



Proposed Industry Funding Model for the Australian Securities and Investments Commission

16 December 2016

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.

As the principal advocate and peak representative body for the \$700 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.

Contact

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|-------------------------------------------|--------------|
| Karen Volpato, Senior Policy Advisor | 0419 127 496 |
| Richard Webb, Policy & Regulatory Analyst | 03 8677 3835 |
| Tom Garcia, Chief Executive Officer | 03 8677 3800 |

1 Executive summary

In brief:

AIST strongly supports the Proposed Funding Model and its move towards transparency and accountability. The method of undertaking levies calculations and producing a CRIS based on ASIC's past year's activities will greatly assist transparency. AIST recommend the need to gather data to examine risk-related metrics. Such metrics should be used to assess the industry by sub-sectors (not-for-profit and for-profit) so that areas needing regulator focus are identified and suitably levied. AIST also believes that there should not be any carve-outs from the government's Cost Recovery Guidelines. In early 2017, AIST will consult with its member funds regarding the portal design and provide feedback. AIST would appreciate a more detailed explanation of the calculation methodologies.

AIST welcomes the opportunity to respond to the paper *Proposed Industry Funding Model for the Australian Securities and Investments Commission* ('Proposed Funding Model').

AIST welcomes the delivery of greater transparency via the Proposed Funding Model through charging based on actual regulator performance and activity in the previous year. Annual October (or thereabouts) consultations coupled with the production of a Cost Recovery Impact Statement ('CRIS) are also very welcomed by AIST. These proposals will address past AIST key concerns that there has been a significant lack of transparency in ASIC levies given the lack of a CRIS or a lack of linking ASIC levies with implementation of the Regulator Performance Framework¹. This has made it difficult to assess the quantum or application of the levies.

AIST strongly supports focussed and properly resourced regulators. Overall, AIST believes that the Proposed Funding Model will deliver a better understanding of resourcing and how the objectives set by government are being met. AIST also believes that the Proposed Funding Model will – on the whole - support the principles of efficiency and effectiveness, transparency and accountability, and stakeholder engagement derived from the Australian Government Cost Recovery Guidelines

¹ Australian Government, (2014). *Regulator Performance Framework*. [online] Australian Government. Available at: <http://tinyurl.com/ht72fsy> [Accessed 31 May 2016].

(‘the CRG’)², the Australian Government Charging Framework (‘Charging Framework’)³ and the Regulator Performance Framework (‘Performance Framework’).

The main areas where AIST has concerns about the Proposed Funding Model may be summarised against each of the Model’s objectives as well as the overall objective of transparency and accountability:

| Objectives | Description | Summary of AIST concerns |
|----------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Transparency and accountability | Only recover costs provided to those paying. Each cost recovered should be documented in a CRIS. | <ol style="list-style-type: none"> 1. All components should be in accordance with the CRG. AIST strongly opposes the concept of items which are not leviable (‘Statutory Levy’) under the CRG being raised. 2. AIST cannot comment on levy components until a CRIS is produced. 3. AIST contends that the additional \$121.3m should also be fully accounted for via a CRIS and not form part of the APRA levy. 4. Monies for the SCT should also be separately accounted for and not form part of ASIC levies. |
| Simple | The model should be simple and enable any entity to calculate its applicable levy. | <ol style="list-style-type: none"> 5. AIST is currently unable to undertake calculations and needs further data – in particular how subsidiaries and double counting are to be handled. |
| Certain | Levies should, wherever possible, provide enough certainty for entities to allow them to incorporate the levies into commercial decisions. | <ol style="list-style-type: none"> 1. How levies might apply to subsidiaries. 2. Whether the general advice levy applies to all giving general advice. |
| Proportional | <p>Levies for each sector should be calculated from readily available metrics of business activity, such as revenue generated or funds under management. Selection of each sector’s activity metric should:</p> <ul style="list-style-type: none"> • Align to expected regulatory oversight, including the level of | <ol style="list-style-type: none"> 1. AIST strongly contends that FUM is not a sufficiently robust proxy to enable aligning regulatory oversight with levies raised. 2. AIST recognises that development of risk-related metrics as a basis for levies is a more complex method than FUM, but recommends |

² Australian Government, Department of Finance, (2014). *Australian Government Cost Recovery Guidelines, July 2014 - Third edition*. Resource Management Guide No.304. [online] Australian Government. Available at: <http://tinyurl.com/lplwh2g> [Accessed 31 May 2016].

