [2013] re-iterated the omission of SMSFs from the list of superannuation entities that are expected to contribute towards the costs of the SuperStream reforms. As in our submission to Treasury on the industry levies for 2012-13, we calculated that a pro-rata proportion of the total cost of SuperStream attributable to the SMSF sector (\$146 billion) would be calculated as \$311 per fund.

We note that members in the SMSF sector have recently crept above the one million mark. We believe that this may be an appropriate time to consider the levying of SuperStream on SMSFs.

### 3.3 Superannuation Complaints Tribunal (SCT)

*The Superannuation Complaints Tribunal is an independent dispute resolution body which deals with a diverse range of superannuation-related complaints and offers a free, 'user-friendly' alternative to the court system<sup>14</sup>*

Regulated superannuation funds are required by law to use the SCT as part of their dispute resolution process, and the SCT in turn deals with complaints about superannuation in the areas of these super funds. The smooth and timely operation of complaints about superannuation is a factor in the level of community support for the superannuation system

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<sup>12</sup> Pokrajac, M. (2011) New SuperStream measures to benefit SMSFs: SPAA. *Super Review*, [online] 9 August. Available at: <http://is.gd/GrQG2R> [Accessed: 27 Feb 2013].

<sup>13</sup> Garcia, T. (2013) *Re: Superannuation Legislation Amendment (Reform of Self-Managed Superannuation Funds Supervisory Levy Arrangements) Bill 2013*. [pdf] Melbourne: Australian Institute of Superannuation Trustees. <http://tinyurl.com/bp7g8hr> [Accessed: 29 Apr 2013].

<sup>14</sup> Superannuation Complaints Tribunal. (2014). [online] Available at: <http://www.sct.gov.au/> [Accessed 13 Jun. 2014]

By virtue of the Financial Industry Levies, super funds pay for the SCT and its operations. Super funds and their members already wait long periods for the resolution of complaints, and there is a correlation between this period and the level of funding received by the SCT.

In the interests of transparency and the smooth operation of the superannuation system, the cost allocation for the SCT should be separately identified in the documentation supporting the levies, as it has been previously.

Furthermore, the SCT is an ASIC-approved dispute resolution scheme. It should not have its independence compromised by ASIC controlling its funding. ASIC has had its funding reduced in the recent federal budget, and is now reviewing its priorities and expenditure. We are concerned that this could mean a reduction in the commitment that ASIC has toward funding the SCT, and result in less efficient and timely handling of disputes.

The SCT must not be treated as an arm of ASIC for the purposes of levy collection. The levy collection process should recognise and respect its independence, and provide funding transparency. Not only should the SCT operate independently of ASIC, it should be seen to do so.

AIST recommends that documentation supporting the application of the levies explicitly identify component funding the SCT.