



Australian Government
The Treasury

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Financial Institutions Supervisory Levies methodology

Discussion Paper
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Consultation Process

Request for feedback and comments

This paper seeks submissions on the design and operation of the Financial Institutions Supervisory Levies. The focus of the discussion paper is on the methodology used for the application of the levies.

While submissions may be lodged electronically or by post, electronic lodgement is preferred. For accessibility reasons, please submit responses sent via email in a Word or RTF format. An additional PDF version may also be submitted.

All information (including name and address details) contained in submissions will be made publicly available on the Treasury website unless you indicate that you would like all or part of your submission to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose.

Respondents who would like parts of their submission to remain in confidence should provide this information marked up in a separate attachment.

Legal requirements, such as those imposed by the Freedom of Information Act 1982, may affect the confidentiality of your submission.

Closing date for submissions: 13 September 2019

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FOREWORD

In 1998, the Government introduced levy setting arrangements to recover the majority of the operational costs of the Australian Prudential Regulation Authority (APRA) and other specific costs incurred by certain Commonwealth agencies and departments. Since the introduction of the Financial Institutions Supervisory Levies Collection Act 1998, the scope of the levies imposition has expanded to include a broader range of activities relating to the financial services sector. Information on how the levies are used to fund various agencies and the activities they undertake is provided in this paper.

Additional funding has been provided to APRA over the last few years. In particular, much of this funding came via the 2018-19 MYEFO and 2019-20 Budget. This funding allows APRA to, amongst other things, increase the number of frontline supervisors for the largest and most complex financial institutions, and enhance APRA's ability to identify new and emerging risk areas, such as governance, culture and accountability as well as cyber risks. In prior budgets, APRA was provided funding to undertake new regulatory activities to support a stable and competitive financial system; improve ADI and executive accountability; and develop new data collection and dissemination systems. APRA also assumed supervisory responsibilities for private health insurers in 2015.

The purpose of this paper is to provide industry with an opportunity to comment on the design and operation of the levies framework. This discussion paper is separate to the annual 'Proposed Financial Institutions Supervisory Levies' paper released each year.¹ That paper generally focuses on how the levies for a particular year are calculated, whilst this discussion paper focuses on the methodology that is applied in calculating the levies.

Comments received will inform future consideration on the Financial Institutions Supervisory Levies and changes to legislation that underpin the levies framework.

The Hon Josh Frydenberg MP

Treasurer

1 <https://treasury.gov.au/consultation/c2019-382473>

1. OVERVIEW OF THE LEVIES

The Government funds APRA and the cost of additional regulatory functions in the financial system through levies on the APRA regulated financial services sector.

The legislative framework is established by the Financial Institutions Supervisory Levies Collection Act 1998, which prescribes the timing of payment and the collection of the levies. A suite of imposition Acts impose levies on institutions operating in the APRA regulated financial services sector. These Acts largely set a CPI indexed statutory upper limit and provide for the Minister to make a determination as to certain matters such as the levy percentages for the 'restricted' and 'unrestricted' levy components (refer to sec. 4.1)², the minimum and maximum levy amounts applicable to the restricted levy component, and the date at which a regulated institution's levy base is to be calculated.

Under s50(1) of the Australian Prudential Regulation Authority Act 1998 (APRA Act), APRA is authorised to collect revenue to cost recover expenses incurred by other Commonwealth entities, including the Australian Securities and Investments Commission (ASIC), the Australian Taxation Office (ATO), the Australian Consumer and Competition Commission (ACCC), the Gateway Network Governance Body Ltd (GNGB) and in 2019-20 only, the Treasury. These expenses relate to:

- certain market integrity and consumer protection functions undertaken by ASIC and the ATO;
- processing claims for the early release of superannuation benefits on compassionate grounds undertaken by the ATO;³
- funding for the Superannuation Complaints Tribunal (ASIC);
- the establishment of a dedicated analysis and advisory function – the Financial Services Competition Branch (FSCB) – to investigate foreign exchange and specific competition issues in Australia's financial system (ACCC);
- governing and maintaining the superannuation transaction network (GNGB); and
- in 2019-20 only, the recovery of costs incurred by The Treasury in conducting a Capability Review of APRA in 2018-19.

A breakdown of the levies by agency/program is set out in Table 1 across the last seven financial years.