³ Australian Government, Department of Finance, (2015). *Australian Government Charging Framework*, Resource Management Guide no. 302. [online] Australian Government. Available at: <http://tinyurl.com/grwr8q> [Accessed 31 May 2016].

| | | |
|-----------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| | <p>anticipated consumer or investor exposure</p> <ul style="list-style-type: none"> • Ensure that the reporting burden for industry is kept to a minimum. | <p>that initial steps be taken to collect data to help formulate such an approach, including:</p> <ul style="list-style-type: none"> - Number of breaches per leviable entity. - Data from External Dispute Resolution sources. - ASIC time spent on particular entities. - Number of entity internal complaints. - Divide the above data into APRA categories (not-for profits and for-profit). |
| Commercially based | <p>Sector definitions should group together entities that are providing similar services, and compete in the same market — for example, group together all investment banking activity in Australia.</p> | <p>AIST reiterates that initial steps should be taken to collate information which identifies which APRA type of fund (not-for-profit and for-profit) generates regulatory activity.</p> |
| Efficient processing | <p>Billing and business activity collection should be done through a web portal that users find simple, clear and fast to use, and that is seamlessly connected to ASIC databases</p> | <p>AIST will liaise with funds in early 2017 to collect feedback about portal design issues.</p> |

2 Consultation issues

2.1 Context and environment for proposed industry funding model

AIST supports well-resourced regulators, with appropriately targeted regulatory focus. In our previous submissions regarding financial sector levies, AIST has expressed its concern that ASIC levies collections have not complied with the Government's Cost Recovery Guidelines to date. AIST believes that the processes outlined in the Proposed Funding Model will aid greater transparency and focus, and is very pleased that there is a proposed detailed consultation process, that levies will be set post regulatory activity, and that a CRIS will be produced each year. We therefore generally support the Proposed Funding Model. Our key concerns relate to:

- Where there are carve-outs to transparency.
- A sufficient link between levies raised and the degree of regulator activity and focus (i.e. the need to commence examining the link between levies raised based on risk related metrics).

2.2 Overview of proposed industry funding model

Question 1

Do you agree with the proposal that all of ASIC's regulatory costs should be included in the industry funding model, excluding ASIC's registry costs and criminal prosecutions incurred by the DPP? If not, please describe your preferred approach and reasons for it.

AIST supports the recovery of supervisory levies on the proviso that such recovery is in line with two principles (next page):

1. The Australian Government Cost Recovery Guidelines ('the CRG')⁴ is adhered to;
2. The OECD's Best Practice Principles for Regulatory Policy^{5 6}, which includes regulatory role transparency, clarity, preventing undue influence, accountability, engagement, funding, and performance evaluation are also met.

AIST agrees with any proposal to include regulatory costs, provided that they meet these two principles. In applying these principles, AIST therefore strongly believes:

- ASIC activities not consistent with the cost recovery framework should not be included.
- Greater transparency than is proposed is needed regarding both the funding of the Superannuation Complaints Tribunal (SCT) funding as well as a fully accounting for how the \$121.3million will be spent.

2.2.1 ASIC activities not consistent with the cost recovery framework

While AIST strongly endorses the Proposed Funding Model in that it will – for the first time – deliver transparency and accountability more in line with the government's CRG, AIST cannot support carve-outs from the CRG. The Proposed Funding Model proposes that certain activities be included in the levy which are not in accordance with the CRG e.g. ESA, financial literacy, administration of unclaimed moneys, administration of the Assetless Administration Fund, or the operation of the North Queensland Insurance aggregator website.

As stated in the CRG, "A cost recovery levy... differs from general taxation as it is 'earmarked' to fund activities provided to the group that pays the levy." A cost recovery levy should only recover costs of the activity provided to a group that pay the cost recovery levy.

While AIST understands that these are all worthy activities, we cannot support carve-outs from the CRG. Such a carve-out would also mean a lack of transparency around regulator activity regarding these particular items. The CRG itself states that 'the cost recovery policy promotes **consistent**, transparent and accountable charging for all government activities and supports the proper use of public resources' (emphasis added).

⁴ Australian Government, Department of Finance, (2014). *Australian Government Cost Recovery Guidelines, July 2014 - Third edition*. Resource Management Guide No.304. [online] Australian Government. Available at: <http://tinyurl.com/lplwh2g> [Accessed 9 Jun. 2015].

⁵ OECD (2014), *OECD Framework for Regulatory Policy Evaluation*, June. Available at: <http://tinyurl.com/nwjzb5z>

⁶ OECD (2014), *The Governance of Regulators*, OECD Best Practice Principles for Regulatory Policy, OECD Publishing. <http://dx.doi.org/10.1787/9789264209015-en>

We appreciate the Government's consideration of tax deductibility – including on items which are levied but not in accordance with the CRG. However we strongly maintain our position that if the items are not leviable under the CRG, they should not be raised.

