



The Voice of Super

5 June 2001

Mr Paul Belin
Acting Assistant Commissioner
Cost Recovery Inquiry
Locked Bag 2
Collins Street East
MELBOURNE VIC 8003



Dear Mr Belin

Thank you for the opportunity to comment on the draft report of the Commission on Cost Recovery.

ASFA considers that the draft report provides comprehensive analysis of the rationale for cost recovery in regard to regulatory agencies. It also shows a good understanding of the issues raised by ASFA in its submission to the Commission and in its evidence to the initial hearings.

So far as the draft recommendations of the Commission are concerned, ASFA agrees that the Commonwealth Government should adopt a formal cost recovery policy for regulatory and information agencies (Draft Recommendation 4.1). A formal policy would assist the regulators and Treasury in developing levy proposals which both generate an appropriate level of revenue and which are raised in a way which is equitable and efficient.

ASFA also considers that as a general rule the funding of cost recovered regulatory activities should be subject to the same budgetary and parliamentary oversight as budget funded government activities (Draft Recommendation 5.1), and that the Government should address the effectiveness of the existing performance review processes and the need for a more performance based efficiency audit approach based on stakeholder consultation (Draft Recommendation 5.2). As outlined in our earlier submission, ASFA is concerned with the limited accountability for expenditure by the regulatory agencies funded out of the financial sector levies, particularly ASIC and the ATO.

ASFA also considers that cost recovery arrangements should not include the cost of activities undertaken for Government, such as policy development, ministerial or parliamentary services and international obligations (Draft Recommendation 6.4). There is evidence that part of the funding from the sector for APRA and ASIC is used for policy development and international obligations or activities not attributable to the Australian financial sector.

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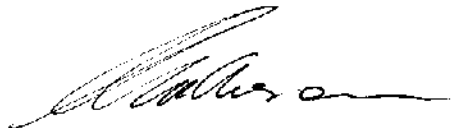
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The Commission may also be interested in the processes for setting the financial sector levies to apply in 2001-02. I attach for your information a copy of the discussion paper that was circulated as part of the levy consultative process together with a copy of the ASFA submission.

ASFA understands that the Government is likely to announce its decision on the levies in the near future, although perhaps after the public hearings of the Commission are complete. The Commission may be interested in comparing the final outcome with what was proposed in the discussion paper. In the past the impact of industry comments has not always been clear in terms of the final outcome. This raises some questions about the accountability of the process.

Yours sincerely,

A handwritten signature in dark ink, appearing to read 'Michaela Anderson', with a long horizontal flourish extending to the right.

Michaela Anderson
Director Policy and Research



The Voice of Super



ASFA Submission to the Government on 2001-02 Financial Sector Levies

May 2001

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ASFA Position in General

ASFA agrees with the principle that the sector should contribute to APRA and ASIC running costs and to the running costs of the Lost Members Register compiled by the ATO. It recently indicated its support for this principle, subject to several important conditions, in its submission to the Productivity Commission inquiry into Cost Recovery. Nevertheless, it considers that it is important that the levies applied are fair and equitable, are calculated in relation to activities that are actually relevant to superannuation funds, and are no more than is required to meet the costs of efficient regulators.

ASFA continues to have concerns about the process and principles currently used in determining the levies to be paid by prudentially supervised superannuation funds. These include:

- the reduction in APRA running costs following the reduction in the number of regulated funds as a result of mergers and the winding up of funds is very low;
- similarly, the transfer of responsibility of self-managed funds to the ATO led to only a minor reduction in APRA costs;
- costs attributed to superannuation funds in regard to the proposed new data collection systems appear to be very high;
- the application of a minimum levy amount applicable to all regulated funds to several thousand Small APRA Funds (SAFs) administered by the one Approved Trustee leads to inefficient and inequitable outcomes, and the application of levies to SAFs formerly administered by CNAL would exacerbate the financial hardship experienced by members of such funds;
- the sector is (still) being expected to pay for establishment costs of APRA, including relocation of staff, establishment of new premises and alignment of salaries and conditions, when these costs are not an intrinsic part of the regulation of superannuation;
- options presented for increasing levy collections do not evenly spread the burden of the proposed levy increase; and
- the poor level of accountability in relation to the costs attributed to the operations of the ATO Lost Members Register and in relation to ASIC's activities and costs for superannuation.

Questions and conclusions related to these issues are outlined below. **In summary, ASFA recommends that the funding target for levies on superannuation funds be reduced by \$4 million pending accountability and justification from APRA, ATO and ASIC.**

Subject to those reservations, ASFA has considered the possible options for setting the levy rate for superannuation funds and associated minimum and maximum levy amounts.

There are three degrees of freedom permitted by the legislation in setting the levy – the maximum, the minimum and the rate applied to assets. It is not possible apart from the maximum and minimum arrangements to vary the levy rate by asset level, such as by application of a multi-part tariff.

