INSURANCE COUNCIL OF AUSTRALIA

Corporations and Schemes Unit (CSU)
Financial System and Services Division
The Treasury
100 Market Street
Sydney NSW 2000

Email: asicfunding@treasury.gov.au

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Dear Sir/Madam

PROPOSED INDUSTRY FUNDING MODEL FOR THE AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION (ASIC)

The Insurance Council of Australia (the Insurance Council) appreciates the opportunity to make this submission in response to the Government's Consultation Paper on the proposed industry funding model for the ASIC (the Consultation Paper).

As explained in its submissions responding to the Interim and Final Reports of the Financial Systems Inquiry (FSI), the Insurance Council does not agree with the proposal for ASIC to move to an industry-funded model. The Insurance Council considers that the Consultation Paper does not adequately make the case for industry funding. Such a significant question requires a more considered analysis which goes beyond referencing developments in other jurisdictions. An informed judgement about the rationale and suitability of a funding model for ASIC requires a detailed assessment about factors that are specific to the Australian regulatory and economic landscape.

While the Insurance Council does not agree with an industry funding model for ASIC, we recognise that its introduction was one of the recommendations made to the Government by the FSI. If an industry funding model were to be introduced, there needs to be strong mechanisms in place to ensure the funding model meets all three of the Government's core principles of cost recovery: efficiency and effectiveness; transparency and accountability; and stakeholder engagement. There is insufficient detail in the proposals in the Consultation Paper to enable an assessment of whether these principles are likely to be realised in practice.

The Insurance Council notes that the six week consultation period has not allowed the Insurance Council to work with its members to assess the full impact of the proposed funding model on the general insurance industry. While the question of industry funding may have been previously aired, the issue of how individual sectors would be levied was first set out in the Consultation Paper, with a Treasury/ASIC briefing half way through the consultation period.

Insurance Council of Australia Limited ABN 50 005 617 318
PO Box R1832 Royal Exchange NSW Australia 1225
t +61 2 9253 5100 f +61 2 9253 5111 www.insurancecouncil.com.au

Our submission is in three parts explaining:

- the industry's in-principle objection to industry funding of ASIC;
- the need for strengthened efficiency, accountability and stakeholder engagement frameworks; and
- issues with the proposed funding model for the general insurance industry.

1. Industry Objection to Cost Recovery

The Insurance Council wishes to reiterate its in-principle objection to industry funding of financial services regulators. The Insurance Council agrees that ASIC should be properly funded to meet its regulatory responsibilities. A properly funded and well-regulated financial system is an essential condition for healthy and sustainable economic growth. However, given the broader societal benefits that a well-functioning financial system provides, the Insurance Council is not convinced that financial services regulators should be funded by industry levies; rather, they should be funded through the general Commonwealth budget.

As the proposed industry funding model for ASIC fails to acknowledge the broader public benefits of ASIC regulation, it seems more akin to a taxation proposition for the financial sector.

Further to this, the Insurance Council considers that there are material risks to the proposed model. Principally, it presents a moral hazard for the Government, as the incentives for proportionate and efficient regulation is diminished by the removal of the cost of regulation – and therefore fiscal discipline – from the Government budget.

Consequently, industry would not have effective control over ASIC resourcing decisions. This raises concerns with respect to accountability. In particular, that it would be difficult for industry to confirm that ASIC's activities, resourcing and the resultant costs are justified. Adding to this, government would have no financial incentive to control ASIC's expenditure, which risks unjustified increases in regulatory costs.

The passing on of these costs would be harmful to industry and consumers, as it would have long term adverse impacts on competition and innovation in the financial system. This would have the effect of making Australia's financial sector less competitive on the global stage. There is also a risk that an industry-funded ASIC may be influenced to act in the interests of its regulated entities (particularly larger financial institutions), rather than the parties it seeks to protect (i.e. investors and consumers).

The Insurance Council also notes that the financial sector is one of the most heavily regulated sectors of the Australian economy and is a major contributor of taxation revenue. In addition to its taxation obligations, the financial sector bears a considerable non-taxation revenue burden associated with compliance obligations, such as in the form of fees, charges and levies.

It seems that there has been an inadequate consideration of the resulting cumulative impact on business that would result from industry funding of APRA and ASIC and the potential flow on effect of this to consumers. An additional levy on the sector would eventually be passed onto general insurance consumers, who are already heavily taxed by way of stamp duties and fire services levies. These taxes have been identified as significant barriers to insurance affordability, and the implementation of an additional levy will conflict with the Government's policy objective of increasing insurance affordability.

On this basis, the Insurance Council is concerned that the rationale for the proposed funding model is largely driven by fiscal considerations, rather than enhancing the efficacy of ASIC and its contribution to the health of Australia's financial system.

2. Strengthened Efficiency, Accountability and Engagement Mechanisms

The *Australian Government Cost Recovery Guidelines* (the Guidelines) set out a useful framework for assessing the proposed funding model. The Guidelines establish three key core principles for government cost recovery:

- efficiency and effectiveness;
- transparency and accountability; and
- stakeholder engagement.

