

APRA'S OBJECTIVES AND FUNDING

This statement summarises APRA's functions and its funding. Its principal source of funding is levies collected annually from regulated financial institutions.



APRA's objectives

APRA's objectives derive from the Australian Prudential Regulation Authority Act 1998 - which sets out the agency's constitution and its broad powers - and various other laws, such as the Banking Act and the Superannuation Industry (Supervision) Act that relate to specific industry sectors.

Based on these, the APRA Board has adopted the following mission statement:

"APRA's mission is to establish and enforce prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by institutions we supervise are met within a stable, efficient and competitive financial system."

This is achieved by:

- (a) formulation and promulgation of prudential policy and practice observed by regulated institutions
- (b) effective surveillance and compliance programs and, where relevant, remediation or enforcement measures, to give effect to the laws administered by APRA and to the standards issued under those laws
- (c) advice to Government on the development of regulation and legislation affecting regulated institutions and the financial markets in which they operate.

APRA's organisation structure

APRA is organised into four main Divisions:

- Diversified Institutions Division (DID)
- Specialised Institutions Division (SID)
- Policy, Research and Consulting Division (PRC)
- the Corporate groups: human resources, information technology, legal, public affairs, risk assessment, finance and secretariat.

Broadly speaking, DID and SID are responsible for activity (b) above. PRC is responsible for (a) and (c), but works closely with the "front-line" supervisors in DID and SID in doing so. The Consulting group in PRC provides specialist advice to the front-line supervisors and participates with them in on-site reviews of regulated institutions. PRC also collects, analyzes and distributes statistics in regulated institutions. The Corporate groups provide support to the agency as a whole.

This structure has been designed to help achieve the integrated, flexible style of prudential supervision expected of APRA. DID supervises conglomerate groups and institutions with international linkages; SID supervises more specialised 'mono-line' financial institutions, using teams of people crossing industry boundaries.

No Division, or group within a Division, is responsible for dealing specifically with any one of the traditional industry groups - "banks", "general insurers", "credit unions" and so on.

This structure follows from two of the main reasons that the Wallis Committee recommended establishing a single prudential regulatory agency like APRA (in contrast to the previous arrangement with specialist industry regulators). These reasons were the blurring of boundaries between traditional industry sectors and the growing importance of conglomerate groups in the financial system.

Funding

The Wallis Committee recommended that APRA be funded on a cost recovery basis from the institutions it regulates. ("The regulatory agencies should collect from the financial entities which they regulate enough revenue to fund themselves, but not more." Financial System Inquiry Final Report, page 532)

APRA is, accordingly, funded primarily from annual levies on financial institutions. A small proportion of funding comes from earnings on funds invested and charges for specific services provided eg publications. APRA is investigating raising more money from direct charges for services provided, eg processing licence applications, but this is still likely to remain a small proportion of overall funding.

Levies are raised from institutions according to the Financial Institutions Supervisory Levies Collection Act 1998 and six supervisory levy Acts that apply to sectors of the financial system. These are Authorised Deposit-taking Institutions, Life Insurance, General Insurance, Superannuation, Retirement Savings Accounts and Non-operating Holding Companies. In each case it is provided that levies will be applied as a percentage rate on assets of institutions in each category, subject to a minimum amount and a maximum amount per institution.

The levies collected by APRA also cover some costs of the Australian Securities and Investments Commission (ASIC) and the Australian Taxation Office (ATO). In 1999/2000 APRA collected levies of \$76 million, of which \$14 million was for the other agencies.

Determining levy rates

By law the Treasurer determines the levy rates to apply each year; he has delegated this role to the Minister for Financial Services and Regulation. The process leading to rate determination is described in the following paragraphs.

The aggregate amount of revenue to be collected through levies is agreed annually by APRA, ASIC and the ATO with the Commonwealth Treasury. This takes account of required expenditure by each agency and APRA's balance sheet reserves.

APRA's required expenditure is determined having regard to the cost-effective achievement of the objectives described above. In addition, the Board of APRA has decided that it would be prudent to have reserves on balance sheet to help meet unforeseen demands on resources and to reduce volatility in levy rates from year to year. The target for reserves has been set, in broad terms, between 5 and 10 per cent of APRA's annual levy revenue.