2.2.2 Superannuation Complaints Tribunal funding

Earlier this year the government appointed an expert panel to review the financial system's external dispute resolution complaints framework. On 6 December the panel released an Interim Report, recommending the Superannuation Complaints Tribunal (SCT) be replaced by an Industry Ombudsman Scheme. AIST believes the SCT ought to be retained and the widely criticised funding model be addressed in order to make it more independent and to improve transparency.

Under the proposal the SCT's funding will continue to be collected through the APRA levy and ASIC will continue to allocate resources to the SCT. This funding arrangement is problematic and AIST believes that the SCT's funding should be independent of ASIC and the amount of resourcing should be determined following industry consultation. The funding model proposals are problematic for a number of reasons:

- The model limits superannuation fund's ability to report to their members because it is impossible for those funds to determine the resources that ASIC has allocated to the SCT. Given the APRA levy is paid by funds out of trust monies, it is imperative that those funds are put in a position whereby they can inform their member how their money is being spent.
- The model leaves ASIC with the absolute discretion on how the SCT's funding is to be determined, with no reference to overarching guiding principles. This, coupled with the fact that ASIC is not accountable for the SCT's operations or outcomes, can result a situation whereby the SCT is grossly underfunded.
- The proposal to not link the SCT's resourcing with outputs is contrary to the Government's CRG.

From 2019 onwards, once the implementation and capital costs from the ASIC reform package are no longer collected through the APRA levy, the SCT funding will be the only ASIC related expense collected through the APRA levy.

It is for these reasons that AIST submits that it may be appropriate for the SCT's resourcing to be collected by the current APRA levy, following an annual industry consultation process. This method is workable because the consultation and collection mechanisms are already in place, and it also ensures that the SCT is adequately resourced into the future.

2.3 Model design objectives

Question 2

Will the proposed model design objectives ensure consistency of approach to setting levies and fees across ASIC's regulated population? Are there other objectives that should be considered? If so, why?

2.3.1 Proposed objectives

AIST supports the model design objectives set out in Table 1 of the Proposed Funding Model. AIST also believes that the following objectives should be added:

- **Transparency.** While AIST appreciates that the objective of Transparency is part of the government's CRG, we strongly recommend that it be included as the first objective. This is important because, in the end levies payable by superannuation funds are ultimately paid out of member's retirement savings.
- **Consistent application of the CRG.** AIST repeats its comment that the CRG must be applied consistently.

2.3.2 Suggested amendments to proposed objectives

Later in this submission, we recommend that initial steps be taken to help formulate an approach to a risk-related metrics as a basis for raising levies. Because of this, we recommend amendments to the proposed model design objectives:

- **Proportional.** Include a sentence at the end of the description to recognise that further work will be done to examine what initial steps might be taken to commence collecting data which might help form a risk-related metrics approach.
- **Commercially based.** Sector definitions should also include sub-sectors for the superannuation industry using the APRA categories (not-for-profit and for-profit). AIST strongly recommends that such sub-sectors be included. This is important because the different sub-sectors reflect different organisational cultural values. As Greg Medcraft recently said, 'culture matters to ASIC because poor culture can be a driver of poor conduct

– and we regulate conduct.⁷ Collection of data at these sub-sector levels is important in focussing ASIC activity and also in helping to assess how risk-related metrics might be formed.

2.4 Model description

Question 3

Do you agree with the proposed model for calculating levies? Is there an alternate approach you would prefer? If so, please explain why.

Question 4

*Do you agree with the proposed definitions for industry subsectors and levy metrics at **Schedule 1**? Is there an alternative approach you would prefer? If so, please explain why.*

2.4.1 Proposed model - introduction

AIST recommends that to aid transparency and to better direct ASIC's focus, initial steps need to be taken to examine the possibility of risk-related metrics driving the collection of levies in the future. AIST acknowledges that data needs to be collected in order to gauge how risk-related metrics might be applied.

Additionally, we outline below how the information provided for the purposes of undertaking basic modelling is difficult to undertake.