2 Note that the Private Health Insurance Supervisory Levy is the exception with a different method of determination of levies payable.

3 In 2018-19 the Early Release of Superannuation Benefits on compassionate grounds program was transferred from the Department of Human Services to the ATO.

Table 1: Financial Institutions Supervisory Levies funding by agency (\$'million)

Agency	FY 13/14	FY 14/15	FY 15/16	FY 16/17	FY 17/18	FY 18/19	FY 19/20
APRA	115.6	116.9	117.5	122.1	136.1	141.6	186.1
ASIC	32.2	28.5	28.2	70.4	49.6	35.5	8.4
ATO	7.3	7.1	17.9	17.8	17.8	31.0	36.3
DHS	4.4	4.5	4.7	4.8	5.1	-	-
ACCC	-	-	-	-	3.0	3.2	3.5
SuperStream	99.5	71.7	61.8	35.5	35.5	-	-
GNGB	-	-	-	-	-	0.6	0.7
Treasury	-	-	-	-	-	-	1.0
Non-APRA prior year under-collection recouped	-	-	-	-	0.9	1.5	-
Total	259.0	228.7	230.0	250.7	248.0	213.4	236.0

Reviews of the levy-setting arrangements were conducted in 2003,⁴ 2005,⁵ 2008-09⁶ and 2013⁷.

2. RATIONALE FOR THE LEVIES

Regulators can be funded by industry, government, or a blend of the two. Most countries fund their prudential regulators through a mixture of government and industry funding.

Prudential regulation can be seen as having public good characteristics, as a stable, well regulated financial sector confers benefits on the entire community, – not just the regulated parties. For this reason, an argument can be made that financial regulation should be funded entirely by government. However, calls on government resources need to be balanced against the potential benefits from alternative uses for government funds and against whether government funding would provide adequate resources for regulators.

The desirability of autonomy for prudential regulators is generally taken to include independence from overall budget targets and, consequently, a high degree of industry funding. Australia's participation in the IMF Financial Stability Assessment Program reinforces the importance of adherence to global 'Core Principles' for banking and insurance, which require that a regulator be funded in a way that does not undermine its autonomy or independence from government.

An industry levy, to meet the general costs of regulation, was recommended by the Wallis Inquiry in 1997 that led to the creation of APRA. The use of a levy ensures that funding for regulators is determined by reference to policies for financial system regulation and supervision rather than targets for the overall budget balance.

4 <http://archive.treasury.gov.au/documents/587/PDF/FSL.pdf>

5 http://archive.treasury.gov.au/documents/966/PDF/Review_impact_on_levies_31_Mar_2005.pdf

6 http://archive.treasury.gov.au/documents/1708/PDF/Review_of_Financial_Sector_Levies.pdf

7 <https://treasury.gov.au/consultation/financial-industry-supervisory-levy-methodology>

3. SIZE AND STRUCTURE OF THE FINANCIAL SECTOR

APRA currently supervises institutions holding \$6.7 trillion assets for Australian depositors, policyholders and superannuation fund members, as at most recent data. In the 1990s and early 2000s, the assets of Australian financial institutions grew by around 10 per cent per annum, but growth has slowed in the decade since the global financial crisis.

Authorised deposit taking institutions (ADIs) account for nearly 67 per cent of the assets of APRA-regulated institutions. ADI assets are over two times the size of nominal GDP. Australia's four major banks together hold about 74 per cent of total ADI assets.

Life insurance companies, general insurance companies and superannuation funds account for about one third of Australian APRA-regulated institutions' assets. Life insurance makes up around four per cent of APRA-regulated institutions' assets. The industry has increasingly focused on wealth management rather than traditional life insurance business, with the industry's superannuation businesses continuing to account for the vast majority of its assets. The general insurance industry is fairly concentrated, with four large companies dominating the sector.

The Australian superannuation industry is relatively large by international standards. The assets of the APRA-regulated superannuation industry totalled \$1.8 trillion at March 2019.

The following table outlines the size and structure of the regulated sectors from June 2014 to June 2018.