Two alternative levy scenarios have been developed by APRA for consideration by the various sectors subject to APRA supervision. Scenario 1 would have the levy rate move

from the current 0.02% to 0.035% (assuming that the revenue target for superannuation proposed in the paper is accepted). Scenario 2 would leave the rate unchanged by increase the minimum from \$300 to \$500 and the maximum to \$62,000 from the current \$41,000 base (actually \$46,000 in 2000-01 due to the supposed one-off increase in funding for the SCT).

Levy arrangements if ASFA suggested funding level is accepted

In this submission ASFA has pointed out a number of areas where there appears to be over-recovery from superannuation funds. If action were taken to correct this, then the total amount to be recovered from the superannuation sector would be lower with a consequent impact on the structure of levies applying to funds.

If the amount of funding required to be raised for the superannuation sector was reduced from \$27.6 million to \$23.6 million as proposed by ASFA, this would allow a general minimum of \$300, a rate of 0.02%, a maximum of less than \$40,000 which would be considerably lower than that which applied in 2000-01, and a substantial reduction in the minimum levy applying to Small APRA Funds.

Levy arrangements if APRA proposed revenue target is accepted

If it proves necessary to accept a revenue target of \$27.6 million as proposed in the discussion paper, ASFA would support a levy structure in 2001-02 for superannuation funds which involved adjustments to each of the rate, maximum and minimum and which also made allowance for the special circumstances of multiple SAFs administered by one Approved Trustee. **This structure could be along the lines of a general minimum of \$330, a maximum of \$45,000, a rate of 0.022% and a minimum for SAFs of \$200 where an Approved Trustee is responsible for more than, say, 500 funds.**

Should adjustment be made to the rate, to the maximum or minimum, or both?

Feedback from ASFA members indicates support for a levy structure in 2001-02 in which the burden associated with any increase in the aggregate funding requirements is spread across the range of funds. Both Scenario 1 and Scenario 2 as presented involve undue volatility in levy payments for a significant proportion of funds and no changes for remainder. Such developments in levies would not be regarded by superannuation funds as being either equitable or efficient.

Similarly both Scenario 1 and Scenario 2 lead to outcomes for the other regulated sectors which lead to undue volatility in levy payments and an inefficient and inequitable sharing of the increased levy burden that is proposed.

ASFA recommends that if there is to be an increase in the amount to be recovered from the superannuation sector then there should be adjustment to each of the rate, maximum and minimum. Similarly, in future when there is a reduction in the amount to be recovered each of these elements would be adjusted.

ASFA Comments on Specific Aspects

Costs of ASIC attributable to superannuation

The allocation of the costs of ASIC activities related to superannuation is less than clear. As ASFA understands it, a total amount of \$12.3 million has been allocated to ASIC for 2001-02 activities in regard to superannuation, insurance and banks, building societies and credit unions. The consultation paper proposes that \$6 million of this total be charged to the superannuation sector.

This funding has a complicated history with very little accountability for the considerable sum involved. The amount provided to ASIC had its genesis in the 1998-99 Budget when additional funding was provided to cover the establishment and ongoing costs of ASIC, including administration costs, an increase in the consumer protection function for the financial sector and IT asset replacement. Although the IT asset replacement would now be well and truly complete, the amount recovered has not decreased and in fact has increased.

ASFA is also concerned that the supposed one-off increase of \$1 million in the amount provided to ASIC in 2000-01 in order to fund the reduction of the backlog of cases in the SCT did not actually lead to a \$1 million increase in the resources available to the SCT. The budget of the SCT in 1999-2000 was \$1.8 million, with the discussion paper indicating that expenditure in 2000-01 is budgeted at \$2.5 million.

Material provided subsequent to the circulation of the discussion paper indicates that the increase in the levy led to reliance no longer being placed on the allocation of interest from the trust account administered by ASIC in regard to Unclaimed Companies Monies. ASFA considers that the \$5.3 million provided to ASIC in 1999-00 should have been sufficient in cover both ASIC's own activities in regard to superannuation and that of the SCT following resumption of full activities. The increase in funding for the SCT should have been reflected in a full pass through of resources to the SCT.

In addition, if it were appropriate in 1999-00 to rely in part on the interest from the trust monies, there is nothing to indicate that it would be inappropriate to apply a similar amount of interest in 2001-02.

Putting the issue of funding for the SCT to one side, a more fundamental concern is a lack of accountability on the part of ASIC in regard to the expenditure of the funds provided to it by the superannuation sector. Despite calls for and promises of greater accountability in regard to the allocation of levies to ASIC in the report of the Review of Financial Sector Levies and in the Government's response to that report, no greater accountability has occurred.

Around \$3.8 million is provided to ASIC by the superannuation sector for activities other than the SCT, but there is no clear link between this amount and the actual level of ASIC activities related to superannuation. The split between each sector apparently related to some sort of crude split of the aggregate complaints received in regard to each sector at

some time in the past. There is no evidence that of the actual costs of ASIC in regard to the superannuation sector or for all of the prudentially regulated sectors. A sum of \$3.8 million would be more than enough to support more than 40 full time staff across a range of position levels, overheads included. The evidence available suggests that the commitment of ASIC resources to superannuation is much less than this, with superannuation barely being mentioned in ASIC's annual reports in recent years.