Estimates of APRA's expenditure are made four years ahead and appear in Commonwealth Budget Papers. (APRA's funding is covered by a Standing Appropriation; while it makes no net call on the Commonwealth budget its levy revenue passes through Consolidated Revenue.)

Until 2002/03, levies will also need to cover APRA's repayment of a loan of \$20 million from the Commonwealth to meet establishment costs of the new agency.

As outlined above, the levies collected by APRA are presently based on six groups of financial institutions. As also explained, APRA's organisation structure does not lend itself to a precise expenditure allocation on this basis. Allocation of corporate support expenditure – approximately 30 per cent of the total – is inevitably somewhat arbitrary. Moreover, the structures of APRA's other Divisions are not aligned closely with industry sectors.

Subject to these caveats, the process by which APRA produces the industry figures needed for levy determination is broadly as follows:

- costs are collected annually in 32 activity cost centres that roll up into the Divisional structure;
- these costs are, in turn, allocated to industry sectors according to cost ratios described below. First, a direct allocation is made based on estimated periodic information about the time taken to perform supervisory duties in relation to different sorts of institutions. Second, corporate support costs are distributed in proportion to the direct allocations;
- estimates of industry cost ratios are averaged over a three year period. The average is determined from the previous year's figures, the estimate for the current year and an assessment for the year ahead – this process is intended to take into account the very approximate nature of each year's calculation and the desirability of avoiding sharp swings in levy rates because of unusual circumstances in a particular year;
- the resulting ratios are applied to budgeted expenditure for the year ahead to produce estimates of the amount to be collected from each sector plus allocations determined by ASIC and ATO; and
- adjustments are made for any significant over or under collections from the current year, and for APRA's balance sheet reserves target. (In this way any over collections will be returned to industry subsequently.)

When industry amounts have been estimated APRA, ASIC and Treasury conduct a round of consultation with industry covering both the funds required for the financial year ahead and levy structures that would raise those.

Recommendations are then made to the Treasurer for levy rates, and minimum and maximum amounts, for the year ahead. For APRA, two important guiding principles are:

- to avoid undue volatility in rates from one year to the next
- to move toward a point where the base levy rate is similar across industry sectors – this follows from APRA’s aspiration to supervise, as far as possible, on a risk-based (rather than institution-based) model and the reality that it will become even more difficult to determine separate industry rates accurately as time passes.

Accountability

APRA is governed by a Board with a majority of members appointed from the private sector.

There are numerous avenues through which APRA is accountable for its expenditure of levy funds. They include:

- industry consultations as part of the annual levy determination process
- the role of the Treasurer in determining levy rates each year
- regular appearances before Parliamentary Committees (as well as Senate Estimates hearings, APRA is subject to annual review by the House of representatives Committee on Economics, Finance and public Administration.)
- audits by the Australian National Audit Office
- an Annual Report to Parliament

In addition, the Government proposes to conduct an assessment of the effectiveness of the various reforms arising from the Wallis Committee’s report in 2003. The Financial Sector Advisory Council, which advises the Treasurer, has been asked to contribute to this.

Specifically in relation to the framework for levy collection, the Government conducted a review in late 1999 and, apart from minor modifications, confirmed the arrangements introduced with APRA’s formation in 1998. It has announced that a further review will be conducted in 2003 in conjunction with the assessment referred to above.

The *Appendices* attached provide further information:

- Appendix 1 – APRA’s cost structure
- Appendix 2 – Process of levy determination for APRA
- Appendix 3 – Levy Rates
- Appendix 4 – Levy arrangements of some overseas supervisory agencies
- Appendix 5 – Report on the Financial Sector Levy Review which was sent to Industry. Please note that there were some changes between the report and the final levy determinations