Table 2: Number and asset base of regulated institutions

Industry	June 2014		June 2015		June 2016		June 2017		June 2018	
	No.	Total asset base (\$b)								
ADIs	169	3,427.5	161	3,853.7	157	4,171.6	149	4,242.0	145	4,322.0
Life insurers and Friendly societies	40	289.3	39	305.8	40	299.7	41	236.7	41	240.0
General insurers	115	114.5	115	121.2	108	122.8	104	125.0	95	121.4
Licensed trustees	170		156		145		139		130	
Non-operating holding companies	25		25		24		25		27	
Private Health Insurers	34		33	11.8	33	12.8	37	13.8	37	14.3
APRA-regulated superannuation institutions	2,749	1,107.3	2,518	1,237.3	2,321	1,292.4	2,167	1,616.7	1,999	1,774.1
Excluding small funds	299	1,105.2	284	1,235.2	266	1,290.4	240	1,614.6	222	1,772.0
Small funds	2,450	2.1	2,234	2.1	2,055	2.0	1,927	2.1	1,777	2.1
Total	3,302	4,938.6	3,047	5,529.8	2,828	5,899.3	2,662	6,234.2	2,474	6,471.8

Note: The addition of 'excluding small funds' and 'small funds' in Table 1 gives the total of 'APRA regulated superannuation institutions'.

4. CALCULATION OF THE LEVIES

4.1 APRA'S COMPONENT OF THE LEVIES

APRA's activities fall into four main categories:

- establishing prudential standards to be observed by supervised institutions (levy recovery);
- assessing new licence applications (licencing charge recovery);
- assessing the safety and soundness of supervised institutions (levy recovery); and
- where necessary, carrying out APRA's resolution authority responsibilities or other remediation, crisis response and enforcement activities (levy recovery).

APRA is largely funded through levies recovered from regulated institutions, which is set by the Government through the annual Budget process. APRA's budget is included in the annual Treasury Portfolio Budget Statements. If APRA is asked to undertake significant new activities, or considers it is inadequately funded to meet future demands, it will submit a New Policy Proposal (NPP) for Government's consideration. Any NPP will be considered in the context of its relative burden across the regulated industries. Following an NPP process, Government decides how much additional funding, if any, will be provided to APRA. As part of the standard Budget process any public comments or concerns about APRA's overall resourcing and activities can be raised in pre-Budget submissions.

APRA also undertakes a range of fee-for-service activities which are directly recovered from relevant institutions.

The current levies methodology is designed to recoup APRA's costs. It is based on the time APRA estimates that it spends on supervising each industry sector. The levy has two components:⁸

- A restricted levy component, reflecting the cost of supervision for an industry. This is structured as a percentage rate on assets, subject to minimum and maximum amounts. Activities covered by this component include costs associated with APRA's onsite and offsite analysis, supervision and risk assessment of individual institutions and its legal and enforcement activities; and
- An unrestricted levy component, which covers costs relating to 'systemic' regulation, rather than costs that can be allocated to an individual institution or industry. While this is also structured as a percentage rate on assets, the key difference is that there are no minimum or maximum amounts. This aims to ensure that the larger institutions pay more according to their size. Activities covered by this component include costs associated with the development of APRA's prudential framework for the industries it supervises, as well as its statistical data collection and publications.

One of the challenges in the levies methodology is the avoidance of cross-subsidisation within each industry. This occurs where a disproportionately large or small levy is charged to a section of the industry, when compared to the actual cost of APRA supervision. To mitigate this, APRA periodically analyses detailed time-recording data on the actual cost of supervision available through its internal time recording system.

⁸ To date APRA's costs for the PHI industry have been collected differently – as a fixed price levy based on June policy data and the total amount collected derived from transitional costing calculations. There are no minimum or maximum amounts. For 2019-20 APRA will commence transitioning to a method of industry allocation consistent with the methodology that is applied to other industries.

One of the modifications resulting from this process has been a steady increase in the levy minimums for each industry from a previously low level. For 2019-20 there was a pause in the increase to the levy minimums to allow the impact of these recent increases to settle more within each industry. APRA will conduct further analysis of time recording data during 2019-20 and the results of that analysis will continue to be an input to the levy-setting process for the 2020-21 financial year.

Consistent with the levy minimums review process, the levy maximums have been considered and modified each year, reflecting the observed cost of supervision. Changes to the maximums are discussed further in section 6.1.

The industry sectors covered by the levies process are:

- Authorised deposit-taking institutions (ADIs) comprising banks, building societies and credit unions;
- Life insurance companies (LIs), comprising life insurance companies and friendly societies;
- General insurance & reinsurance companies (GIs);
- Private health insurers (PHIs); and
- Superannuation entities, excluding self-managed superannuation funds (Super).