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.

Pending greater accountability and justification, ASFA recommends that the costs attributed to superannuation by ASIC be reduced from \$6 million to \$5 million.

This level of funding would be similar to that which applied in regard to ASIC in 1999-00 and would allow for a reversal of the supposed one-off increase in the maximum levy applying to superannuation funds that was applied in 2000-01.

Costs related to the Lost Members Register and Unclaimed Monies

An amount of \$2.4 million is sought to be recovered from levies on regulated superannuation funds for the costs incurred by the ATO in running the Lost Members Register and for the operation of arrangements dealing with unclaimed superannuation monies.

ASFA considers that a greater level of accountability is needed for this amount. On the face of it the sum allocated is very large for the task of operating a central computerised list compiled from information supplied by funds in computer readable format. Some costs would relate to the operation of telephone inquiry lines, but the total amount appears excessive. The entire operations of the SCT are sustained by an amount smaller than that which the ATO is seeking.

ASFA understands the sum of \$2.4 million was originally estimated on the basis of much higher levels of telephone and written inquiries from the public than has actually been the case and fairly generous estimates of the costs involved. The amount should be reviewed in the light of actual inquiry levels and costs. If the costs are of this order, then consideration should be given to alternative delivery mechanisms for the information, or contracting out of the administration of the function.

Pending greater accountability and justification ASFA recommends that the amount provided to the ATO be reduced from \$2.4 million to \$1.4 million.

Reduction in running costs of APRA following the amalgamation, transfer and closing down of superannuation funds

The discussion paper at page 8 indicates an expected contraction in the number of superannuation funds (excluding SAFs) of 22% and for SAFs of 38%. This is a fall in the number of non-SAF funds from 4,469 to 3,485 and in the number of SAFs from a projected 9,400 in 2000-01 to 5,850 funds in 2001-02. APRA has previously argued that the cost of supervising the smallest of funds, including SAFs, is at least \$300 a fund. On this basis the reduction in the number of funds supervised should reduce APRA's costs by at least \$1.3 million in the case of SAFs and by at least \$300,000 in the case of other supervised funds. To the extent that the non-SAF funds that have been wound up or merged are much bigger than SAFs then the reduction in costs should be even greater, as much as \$3 million if the funds that are expected to close down are spread across the size range of funds. On this basis APRA's costs of supervision in 2001-02 in regard to superannuation should decrease by at least 10% and perhaps by as much as 20%.

However, according to Table 7, the proportion of time spent supervising the superannuation sector is expected to decrease only marginally, from 36.3% to 35.4% of total time spent supervising. While some sort of averaging has been applied to these figures in order to reduce fluctuations, ASFA considers that a figure closer to 30% of total time spent would be more appropriate given the decline in the number of entities.

The method of the calculation of the three year average is not specified. However, the figures for 1999-00 and 2000-01 appear to relate to the budgeted costs for each sector in those years, rather than relating to time based methods or a lagged average. The application of a moving average should generate a figure for superannuation funds lower than 35.4% because the projected fall in the number of superannuation entities follows similar falls in the current and previous financial years.

ASFA considers that greater accountability should be provided by APRA making available the raw numbers on which the estimate for 2001-02 is based. Also it would appreciate APRA providing reasons for why the level of supervisory time devoted to superannuation is not projected to fall in line with the decline in the number of regulated funds. In the absence of further details as to APRA's time spent in actual supervision, ASFA considers that the allocation method used in the discussion paper provides what could be termed as a generous estimate of the time involved.

A reduction in the estimated time spent from 35.4% to less than 33% would reduce the levy burden on the superannuation sector by around \$1.5 million.

ASFA also notes that the number of funds paying levies in 2000-01 may be higher than projected given that a large number of late lodging funds submitting returns after the 14 March cut-off used in the analysis in the discussion paper. This reduces the funding burden for 2001-02 given that there will be less of a shortfall to be carried forward and it will lead to a higher base for any reduction in the number of funds in 2001-02 paying the levy.

Costs of new data collection systems and ongoing recovery of "establishment costs"

One of the claimed advantages of the establishment of APRA was that it would lead to savings in the form of ongoing supervision costs. However, the first decade of the operation of APRA seems likely to be characterised by special transitional and establishment costs.

The discussion paper indicates that APRA's depreciation costs will increase by \$1.4 million a year as a result of the program developing technology to assist with analysis of the financial sector and to reduce user burden associated with the completion of statistical returns. This implies a total cost of the project of around \$7 million (assuming that is depreciated over 5 years from 2001-02 onwards), with the superannuation sector being held accountable for around \$2.5 million of this cost.

ASFA has concerns in regard to the total costs of this project, and the amount assigned to the superannuation sector. While the superannuation sector is expected to pay \$2.5 million of the costs of the project, there has been no consultation with the sector or discussion of the statistical needs of the sector or the reporting burden of current arrangements. ASFA understands that it will be some years before statistical returns by superannuation funds will be significantly altered, and that the main beneficiaries of the new arrangements will be ADIs and insurance companies. Accordingly, ASFA considers that the cost burden of this project placed on superannuation funds should be reduced.