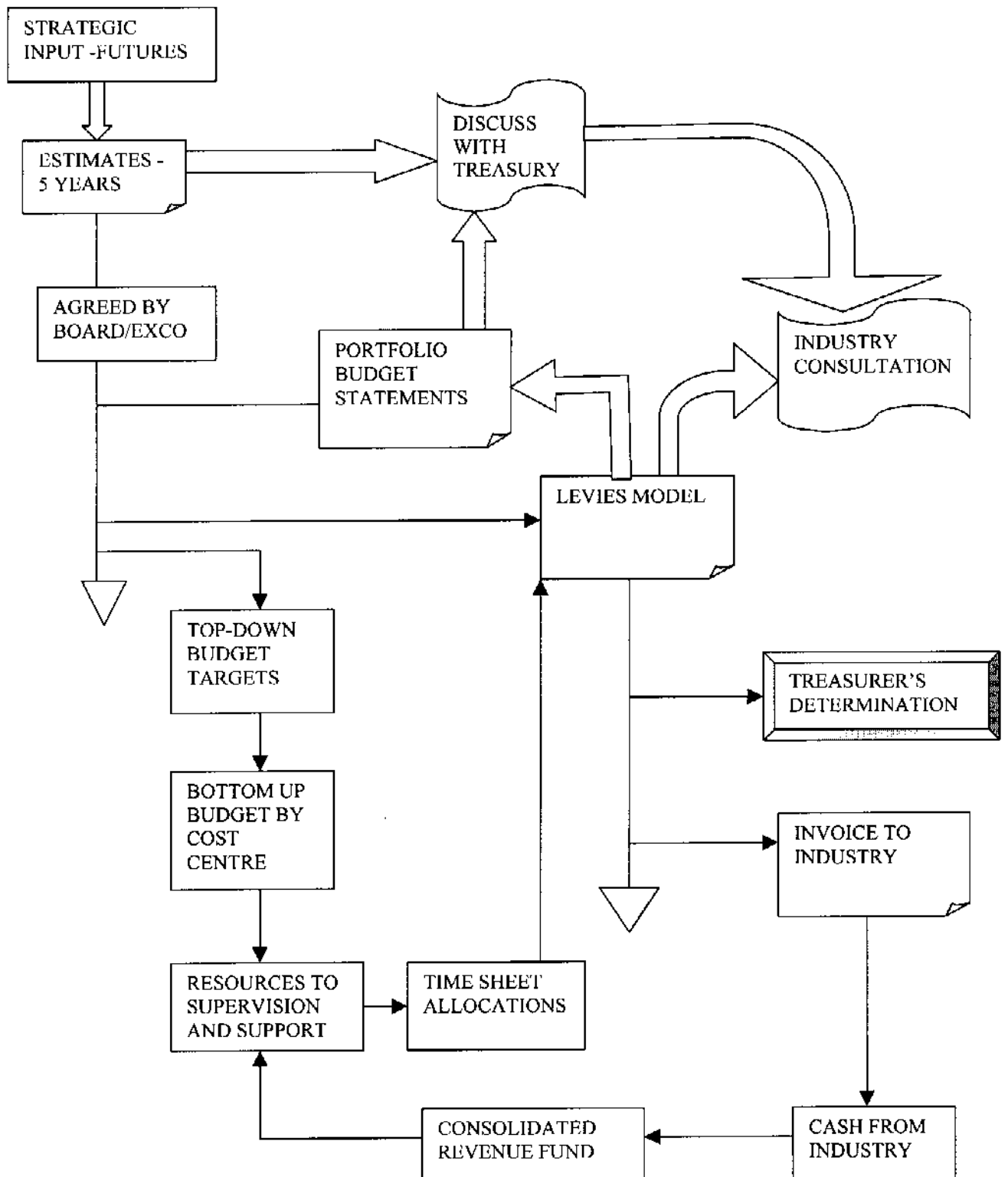
Australian Prudential Regulation Authority
November 2000

Appendix 1 – APRA’S cost structure

APRA is predominantly a service organisation. Its cost structure is driven by headcount. Two thirds of operating costs are employee-related costs. Such costs include salaries, superannuation, training and travel. One quarter of the costs relate to overheads including facilities, consumables, telecommunications and professional support such as audit. The balance of operating cost is depreciation. In the first two years of APRA’s operation, abnormal costs associated with the initial start up of the organisation have been incurred. This has included the building of infrastructure, the set up of head office in Sydney, establishing the new APRA organisational teams and the development of new processes and systems to support the new structure. Establishment costs are being recovered from industry over four years.