The levy allocation methodology is designed to fully recover the costs from each industry sector and minimise cross-subsidies across sectors.

The estimated asset value of each institution is used as a basis for allocating the quantum of the sectoral levy to each regulated institution.

For simplicity, the levies model is adjusted by over and under collection of the levies in prior periods by sector. Over or under collection occurs from time to time, mainly from either a difference in the actual asset values of institutions or from changes in the population of regulated institutions.

Table 3: APRA's levy requirement by industry for 2019 20 (\$'million)⁹

Industry	2019-20 Restricted component	2019-20 Unrestricted component	2019-20 Total
ADIs	46.6	38.5	85.1
Life insurance/ friendly societies	12.8	7.3	20.1
General insurance	21.0	9.5	30.5
Superannuation	30.0	14.3	44.3
Total	110.4	69.6	180.0

4.2 OTHER COMPONENTS OF THE LEVIES

APRA has authority to recover other specific costs incurred by certain Commonwealth agencies and departments.

The specific costs to be recovered are included in the determined levy rates by industry sector and the estimated asset value is used as the basis for the calculation of the quantum of the levy component.

⁹ Excluding PHI industry levies of \$6.1 million.

Table 4: Other Commonwealth agency levy requirements by industry for 2019-20 (\$'million)

Industry	ATO	ASIC	GNGB	ACCC	Treasury	Total 2019-20 levy
ADIs	-	-	-	3.5	0.6	4.1
Life insurance/ friendly societies	-	-	-	-	0.1	0.1
General insurance	-	-	-	-	0.1	0.1
Superannuation	36.3	8.4	0.7	-	0.2	45.6
Total	36.3	8.4	0.7	3.5	1.0	49.9

5. RECENT DEVELOPMENTS IN THE FINANCIAL INSTITUTIONS SUPERVISORY LEVIES

Funding for Commonwealth agencies and departments through the Financial Institutions Supervisory Levies is considered in the Government's annual budget process. As part of this process, agencies may bring forward new spending proposals and identify how they will be funded. In these instances, the Expenditure Review Committee of Cabinet considers whether it is appropriate to fund these proposals through the levies.

During 2018-19, APRA's funding was increased significantly through two funding measures approved in both the Mid-Year Economic and Fiscal Outlook and Commonwealth Budget processes. These increased APRA's funding over the forward estimates by approximately \$210 million, with a corresponding increase in APRA's approved cost base occurring in 2019-20. The measures were:

- *Government Response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*; and
- *Australian Prudential Regulation Authority – New and expanded functions*.

To maintain equity within the industries for the restricted levy components, the levy maximums for Super, LIs and GIs were increased significantly by around 85, 48 and 44 per cent respectively to accommodate this large overall increase.

The ADI industry sector had a smaller increase of 4.2 per cent in its levy maximum from \$3.0 million to \$3.125 million due to the maximum allowable under the current legislation (the statutory maximum).¹⁰ To address this restriction, \$3.1 million of the Australian Prudential Regulation Authority – New and expanded functions measure for the supervision of the largest and most complex institutions, was deferred from 2019-20 to 2020-21. Part of this decision includes conducting a review of the statutory maximums to be completed prior to the setting of the 2020-21 levies, and to ensure these institutions continue to pay their fair share of APRA's supervisory effort.

The small increase in the ADI maximum, along with the deferral of the \$3.1 million will have enabled, over the two years,¹¹ equity within the ADI industry sector to be broadly maintained.

¹⁰ 'Statutory upper limit' as defined in the *Authorised deposit-taking Institutions Supervisory Levy Imposition Act 1998*.

¹¹ Subject to the outcome of the review of statutory maximums.

6. CONSULTATION ISSUES

Since the introduction of the levies, the scope of the levies imposition has expanded to include a broader range of activities relating to the APRA-regulated financial services sector. In addition, the financial services sector has undergone substantial change over the same period.

Comments are sought broadly on the design and operation of the levies framework and whether it is still fit for purpose. Stakeholders are also encouraged to respond to the specific questions below.