ASFA also has reservations about the quantum of the amount budgeted for establishment costs, and its attribution to the superannuation sector in 2001-02. The proportion of these costs to be borne by the superannuation sector appears related to the estimated share of time spent by APRA supervising the sector at some time in the past. With the number of superannuation funds falling sharply in recent years, a decreasing number of funds are being required to meet these establishment costs. An alternative approach would be to assign a greater proportion of these costs to the sectors where the number of participants is more stable on an ongoing basis as it is the ongoing entities which will reap any benefits of the consolidation of the regulators.

ASFA recommends that the amount of establishment and new data collection costs attributed to the superannuation sector be reduced by \$0.5 million.

Implications of the minimum levy for Small APRA Funds with the one Approved Trustee

The proposed minimum levy for SAFs of either \$300 or \$500 is many times the levy applying to Self Managed Funds (\$45 in 2000-01). While the degree of regulatory supervision provided to SAFs no doubt is potentially higher than that applying to SMFs, the minimum levy has the potential to distort choice between establishing a SAF and SMF. Recent developments in regard to the SAFs which had CNAL as their Approved Trustee also cast doubt on whether APRA and ASIC provided prudential supervision and consumer protection commensurate with the levies paid.

It also leads to inefficiency and inequity when one Approved Trustee is responsible for many thousands of SAFs. ASFA is aware of one Approved Trustee which made total levy

payments in regard to SAFs of more than \$1.3 million in 2000-01. An APRA on site visit was of three days' duration, and there would of course be processing and other supervisory costs at the APRA offices. However, while a charge of \$300 may reflect the true costs of dealing with the sole fund administered by an Approved Trustee, there are obvious economies of scale when an Approved Trustee is responsible for some hundreds of funds.

ASFA suggests that the minimum levy be \$200 where an Approved Trustee is responsible for, say, more than 500 funds.

ASFA also suggests that some concession should be made in 2001-02 for the five hundred or so SAFs that had CNAL as their trustee prior to the recent removal of that trustee. Many of those funds have suffered significant financial loss as a result of the deficiencies in the investments made by CNAL, with some funds having no access to any funds at all for the immediate future. Requiring the new trustee of those funds to remit \$150,000 or \$250,000 in levies in 2001-02 would exacerbate the already troubled financial state of those funds.

DISCUSSION PAPER FOR CONSULTATION WITH THE FINANCIAL SECTOR INDUSTRY ON LEVIES FOR 2001-02

1. Introduction

The purpose of this paper is to seek industry views on the proposed financial sector levies for the 2001-02 financial year. The financial sector levies are set to cover the operational costs of the Australian Prudential Regulation Authority (APRA), and the market integrity and consumer protection functions of the Australian Securities and Investments Commission (ASIC) and the Australian Taxation Office (ATO). ASIC's costs include the operations of the Superannuation Complaints Tribunal.

The paper sets out information about the total level of levy required for 2001-02. It includes detailed information on the main factors driving the change in the total levy required from the 2000-01 to the 2001-02 financial year, and presents alternative scenarios on how best to achieve the total levy required. The paper was prepared by APRA in conjunction with Treasury and does not represent Government policy. Once industry views have been considered, recommendations will be made to the Minister for Financial Services & Regulation, the Hon Joe Hockey MP, and the Minister will announce the 2001-02 levies before the end of the current financial year.

The current sectoral approach to cost recovery remains in place for the 2001-02 financial year, consistent with the industry's preferred structure for imposing levies as a result of the levy review completed last year. During that review, industry supported a continuation of the levy framework which levied industry by sector on a percentage of assets basis with an upper and lower limit on the levy payable. This structure reflects the rationale that irrespective of size, there is a minimum effort involved in supervising an institution, while beyond a particular level of assets, there is no incremental cost.

Industry also agreed that a further review of the levy framework should be undertaken in around 2003 to reconsider whether a move away from the sectoral approach would be more appropriate at that time.

In addition, consistent with the concerns expressed in that review about the pace of industry convergence and consolidation, we have been mindful of the need to move towards a more uniform levy structure across sectors, while ensuring that each sector pays for its share of prudential supervision costs.

As in the past, the levy model and the resultant rates are derived after taking into account various key parameters such as:

- the current levy rates, minimum and maximum levies as set by the Minister's determination for the current year;
-

- the current year's collection against the estimated collection for the year;
- APRA's estimated supervision costs and estimated costs of the ATO and ASIC;
- the estimated time to be spent on supervision of each industry (this is used to apportion the cost of supervision by industry sector); and
- the asset values of entities, the expected growth of assets and any changes to the industry from mergers and deregistration.