The flow of costs starts with those costs that can be directly attributed to one of thirty-two cost centres. Cost centres have been set up within four divisions. General managers and employees are assigned to cost centres. Certain costs are pooled in support cost centres such as facilities. They are then allocated out as indirect costs to other cost centres on the basis of usage. Allocation keys are chosen to reflect usage patterns and are typically based on headcount, office space or consumption statistics. For levy purposes, costs are aligned by industry. As previously noted, the primary organisational alignment is risk based and not by industry. Time sheets are used to determine the percentage of resources committed to activities and industries. Where time is not directly attributable to an industry it is pooled as unallocated. The unallocated time pool is absorbed into allocated time, in the ratio of allocated time to total time. In this way, cost by industry is determined. Averaging of time allocations is used to dampen the volatility that might otherwise be caused by the fluctuations in the condition of particular sectors or individual companies and the amount of supervisory attention they require.

Appendix 2 –process of levy determination for APRA



Appendix 3 –levy rates

a) For 1999/2000

INDUSTRY	PERCENTAGE OF ASSETS	MINIMUM	MAXIMUM
NON-EXCLUDED SUPERANNUATION FUNDS	0.04%	\$300	\$41,000
RETIREMENT SAVINGS ACCOUNT PROVIDERS	0.04%	\$5,000	\$18,500
LIFE INSURERS	0.02%	\$500	\$280,000
GENERAL INSURERS	0.02%	\$5,000	\$75,000
AUTHORISED DEPOSIT-TAKING INSTITUTIONS	0.013%	\$500	\$1,000,000
NON-OPERATING HOLDING COMPANIES	FLAT RATE CHARGE OF \$10,000		

b) For 2000/01

INDUSTRY	PERCENTAGE OF ASSETS	MINIMUM	MAXIMUM
SUPERANNUATION FUNDS	0.02%	\$300	\$46,000
RETIREMENT SAVINGS ACCOUNT PROVIDERS	0.02%	\$5,000	\$18,500
LIFE INSURERS	0.02%	\$500	\$280,000
GENERAL INSURERS	0.02%	\$5,000	\$100,000
AUTHORISED DEPOSIT-TAKING INSTITUTIONS	0.012%	\$500	\$1,000,000
FOREIGN BANK BRANCHES	0.006%	\$500	\$500,000
NON-OPERATING HOLDING COMPANIES	FLAT RATE CHARGE OF \$10,000		

Appendix 4 - levy arrangements of some overseas supervisory agencies

The following provides a high level description of the structure and funding of APRA compared to the Financial Services Authority (FSA) in the UK and the Office of the Superintendent (OSFI) in Canada. The different roles and responsibilities make comparison complex and possibly arbitrary. For example the FSA has responsibility for consumer protection, an activity carried out by ASIC in Australia. Nevertheless, the intention is to describe possible methods of funding regulatory work in three countries.

a) Australia -Australian Prudential Regulation Authority (APRA)

APRA started regulation in July 1998 and took over the responsibilities of regulation from the Reserve Bank and from the Insurance and Superannuation Commission. APRA was formed in response to the Financial Systems Inquiry, which concluded in March 1997 under the Chairmanship of Stan Wallis. In July 1999, APRA incorporated the regulatory work of the State based systems under the Australian Financial Institutions Commission (AFIC). Thereby, eleven institutions covering banks, credit unions, building societies, life insurance, friendly societies, general insurance and superannuation funds were integrated into a single regulator. The regulator has a head office in Sydney and state offices in Melbourne, Adelaide, Perth, Brisbane and Canberra. APRA has about 400 staff and total costs in 1999/2000 were about \$52 million.

APRA is predominantly funded by levies to industry, which aim to cover the costs less additional income. Any over or under recoveries in levies in prior periods are adjusted for in the current period. Additional income comprises fees and charges, cost recoveries and interest on cash deposits.

The percentage of total costs by activity for 1999/2000 was:

- Supervision, rehabilitation and enforcement 49%;
- Development of prudential policies and standards 14%;
- Liaison with industry 9%; and
- Administrative support and corporate governance 28%.

The percentage of cost by category for 1999/2000 was:

- Employment costs 66%;
- Administrative costs 29%; and
- Depreciation 5%.

The following is indicative of the cost of supervision by financial sector¹:

- Authorised Deposit Taking Institutions (ADIs) \$22 million (37%);
- Insurance \$14 million (23%); and
- Superannuation \$24 million (40%).