6.1 THE LEVY BASE USED FOR EACH INDUSTRY SECTOR

The current base used for the calculation of the levies is the asset value at the asset date (30 June and 31 March for superannuation institutions and non-superannuation institutions, respectively). In order to conduct its modelling effectively, APRA must:

- collect and confirm leviable entities' asset values; and
- in the case of superannuation, as necessary, adjust the asset value data using factors that take into account likely asset growth from the modelled date to 30 June – and for all other industries, adjust for any industry consolidation that may have occurred between the asset/modelled date and the end of the financial year.

To date, there has been minimal industry concern regarding the use of asset values to calculate the levies; although stakeholders have raised concerns regarding the levels that the minimum and maximum are set at for the restricted component of the levies.

In its 2013 Performance Audit of the Determination and Collection of Financial Industry Levies, the Australian National Audit Office (ANAO) found that the methodology developed to implement the levies met the Government's intent of recovering the full costs of APRA's administration, was administratively simple and uniform; and equity and competitive neutrality had been applied when the levies were imposed on entities.¹²

Question 1 – Is the current levy base appropriate for each industry sector?

6.2 THE CURRENT SETTING OF RESTRICTED (SUPERVISORY) AND UNRESTRICTED (SYSTEMIC) LEVY AMOUNTS FOR AUTHORISED DEPOSIT TAKING INSTITUTIONS

Section 4.1 of this paper outlines the methodology used to calculate the levy to recoup APRA's costs.

As explained above, APRA's activities and the time spent on them are broadly broken down into the cost of supervision (the restricted component) and the system impact (the unrestricted component). Each component is then apportioned across the different industries based on the total resources APRA expects to dedicate to each industry.

The restricted component reflects the cost of prudential supervision for an industry. It is subject to Treasurer determined minimum and maximum amounts as provided for in the relevant industry Imposition Act. The maximum cannot exceed the statutory cap set out in the Act, which is indexed to

12 https://www.anao.gov.au/sites/default/files/AuditReport_2013-2014_09.pdf

CPI. The minimum and maximum parameters reflect that the cost of APRA's prudential supervision does not fall below a certain amount, or rise above a certain amount, regardless of an institution's size.

Adjustments to the minimum and maximum parameters for the restricted levy component are made annually by the Treasurer following industry consultation through the annual FISL process. These adjustments are designed to support an equitable sharing of the levy burden within each industry sector.

The introduction of the unrestricted levy component in 2005-06 sought to resolve the issue of ensuring that the larger institutions are levied proportionately more in accordance with their size, compared to smaller ones. Specifically, having a levy component that is uncapped ensures that larger institutions are subject to a higher levy amount.

For ADIs, the maximum for the restricted levy component is now set at the statutory cap. As set out in the consultation paper on the proposed levies for 2019-20, following an increase in APRA's funding, it was necessary to defer \$3.1 million in supervisory levies payable by these largest institutions to ensure they continued to pay their share of APRA's supervisory effort.

Reflecting its role, APRA's regulatory intensity of the largest institutions has significantly increased over recent years (and therefore its level of funding). To avoid further deferrals of levies payable by these institutions, it is appropriate to reconsider the statutory cap provided for in the legislation (currently \$3.125 million).

Question 2 – What is the appropriate level for the statutory cap for the restricted component of the levies on ADIs?

6.3 'DOES THE CURRENT LEVIES METHODOLOGY PROVIDE ADEQUATE TRANSPARENCY AND IS IT APPROPRIATE FOR INDUSTRY SUB SECTORS?'

Information concerning APRA costs is provided in the annual 'Proposed Financial Institutions Levies' paper and in APRA's annual report. Further transparency of the process is achieved by a Cost Recovery Impact Statement (CRIS) to be released for each levy year — with the next one to be prepared following the outcome of this methodology review. Regarding the timing of the annual CRISs, industry has indicated concerns during annual consultations that APRA publishes its CRIS after the consultation process.

The CRIS contains further expenditure information where appropriate. It demonstrates consistency, transparency and accountability of such cost recovered activities and promotes the efficient allocation of resources and compliance with the Australian Government Cost Recovery Guidelines July 2014 (CRGs) under the Australian Government Charging Framework. The CRIS also covers APRA's current licensing and authorisation charging activities. These charging activities were reviewed as part of a Treasury portfolio charging review in 2016-17.

Question 3 – What changes would stakeholders find useful to the annual levies consultation process?