In addition to the possible levy scenarios for 2001-02, the paper provides more detailed information about the make up of regulators' costs, as recommended in last year's levy review. In particular, it provides more detailed supporting information on:

- the current year's experience of levies collected against the original planned budget, and the expected level of costs against the budget;
- expenditure estimates for 2001-02;
- time allocation of supervisory effort by industry and the cost apportionment;
- industry growth and rationalisation by sector;
- the case for fees-for-service; and
- levy parameter scenarios to fund APRA and the relevant costs of ASIC and the ATO.

2. Outcomes for 2000-01

Levy revenue estimates for 2000-01 made at the end of 1999-00 estimated levy revenue at \$61.0 million. Table 1 details the currently estimated collection of levy revenue for 2000-01 compared with the original budget estimate.¹

The under collection is most significant in the Superannuation sector. Levy revenue estimates were based on 2900 more SAFs² than are now expected to lodge returns for 2000-01, and a higher growth in funds than has occurred. The true extent of the resulting under collection is masked by the unplanned collection from earlier periods of \$2.4 million. The net under collection in 2000-01 will need to be addressed in the year ahead, along with the expected continuation of industry rationalisation.

¹ As not all revenue for 2000-01 has been received, the levy revenue values for 2000-01 are the expected receipts for 2000-01.

² SAFs are small superannuation funds administered by APRA. SAFs have five or less members, but do not meet the definition of self managed funds and are not eligible to be administered by the ATO.

Table 1: Levies expected compared with the 2000-01 budget (\$'000)

Industry sector	Budgeted collection	Estimated actual collection	Difference
ADIs ^a	21 984	22 525	541
Superannuation	25 072	24 170	- 902
Life insurance/Friendly societies	8 699	8 453	- 246
General insurance	5 150	5 171	21
Retirement savings account	58	109	51
Total	60 963	60 428	- 535

(a) ADIs comprise domestic banks, foreign owned banks operating in Australia, building societies and credit unions.

Table 2 compares the number and asset values of institutions used to determine levies for 2000-01 with those estimated to apply to 2001-02. It should be noted that the asset values used for estimating the levy would differ from the assets used to invoice the levy in the following year.

Table 2: Institutions' assets used in the modelling of levies

Industry sector	2000-01		2001-02	
	Number ^a	Total asset base (\$ million) ^b	Number ^c	Total asset base (\$ million) ^d
ADIs – banks	50	700 229	49	738 909
– building societies	21	12 941	18	13 063
– credit unions	222	24 932	215	26 919
Super – excluding SAFs	5 724	308 375	4 469	323 492
– SAFs only	9 400	na	5 850	na
Life/Friendlies – Life insur.	44	174 063	41	183 277
– Friendly soc.	50	6 236	41	5 989
General insurers	161	56 192	154	63 360
Retirement savings accounts	8	188	8	188
Total	15 680	1 283 156	10 845	1 355 197

na = not available.

(a) As at January 2000.

(b) As at December 1999.

(c) As at January 2001.

(d) As at December 2000.

3. Summary of funding requirements for 2001-02

Table 3 summarises expenditure and funding needs for 2001-02. It includes the impact the under collection for 2000-01 will have on the levies that need to be collected in 2001-02. (Note the favourable impact the over collection in the prior year has on the levy for 2000-01.)

Table 3: Levies to be collected and operating costs (\$ million)

Levy determinants	2000-01		2001-02
	Budget	Estimated actual	Budget
APRA – expenses	51.1	51.0	53.0
– income (eg sales, interest)	- 1.3	- 1.7	- 1.1
– budgeted deficit	- 0.8	- 0.3	nil
– Over/under collection from previous year	- 3.0	- 3.0	0.5
– Over/under collection estimated for current year	nil	- 0.5	nil
– APRA sub-total	46.0	45.4	52.4
Levy funding required			
APRA	46.0	45.4	52.4
ASIC	12.6	12.6	12.3
ATO	2.4	2.4	2.4
Total	61.0	60.4	67.1

Table 4 provides a breakdown by industry sector of ASIC's supervisory costs for 2000-01.

Table 4: ASIC's supervisory costs

Industry sector	Cost 2000-01 (\$ million)	Cost 2001-02 (\$ million)
ADIs	2.7	2.7
Superannuation	6.3	6.0
Life insurance/Friendly societies	1.9	1.9
General insurance	1.7	1.7
Total	12.6	12.3

Levies need to rise from the current year's budgeted \$61.0 million to \$67.1 million. While on the face of it this appears to be a large increase, the change in levies needs to be examined over more than a single year because of the impact of possible under/over collection. In the current year, with the benefit of a large carry over from 1999-2000, levy collection in 2000-01 decreased by 9.3 per cent from 1999-2000. Averaging the increase in levies across 2000-01 and 2001-02, the average increase in the levy is 0.7 per cent. Table 5 provides a more detailed breakdown of the reasons for the increase in levies.

Table 5: Difference in the estimated actual collection 2000-01 and budgeted collection 2001-02

Factor causing variation in levy	Amount (\$ million)
Increase in operating expenses for 2001-02	2.0
Reduction in other income for 2001-02	0.6
Deficit funded by APRA in 2000-01 ^a	0.3
Effect of the change in carryover from the previous year	3.5
Repayment of 2000-01 under collection ^a	0.5
Less: reduction in ASIC portion of levies	(0.3)
Net difference between 2001-02 and 2000-01	6.6

(a) These deficits were met by a drawdown of APRA's cash reserves.