¹ The financial costs include those incurred by ASIC and the ATO. Adjustments are made for over and under recoveries in the prior period.

b) UK -The Financial Services Authority (FSA)

The FSA is the amalgamation of several responsibilities towards a single regulator. The FSA is responsible for overseeing the regulation of investment business under the Financial Services Act 1986 and for banks under the Banking Act 1987. The primary strategy of the FSA is the introduction of a common risk model for use across all sectors of the financial industry with a move away from institution-based routine supervision. The FSA employs about 1900 staff predominantly in London. Total costs for 1999/2000 are about PS 196 million.

The FSA has a complex range of activities, some of which are intended to be temporary in nature with considerable volatility from year to year. They cannot, therefore, be subject to firm budgetary limits. In this context, the FSA has established a framework within which to manage and report costs and funding.

The FSA sets fees by type of body, firm or scheme, which reflect the costs applicable to the category. The costs of staff time are attributed to specific activities and where possible by individual fee payers. Other costs are allocated in the same way. Keys allocate indirect costs to the individual fee payers. Overheads are apportioned on the basis of pro rata to time costs. The surplus of fees over costs is tracked by regulated body by taking into account over or under recoveries in prior years.

The FSA has identified four streams of activities, which have distinct cost and funding characteristics²:

1. Mainstream regulatory activity –funded principally by fees (90%). Of this amount, 60% is funded by organisations with which the FSA has a contractual agreement and 40% is funded by statutory fees on organisations that the FSA directly regulates;
2. Pensions review –a temporary activity, funded by a separate levy (6%);
3. External enforcement costs –potentially volatile from year to year depending on incidence of cases, funded principally by fines and recoveries of costs (1%); and
4. Ombudsman schemes -a new Financial Services Ombudsman, funded principally by case fees (3%).

The percentage of total costs budgeted by activity for 1999/2000:

- Financial supervision 53%;
- Authorisation and enforcement 18%;
- Policy, legal, communications and Board 14%;
- Corporate activities 14%; and
- Other 1%.

² The percentages by activity are the budget numbers for the costs 1999/2000

The percentage of budgeted cost by category for 1999/2000 is:

- Employment costs 70%;
- Administrative costs 26%; and
- Depreciation 4%.

The following is indicative of the cost of supervision by financial sector:

- ADIs PS 54 million;
- Insurance PS 13 million; and
- Credit Unions PS 1 million.

c) Canada –the Office of the Superintendent of Financial Institutions (OSFI)

OSFI supervises and regulates all banks in Canada, and all federally incorporated trust and loan companies, insurance companies, cooperative credit associations, fraternal benefit societies and pension plans. OSFI is organised in four sectors: Supervision, Regulation; Specialist Support; and Corporate Services. The organisation employs about 400 people in offices located in Ottawa, Montreal, Toronto and Vancouver. The total costs are about Canadian \$49 million. OSFI is funded mainly through asset-based membership or membership-based assessments on industry and a modified user-pays program for selected services. A small portion of OSFI's revenue is derived from the Government of Canada for actuarial services relating to the Canada Pension Plan.

As part of OSFI's accountability framework, dialogue is maintained with stakeholders on costs and benefits associated with fulfilling its mandate. Each year, OSFI explains its budget to industry and stakeholders and seeks their input for the asset or premium-based assessments on the industry and the modified user-pay program from which OSFI secures the bulk of its revenue.

OSFI recovers its costs from by industry in the following percentages:

- Banks, trust and loan companies 41%;
- Life Insurance and Fraternal Benefit Societies 28%;
- Property and Casualty Insurance companies 16%;
- Government of Canada –Actuaries 6%;
- Cooperative credit associations 1%; and
- Other 8%.

The make up of OSFI's cost structure for the 1999/2000 is as follows:

- Employee related 66%;
- Administrative costs 29%; and
- Depreciation 5%.

After extensive consultation with financial institutions and their industry associates, OSFI introduced a program of charging individual financial institutions for selected services. Phase one of this program was effective from January 1999. OSFI has embarked on phase two of this program and is evaluating the fairness of its current methodology for assessing costs to financial institutions. Also they are considering the introduction of assessment surcharges to recover directly from problem institutions additional costs associated with enhanced supervision. OSFI is also evaluating penalty fees for late or erroneous filings of returns. OSFI has published a schedule of fees. In addition, for large complex transactions, such as bank mergers and demutualisations of life insurance companies, OSFI will enter into separate contractual arrangements to recover the higher costs associated with such requests.

