



Investment & Financial Services Association Ltd

ACN 080 744 163

9 November 2000

Mrs Helen Owens  
Presiding Commissioner  
Cost Recovery Inquiry  
Productivity Commission  
Locked Bag 2  
Collins Street East PO  
Melbourne VIC 8003

Dear Mrs Owens

**RE: COST RECOVERY INQUIRY**

The Investment & Financial Services Association represents Australia's leading investment managers and life insurance companies. Our 70 members hold more than \$550 billion in assets under management on behalf of nine million Australians who have superannuation and managed funds.

IFSA agrees with the Commission's discussion paper that the rationale for many current fees, levies and charges is not always clear. This seems particularly true in the financial services industry, where fee and levy revenue well exceeds the running costs of the relevant regulatory activities. Consequently, IFSA strongly supports the Commission's efforts, through this inquiry, to establish appropriate and balanced principles and guidelines for cost recovery.

*Principles for Cost Recovery*

We would like to suggest some issues for consideration in establishing principles for cost recovery. We see a difference between regulatory activities undertaken for public policy reasons, and those activities that could be seen as providing a particular service to individual businesses or industries.

Where government activity – including regulatory activity – is essentially of a service delivery nature, it is appropriate that the costs of that activity be recovered through fees, charges and levies. Payers of these fees, charges or levies may be receiving benefits that do not flow directly on to the broader community. They may be direct commercial or private benefits, or indirect benefits that are greater for these payers than for the community as a whole. These benefits might include regulatory activity that contributes to the smooth and efficient operation of an industry or business activity.

Where regulation is undertaken primarily for public policy reasons, the justification for cost recovery is much less clear. Where regulation creates economic externalities that benefit payers, such as public confidence in an industry, some level of cost recovery appears justified. If regulation is purely for public policy reasons, and no externality arises for payers, the case for funding the costs of regulation from fee or levy revenue is weaker and the case for public funding is stronger.

For example, the public policy rationale is particularly true of policing activity. The benefits of investigation and enforcement activity are primarily public policy benefits, yet regulators (whose cost recovery income exceeds their total operating costs) meet the cost of enforcement.

IFSA's view is that, given the significant public policy purposes that underlie financial sector regulation, a reasonable proportion of the cost should be borne by the whole community, through public funding. Fee and levy revenue should not be expected to meet the whole cost of regulation – and certainly should not exceed the running costs of the relevant regulators.

#### *Guidelines for cost recovery*

IFSA suggests that guidelines for the application of cost recovery should be developed, based on the principle of distinguishing private benefits (to industry or individual businesses) from public policy objectives. These guidelines should aim to strike a balance between the public (policy) and private benefits which flow from regulation. This balance should then be reflected in the proportion of revenue sought from cost recovery for regulation, and the proportion provided from public funding.

IFSA accepts that regulation does create significant positive externalities for the financial services industry, and consequently the industry should contribute towards the cost of regulation. These externalities include:

- support for public confidence in regulated financial products and services; and
- contribution to a level playing field, on which regulated products and services can compete on their merits.

Much of financial services regulatory activity is undertaken for pure public policy reasons, and does not create positive externalities for the financial service industry. While IFSA (along with many other bodies) has strongly supported these public policy objectives, we are of the view that the whole community should fund them. Examples include:

- policing activity (as discussed above);
- regulation to prevent or limit tax deferral;

- retirement incomes policy objectives, such as the required features of complying pensions and annuities; and
- retirement savings (superannuation) and incomes public education.

IFSA also suggests that cost recovery guidelines should support appropriate matching between costs recovered from similar activities. In its recent report into APRA, the House of Representatives Standing Committee on Economics and Financial Administration found that the balance of levies charged between deposit taking institutions, and the superannuation and life insurance industry, is out of proportion with the funds managed or held by these industries.

Where applicable, cost recovery should also match the costs of the activity involved. For example, the House of Representatives Standing Committee found that APRA could not identify the cost of particular regulatory activities, such as in the life insurance industry, or relate these costs to levy revenue from this industry.

#### *Surplus revenue from regulatory activity*

IFSA does not support the recovery of fee, charge and levy revenue that exceeds the cost of the relevant regulatory activity. Overall fee and levy revenue related to regulatory activity in the financial sector far exceeds the cost of that activity. In the 1998-99 financial year:

- the Australian Prudential Regulation Authority received fee and levy revenues of \$62.8m while operating costs were \$42.7m; and
- the Australian Securities and Investments Commission received fee and charge revenues of \$339m while operating costs were \$145.5m.

IFSA does understand that government relies on this surplus of revenue from regulatory activity as part of its general budgetary revenues. A surplus is nonetheless difficult to justify on the basis of either cost recovery or public policy (regulation) principles.

Yours sincerely



**Lynn Ralph**  
Chief Executive Officer