APRA's costs are not expected to rise in real terms in the out years. However, there may be changes to levy parameters in future years in response to industry consolidation and restructuring or unexpected asset growth creating over/under collection in industry sectors.

4. Amounts to be collected in 2001-02

Table 3 indicated that APRA needs \$53.0 million to carry out its supervisory role in 2001-02. Table 6 provides a breakdown of the main reasons for the increased need for further funds.

Table 6: APRA budget

Cost components	2000-01 (\$ million)	2001-02 (\$ million)	Increase (\$ million)	Increase (%)
Employee costs	36.6	38.2	1.6	4.4
Administrative costs	12.0	10.8	(1.2)	(10.0)
Depreciation	2.5	4.0	1.5	60.0
Total	51.1	53.0	1.9	3.7

APRA has employed an average of about 400 employees through 2000-01 plus about 10 contractors. This is short of the desired full complement of 417 (assuming an average vacancy rate of 15), which is the number required for 2001-02. The 4.4 per cent increase in employment costs reflects a combination of increased staff numbers and increases in average remuneration needed to remain competitive in the employment market. Savings in travel will partially offset these increases.

APRA will reduce administrative costs with savings in consumables, professional fees and the improved use of properties.

APRA has a progressive capital program aimed at developing technology to assist with the complex analysis of the financial sector. This will have a profound impact on the way in which supervision is carried out including a reduction in user burden associated with the completion of statistical returns. This will increase annual depreciation by \$1.4 million to a total of \$4.0 million.

The total increase in APRA's costs will be 3.7 per cent after a period of having significantly reduced costs as part of integrating prudential supervision.

Sectoral allocation of costs

Time spent on prudential supervision of APRA is tracked by supervisory division and is costed. However, the costs of the remaining two divisions is apportioned on the basis of the direct sectoral cost to total cost. Table 7 provides a comparison of the time spent to supervise each industry sector as a share of the total.

Table 7: Share of time spent supervising industry sectors^a (%)

Industry sector	1999-00	2000-01	2001-02^b
ADIs	39.5	43.0	39.2
Superannuation	40.8	36.3	35.4
Life insurance/Friendly societies	12.8	13.6	12.5
General insurance	6.8	7.0	12.8
Retirement savings accounts	0.1	0.1	0.1
Total	100.0	100.0	100.0

(a) A three year average (1999-2002) is used to smooth year-to-year fluctuations in time spent on a specific sector.

(b) Estimated.

Based on the above methodology, Table 8 allocates the cost based on the time spent on each sector. The budgeted total cost for APRA for 2001-02 is \$53.0 million. From this amount \$1.1 million is deducted reflecting income obtained from other activities such as interest earned from investments and other fees and charges. The net allocated funding requirement for APRA is \$51.9 million.

Table 8: Estimated cost per sector for 2001-02 based on time spent supervising each sector^a

Industry sector	Percentage (%)	Cost (\$ million)
ADIs	39.2	20.3
Superannuation	35.4	18.3
Life insurance/Friendly societies	12.5	6.5
General insurance	12.8	6.7
Retirement savings accounts	0.1	0.1
Total	100.0	51.9

(a) Average for the three years 1998-99 to 2000-01.

This in turn determines the funding to be recovered from each industry sector adjusted for any under/over collection from prior periods. Tables 9 and 10 explain the full apportionment of costs by industry sector and shows sector costs for 2000-01 and 2001-02 respectively.

Table 9: Budgeted cost of supervision by industry sector for 2000-01 (\$ million)

Industry sector	APRA			ASIC costs	ATO costs	Total levy required
	Expenses	Adjust for carry forward	Levy funding required			
ADIs	21.0	1.6	19.4	2.7		22.0
Superannuation	17.8	1.3	16.5	6.3	2.4	25.1
Life ins/Friendly soc	6.7		6.7	1.9		8.7
General insurance	3.4		3.4	1.7		5.1
Retirement savings accounts	0.1		0.1			0.1
Total	49.0	3.0	46.0	12.6	2.4	61.0

Note that items may not exactly sum to the totals due to rounding.

Table 10: Forecast cost of supervision by industry sector for 2001-02 (\$ million)

Industry sector	APRA			ASIC costs	ATO costs	Total levy required
	Expenses	Adjust for carry forward	Levy funding required			
ADIs	20.3	(0.5)	19.8	2.7		22.4
Superannuation	18.3	0.8	19.1	6.0	2.4	27.6
Life ins/Friendly soc	6.5	0.2	6.7	1.9		8.7
General insurance	6.7		6.7	1.7		8.4
Retirement savings accounts	0.1		0.1			0.1
Total	51.9	0.5	52.4	12.3	2.4	67.1

Note that items may not exactly sum to the totals due to rounding.