Revenue derived by OSFI in 1999/2000 was:

- Assessments \$41.3 million;
- PBSA (pensions) fees \$3.8 million;
- User pays fees \$2.4 million;
- Actuaries \$2.8 million; and
- Other \$0.9 million.

REPORT ON THE FINANCIAL SECTOR LEVY REVIEW

The purpose of the levy review was to evaluate the current levy arrangements ability to provide an efficient, equitable and durable funding mechanism for the supervision of prudentially regulated institutions consistent with the principles included in the Financial System Inquiry recommendations¹.

The Treasury and APRA undertook the review. Industry groups have been consulted throughout the review² and will continue to be consulted further prior to implementation of levies for the 2000-01 financial year.

Summary of Recommendations

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

1. Continue to impose levies on a sectoral basis.
2. Retain concepts of minimum and maximum amounts payable.
3. Charge small APRA superannuation funds (SAFs) the same rate as other prudentially regulated superannuation funds recognising the importance of these financial institutions receiving an appropriate level of prudential regulation.
4. Maintain the existing timing of collection of levy payments.
5. That the 'double counting' of assets for the purposes of calculating the levy payable is not inconsistent with the goal of collecting revenue from the relevant financial sector to fund the costs of regulating that sector.
6. Do not merge the levy imposed on providers of Retirement Savings Accounts (RSAs) with the levy imposed on the Authorised Deposit-taking Institution (ADI) sector at this time.

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

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

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

7. Rebate up to \$1 million of over collection of levies to industry in order to provide for stability in the levy rates determined by the Treasurer.
8. Recognising the lower level of demand placed on the regulator by foreign bank branches provide for a concessional levy on foreign bank branches.
9. Provide a concession to a small number of Pooled Superannuation Trusts (PSTs) used as an administrative device for the investment of funds from a number of corporate superannuation funds under the control of one employer sponsor.
10. APRA to introduce fees/charges for non-supervisory elective services.
11. The regulators are to provide more detailed specific activity cost information to assist with setting levies more reflective of the costs of supervision.
12. Undertake a review of the levies framework in around 2003 to consider the extent of convergence amongst sectors and whether a group based model would be more appropriate.

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

Discussion of Recommendations

1. *Continue to impose levies on a sectoral basis.*

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

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

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

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

2. *Retain concepts of minimum and maximum amounts payable.*

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Under the current legislation, levies are calculated and payable by all industries at the same date, apart from the superannuation industry. The levy on the superannuation

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Overcollection of levies can occur for the following reasons:

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

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

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

Proposed rebate process for super industry

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

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

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

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

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

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

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

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

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

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

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

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

The Association of Superannuation Funds of Australia (ASFA) has identified a special group of PSTs that are administrative entities used for pooling investment funds from a number of corporate superannuation funds who are under the control of one employer sponsor. These PSTs typically arise where a company has taken over or merged with other companies and has employees in a number of corporate superannuation funds controlled by the employer. There are often legal impediments preventing the merging of

these funds (eg because they have differing benefit structures), so in order to achieve efficiencies the funds assets are directed into a single PST for management and investment purposes.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Industry groups were very supportive of a move to a group-based model, particularly as it would be consistent with broad trends towards convergence being observed across the financial sector. However, industry considered that the change would be premature at this time as the pace of convergence and industry rationalisation was uncertain, and it would be more appropriate if the issue could be revisited after a period of time.

Accordingly, the review team recommends a review in 2003, as this would allow a significant period of time for further industry rationalisation and convergence, and it would be consistent with the timing of the review of financial sector reforms scheduled to be undertaken by the Financial Sector Advisory Council in 2003.

Conclusion

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

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

- whether levies would continue to be levied by sector or on some other basis. In the event there was widespread support for retaining the sectoral approach - see recommendation 2;
- the proposal to allow for a graduated levy to be charged within sectors - see recommendation 3;
- a proposal to increase the statutory maximum applicable to the ADI sector - see recommendation 2; and
- a proposal to merge the providers of RSAs with the ADI sector - see recommendation 6.

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