2.4.2 Risk-related metrics

2.4.2.1 Why risk-related metrics are important

AIST strongly supports the OECD comments that “Enforcement needs to be risk-based and proportionate: the frequency of inspections and the resources employed should be proportional to the level of risk and enforcement actions should be aiming at reducing the actual risk posed by infractions.”⁸

⁷ Medcraft, G. (2016). *The importance of corporate culture*. Speech given to the Australian Club Melbourne, International Table Luncheon (Melbourne, Australia) 8 December 2016, [online] Available at: <http://tinyurl.com/gn7jhh4> [Accessed 16 December 2016]

⁸ OECD (2014) OECD Regulatory Policy Regulatory Enforcement and Inspections, OECD Best Practice Principles for Regulatory Policy, OECD Publishing [online] Available at <http://www.oecd.org/gov/regulatory-policy/enforcement-inspections.htm>

In practical terms, the OECD notes that this means resources are effectively planned on the risk level and resources are rationally allocated. Risk-focus and proportionality requires that inspections and enforcement actions are not to fall below a ‘threshold’ level.

2.4.2.2 What data could be gathered

AIST recognises that development of risk-related metrics as a basis for levies is a more complex method than FUM, but recommends that initial steps be taken to collect data to help formulate such an approach, including:

- Number of breaches per leviable entity.
- Data from External Dispute Resolution sources.
- ASIC time spent on particular entities.
- Number of entity internal complaints.

We reiterate our earlier comment that it is important that this data be divided into sub-sectors using the APRA categories (not-for-profit and for-profit).

2.4.2.3 AIST indicative modelling based on proposed model

The information provided for the purposes of undertaking basic modelling is difficult to undertake in order to do basic costing. We compared four funds with the following features:

| Fund | Number of members | Funds under management | Authorisation to provide advice | Number of advisers providing a personal advice service |
|-------------|-------------------|------------------------|---------------------------------|--------------------------------------------------------|
| Large fund | 2,103,000 | \$90 billion | Personal and general | 40 |
| Medium fund | 175,000 | \$4 billion | Personal and general | 4 |
| Small fund | 2,000 | \$0.5 billion | No authorisation | 0 |
| ERF | 975,000 | \$0.5 billion | General only | 0 |

For the purposes of our calculations, we have assumed that the funds have no additional corporate entities or investment vehicles in their overall structure. We have commented further on this matter later in our submission.

| Fund | Large proprietary company | Super trustee minimum | Super trustee variable | Personal advice on Tier 1 products | General advice only | Total indicative levy charged | Levy per member |
|-------------|---------------------------|-----------------------|------------------------|------------------------------------|---------------------|-------------------------------|-----------------|
| Large fund | \$350 | \$18,000 | \$448,750 | \$38,400 | \$0 | \$505,500 | \$0.24 |
| Medium fund | \$350 | \$18,000 | \$18,750 | \$3,840 | \$0 | \$40,940 | \$0.23 |
| Small fund | \$350 | \$18,000 | \$1,250 | \$0 | \$0 | \$19,600 | \$9.80 |
| ERF | \$350 | \$18,000 | \$1,250 | \$0 | \$920 | \$20,520 | \$0.02 |

As can be seen, the cost per member for smaller funds appears to be substantially higher than the cost per member for other sized funds.

2.4.2.4 Exemptions for the provision of general advice

Amongst the costs, we note that superannuation funds which are authorised to provide a general advice service only will be charged an additional \$920. We note regulation 7.1.33H of the *Corporations Regulations 2001*, which exempts financial product issuers from the need to hold this authorisation in order to provide a general financial product advice service.

The CRG argues that levies should be paid by the entities that create the need for regulatory activity. The exemption provided by reg 7.1.33H makes this charge highly arbitrary, given that the small fund in our example could legally provide a general advice service and not be charged for it under this model, despite providing a regulated service. We strongly recommend that the ability to charge these entities a levy for providing general advice provides a clear signal of the spotlight of the regulator to protect consumers in this space.

AIST is justifiably concerned that ASIC finds it difficult to verify licensees providing general advice where class order or exemptions prescribed in the regulations are in use. AIST will examine this matter separately, as we believe that consumers are at risk.

2.4.2.5 Number of corporate entities

Our examples above do not consider common situations involving different corporate structures. We note in particular that there appears to be double counting in certain situations involving subsidiaries or where a fund uses its own investment vehicles.

A useful example is where a fund holds all assets within an investment vehicle such as a Pooled Superannuation Trust (PST). We would expect that in this instance, the fund would also be subject to additional fixed and variable charges arising from the additional RSE. We recommend that the following example be considered.

Example

Fund A and B are similar sized superannuation funds, with a similar number of members. However, unlike Fund B, Fund A holds all assets within a PST.

As a result of this, under ASIC's industry funding model, Fund A would be required to pay the following additional amounts compared to Fund B:

- An estimated \$0.05 per \$10,000 of FUM greater than \$250,000 of the assets in the PST.