Authorised Deposit Taking Institutions

From Tables 9 and 10, ADIs are expected to be responsible for \$20.3 million of APRA's costs in 2001-02 (\$21.0 million in the current year) and \$2.6 million of ASIC's costs. APRA has over collected \$0.5 million from ADI institutions and will return the over collection in 2001-02.

Table 2 indicates that significant growth will take place in the total asset base of ADIs, but there will also be some contraction in the numbers of institutions. It is estimated that 39.2 per cent of APRA's resources will be committed to supervising ADI's in 2001-02.

Superannuation

The estimated cost of supervision of superannuation for 2001-02 is \$26.7 million, comprising \$18.3 million in APRA costs, \$6.0 million in ASIC costs and \$2.4 million ATO costs. However, due to an estimated \$0.8 million net shortfall in levy collection in 2000-01, the total levy required to fund supervision is \$27.5 million. This compares to the \$25.1 million estimated levy on the sector in 2000-01, consisting of supervision costs of \$26.4 million partly offset by an over collection of \$1.3 million in the previous year.

The expected net shortfall of \$0.8 million is determined by the net impact of: a shortfall of \$2.1 million due to superannuation funds merging; a shortfall of \$0.3 million due to lower than expected growth in the number of new funds; a shortfall of \$0.9 million due to an overestimate in the number of SAFs; and an offsetting late payment of levy fees of \$2.4 million.

In 2001-02, it is estimated that the assets of superannuation funds (excluding SAFs) will grow by 4.9 per cent from 2000-01 (see Table 2). However, there is expected to be a contraction in the number of institutions by 21.9 per cent. SAFs will continue to decline in number (37.8 per cent current year-on-year), either consolidating or transferring to the ATO as Self-Managed Superannuation Funds. Accordingly, it is estimated that the proportion of APRA's supervisory time allocated to this sector will decline from 36.3 per cent to 35.4 per cent (see Table 7).

The 2001-02 levy on superannuation includes funding of \$12.3 million for the ASIC's operation of its consumer protection functions (\$10.1 million) and the operation of the Superannuation Complaints Tribunal (SCT) (\$2.2 million). As the superannuation sector is the beneficiary of the dispute resolution services provided by the SCT, it is reasonable that the levy for the SCT apply only to superannuation entities. Funding for the SCT has been reduced from \$2.5 million in 2000-01 to \$2.2 million in 2001-02 reflecting the reduction in the backlog of complaints.

Insurance

APRA's costs of prudentially supervising the life insurance industry is estimated to be \$6.5 million during 2001-02 (\$6.7 million for the current year) while ASIC will require \$2.0 million. APRA has under collected \$0.2 million in levies for the current year, due to consolidation in the industry, and this will be carried forward for collection in 2001-02.

Table 2 indicates that APRA expects the asset base for the life insurance industry will increase by 5.3 per cent and a contraction in the industry from 44 to 41 institutions. There has also been a considerable contraction in the number of friendly societies and the asset base is expected to decline by 4.0 per cent.

Similar supervisory work patterns are expected for 2001-02 with 12.5 per cent of APRA's funding required from life insurance and friendly societies, down from 13.6 per cent estimated for the current year.

The general insurance industry supervision costs are estimated to be \$6.7 million for 2001-02 (\$3.4 million for the current year) and \$1.7 million for ASIC. The expected collection and the forecast for 2000-01 are very close.

Table 2 indicates that APRA expects that the assets of general insurance institutions will rise by 12.8 per cent, but the industry is expected to contract from 161 to 154 institutions.

The increase in supervisory costs in general insurance reflects additional work required for day to day supervision as well as the development of a major package of accompanying policy reforms. This is estimated to continue in 2001-02 and will require 12.8 per cent of APRA's funding needs being committed to supervising the general insurance industry. The average experience over three years is used to derive this percentage allocation in order to smooth out temporary increases in workload.

5. Possible levy scenarios for 2001-02

While there are a number of combinations of levy rate and maximum/minimum that can be considered to meet revenue needs, the following two scenarios are presented for industry consideration:

- Scenario 1 is based on fully funding the levy requirement by changing the *levy rate* only for each sector; and
- Scenario 2 is based on increasing the *maximum* for each sector and the minimum for the superannuation sector (from \$300 to \$500).

The results of each scenario are shown in the table at Attachment A. The scenarios attempt to address the significant shortfall in funding in the superannuation, life insurance/friendly society and general insurance sectors through changes to the levy rate or the maximum/minimum amount payable. The scenarios are based on the same institutional database, and assume the same growth rates and provision for industry consolidation.

For illustrative purposes, the status quo in parameters has been included to demonstrate the revenue shortfall that would occur. If levy parameters were unchanged from the current year, APRA would be under funded by \$11.0 million in 2001-02. As noted above, the main reason for the shortfall is the reduction in industry participants, particularly in the superannuation and life insurance/friendly society sectors. The effect of this scenario would be to reduce significantly APRA's capacity to fulfil its prudential supervision role.