We understand that there are minimum costs associated with ASIC's administration of additional corporate vehicles in an aggregated corporate structure. It is understandable that conglomerates with complex structures are going to incur more basic maintenance and regulatory costs associated with the use of additional vehicles. Yet it is simply risible to suggest that a fund which holds all assets within a PST are going to warrant twice the attention of the regulator as a similar sized fund which does not, if funds under management are taken as a likely predictor of regulatory attention.

This situation would result in members paying twice for exposure to the same amount of funds under management as we would expect that regulatory costs such as these would be passed back to them. AIST recommends that a debit and credit system be used in order to ensure that double counting does not arise.

2.4.2.6 Methodology for calculating risk

As part of this submission, we have indicated our dissatisfaction with the use of assets under management as a proxy for risk. As part of our example above, we noted a comparison between a small fund with \$500 million in FUM, compared to an ERF also with \$500 million in FUM.

We understand the reluctance on the part of the regulator to assess the likelihood of risk posed by regulated entities, and welcome the bases for many of the subsectors used in this discussion paper. Having said that, we do not agree that the risks associated with the two small funds used

as examples are identical, and we continue to recommend that a measure be made to allow for the risk posed by entities on a more rigorous basis.

The basis for such a risk assessment does not need to be undertaken at a micro level, although as we explained above, undertaking this at a micro level would be able to remove instances of double counting. We consider that a viable alternative may be to consider super funds along lines similar to APRA, where funds are categorised by the type of fund that they are. In this instance, we would propose that not-for-profit funds be considered separately to for-profit funds. After accounting for minimum basic costs, assessment could be made of the total overall attention that the sector has received from the regulator in a more targeted way.

We take this opportunity to reiterate that balancing complexity against simplicity requires the need to examine such things as breaches, time spent by the regulator and other use of regulator resources by sub-sector in order to appropriately identify which areas (based on their culture) are causing greater regulator focus. This is needed in order to adequately protect consumers – and to do this, some degree of additional data analysis is required.

2.5 ASIC stakeholder engagement and accountability

Question 5

Do you agree with the proposed timeline for the annual reporting? Are there any reasons as to why the suggested timelines may not work for your organisation's business cycle?

Question 6

Do you agree with the proposed engagement and accountability measures? Are there additional measures you would prefer? If so, please explain why.

AIST supports the proposed timeline for the annual reporting and the proposed engagement and accountability measures. In particular, the production of a CRIS in October based on past regulator activities is most welcome.

AIST reiterates the need for the breakdown of regulator time spent per sub-sector (not-for-profit and for-profit) to improve transparency, and to ensure that those entities which generate regulator activity are levied in such a manner to reflect the cost impact they cause.

AIST would greatly appreciate further information about the levy calculation methodology in early 2017. We wished to be placed in a position where we can explain the levy impact to our member funds.

2.6 Implementation

Question 7

Do you have any preliminary comments on the legislative arrangements?

Question 8

Do you have any comments on the proposed implementation timetable? Please provide details of any concerns.

While AIST believes the proposed implementation timeline is workable, we request the following:

- That there is a more detailed explanation of the calculation methodologies based on the queries we have raised before consultation on the legislative package begins. We appreciate that much of the detail will be in the regulations, but nonetheless a mid-late January explanation (perhaps via a Roundtable) would be most useful – following review of the various submissions received regarding this consultation.
- AIST would wish to consult with its member funds in early 2017 regarding the portal. We would appreciate a further Roundtable regarding initial thoughts about the portal design so that we may better consult with our member funds.

2.7 Regulatory impact

Question 9

What do you estimate the regulatory cost of complying with the new requirements in the model to be? In order to answer this, you may wish to consider information such as the following:

- *How many hours will it take to train relevant staff about the new compliance requirements?*
- *How many hours will it take to implement / update systems to ensure compliance?*
- *Will you need to procure professional advice or services to comply with the model? What is your estimate of the total cost of this procurement?*

- *How many hours will it take for relevant staff to evaluate and plan for the new regulatory requirements?*
- *How many hours will it take for staff to assemble and report any information required?*
- *What is the estimated total labour cost of these activities?*

Please only consider the cost of additional activities, beyond compliance activities that you currently perform. Please do not include the costs of levies and fees to be paid or opportunity costs in answer to this question. We seek this feedback elsewhere.

In order to gather member fund feedback about costs, AIST would appreciate further consultations regarding the calculation methodology and the design issues associated with the portal.

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