Scenario 1 - Levy rate increased

This scenario shows the extent to which levy rates would need to change to raise the revenue required without changes in the maximum/minimum. Table 11 shows the results (changes are highlighted in bold).

Table 11: Levy rates by sector (%)

Industry sector	Current (2000-01)	Proposed (2001-02)
ADIs	0.012	0.012
Superannuation	0.02	0.035
Life insurance/Friendly societies	0.02	0.037
General insurance	0.02	0.078
Retirement savings accounts	0.02	0.02

Scenario 2- Specific parameters changed

An alternative scenario is to raise the maximum levy for all sectors to the extent permitted by the current legislation, and the minimum for superannuation. This scenario is consistent with the strategy of achieving greater uniformity in levy parameters across sectors and also reflects ongoing consolidation in the industry. Table 12 shows the results.

Table 12: Proposed maximum and minimum by sector (\$'000)

Industry sector	Minimum current (2000-01)	Minimum proposed (2001-02)	Maximum current (2000-01)	Maximum proposed (2001-02)
ADIs ^a	0.5	0.5	1000	1005
Superannuation	0.3	0.5	41	62
Life insurance/Friendly societies	0.5	0.5	280	364
General insurance	5.0	5.0	100	337
Retirement savings accounts	5.0	5.0	18.5	18.5

(a) Section 8 of the *ADI Supervisory Levy Imposition Act 1998* provides for the ADI maximum to be indexed for inflation using Australian Bureau of Statistics consumer price index data.

6. Fees for service

Certain activities performed by APRA are elective services to industry and consume part of APRA's resources. Consistent with the recommendations of last year's levy review, it is proposed to introduce fees and charges for these services, to reflect the cost of providing these services and to reduce the cost burden on other levy paying entities, although it is not expected such fees would be a material source of funding for APRA.

To qualify as a fee-for-service, the criteria to be met are that:

- a specific service must be provided;
- the service is rendered to or at the request of the party paying the account; and
- the impost is proportionate to the cost of the service rendered.

To date, fees for service have provided \$0.25 million revenue for the year to June 1999 (excluding the Australian Government Actuary), and only \$21,000 in the six months to December 2000.

Possible activities to be considered for fees-for-service are discrete one-off services that require incremental tasks in addition to normal supervisory activity such as banking licence applications.

APRA is proposing to charge fees for licensing activity in 2001-02, examine more fully the issues associated with the provision of other discrete services during 2001-02, and may introduce further fees-for-service in 2002-03.

Attachment A**Illustration of the effect of changes in parameters**

Type of entity	Criteria	Parameters unchanged	Scenario 1 Rates increased	Scenario 2 Maximums and superannuation minimum increased
Authorised deposit-taking institutions	% of assets	0.0120%	0.0120%	0.0120%
	minimum	\$500	\$500	\$500
	maximum	\$1,000,000	\$1,000,000	\$1,004,688
	levy raised	\$22,325,427	\$22,367,199	\$22,367,199
	target collection	\$22,367,200	\$22,367,200	\$22,367,200
	excess/deficit	(\$41,773)	(\$1)	(\$1)
Superannuation funds	% of assets	0.020%	0.035%	0.020%
	minimum	\$300	\$300	\$500
	maximum	\$41,000 ^a	\$41,000	\$62,355
	levy raised	\$21,656,211	\$27,603,992	\$27,603,991
	target collection	\$27,603,992	\$27,603,992	\$27,603,992
	excess/deficit	(\$5,947,781)	\$0	(\$1)
Life insurers & Friendly societies	% of assets	0.020%	0.037%	0.020%
	minimum	\$500	\$500	\$500
	maximum	\$280,000	\$280,000	\$363,690
	levy raised	\$7,228,082	\$8,728,231	\$8,728,231
	target collection	\$8,728,231	\$8,728,231	\$8,728,231
	excess/deficit	(\$1,500,149)	\$0	\$0
General insurers	% of assets	0.020%	0.078%	0.020%
	minimum	\$5,000	\$5,000	\$5,000
	maximum	\$100,000	\$100,000	\$337,080
	levy raised	\$4,876,026	\$8,355,925	\$8,355,925
	target collection	\$8,355,925	\$8,355,925	\$8,355,925
	excess/deficit	(\$3,479,899)	\$0	\$0
Retirement savings accounts	% of assets	0.020%	0.020%	0.020%
	minimum	\$5,000	\$5,000	\$5,000
	maximum	\$18,500	\$18,500	\$18,500
	levy raised	\$58,387	\$58,387	\$58,387
	target collection	\$44,652	\$44,652	\$44,652
	excess/deficit	\$13,735	\$13,735	\$13,735
Overall budget position (2001-02)	levy raised	\$56,144,133	\$67,113,734	\$67,113,733
	target collection	\$67,100,000	\$67,100,000	\$67,100,000
	excess/deficit	(\$10,955,867)	\$13,734	\$13,733

(a) The levy applying to the Superannuation sector was set as a one-off at \$46,000 in 2000-01 to fund the backlog of complaints to be undertaken by the Superannuation Complaints Tribunal.