The Insurance Council submits that these principles should be used to set the benchmark in assessing the efficacy of any proposed funding model.

The Guidelines also suggest that cost recovery can:

> "…improve the efficiency, productivity and responsiveness of government activities and accountability for those activities".

Similarly, the *Australian Government Charging Framework* states:

> "Entities should aim to minimise charges through the efficient implementation of these activities, whilst maintaining the policy intent and complying with any relevant legislative or policy requirements."

A connection is often made between industry funding and efficiency by reference to the incentives for regulated entities to reduce the cost of regulation. However, there is no similar incentive structure for the regulator to improve its efficiency in performing its regulatory mandate. The Consultation Paper suggests that an industry funding model will generate greater scrutiny of ASIC's regulatory costs, and thereby put industry in a better position to hold ASIC more accountable for the efficiency in which it undertakes its regulatory activities. However, there is no mechanism under the proposals where industry can genuinely impact ASIC's regulatory costs.

In contrast, we believe the funding model, as proposed, may actually entrench existing inefficiencies. An example is how the funding model will apply to entities that provide multiple regulated services. The Consultation Paper states that there will be no discount available on the multiple levies that apply to such entities as ASIC's supervisory teams focus on the specific activities of regulated entities, rather than the entity in its entirety. By designing the funding model this way, any incentives to realise efficiencies of scope are removed.

The Insurance Council submits that greater consideration needs to be given to establishing incentives for the regulator to continually improve its efficiency. We note that the Consultation Paper canvasses the range of funding models that are currently in place in other jurisdictions, including models that are comprised of part industry and part government funding. We suggest that a funding model which comprises a greater government share of funding than that envisioned under the proposed model, may create greater incentives for the regulator to continually maximise efficiencies.

The Insurance Council also submits that any industry funding needs to be accompanied by greater transparency and accountability. We agree with the FSI that the Government should establish a new Financial Regulator Assessment Board to advise it annually on how financial regulators have implemented their mandates. Similarly, the Insurance Council endorses the FSI recommendations that regulatory accountability would also benefit from government setting out more clearly how regulators should interpret their mandates in Statements of Expectation (SOEs) and the increased use of outcomes-focused performance indicators.

While this broad framework for establishing accountability is essential, it must also be accompanied by genuine performance metrics to ensure that accountability is instilled into the everyday activities of ASIC. The Insurance Council is encouraged by the indication by ASIC in its Corporate Plan that it may look to set sector-specific metric targets. We submit that setting sector-specific metric targets is essential for industry to make an informed assessment of the Regulator's performance. We would hope that these metrics would be the basis of a dynamic process of year-on-year improvement.

Establishing greater incentives to generate efficiencies and robust accountability mechanisms will need to be complemented by genuine stakeholder engagement. While the Insurance Council has regular contact with ASIC, primarily through quarterly liaison meetings, ASIC's interactions with industry tend to be reactive rather than proactive. The discussions which the Insurance Council and its members have with ASIC largely focus on risk areas that ASIC has identified, rather than involving active industry involvement in the identification of risks and priorities.

ASIC's Corporate Plan 2015-16 to 2018-19 and Focus for 2015-16 (the Corporate Plan), sets out the Regulator's response to the key risks it has identified. It is a useful document in helping industry understand the Regulator's perspective of the regulatory landscape. However, we suggest that in developing these strategic priorities, it would be beneficial for ASIC to have an open dialogue with industry about the emerging issues/risks and how they should be tackled. Early engagement would provide industry with the opportunity for meaningful input to ASIC's corporate planning and ensure informed feedback on the annual funding consultation by government.

3. Issues for the General Insurance Industry

3.1. Impact for the Industry

It is proposed that the AFS Licensee levy will be applied to insurers (including general insurers) using a flat levy methodology. While this methodology creates inequities amongst insurance product issuers of varying sizes and is of particular concern to some of our smaller members, the simplicity of the calculation appeals to some members. The general insurance sector poses lower systemic risks relative to other sectors, and we believe this is reflected in the quantum of the proposed levy.

However, the Australian Financial Services (AFS) Licensee levy is one, and for some members a relatively small, component of the overall ASIC funding levy. While we appreciate Treasury's engagement with the Insurance Council and its members in estimating the impact of the funding arrangements for the general insurance industry, we believe that the total amount to be raised from the industry has been substantially underestimated. The flat levy payable by general insurance product issuers will be inflated by additional levies on companies and AFS Licensees, for the provision of financial/general/wholesale advice and services subject to fees. Members typically have multiple AFS Licences, and this will also contribute to the total levy.

Of concern, general insurers that provide Lenders' Mortgage Insurance (LMI), further detailed below, will also be captured under the levy for Australian Credit Licensees.

In analysing the cost impact on the general insurance industry, the Government should not consider the proposed insurance provider levy in isolation. Rather, this cost impact analysis should consider the totality of the likely cost impact incorporating all components of the funding arrangements.

3.2. Issues for LMI Providers

The Insurance Council would like to bring to Treasury's attention that the funding models in the Consultation Paper do not take into account the unique role of LMI providers. Under current proposals, LMI providers would be levied as general insurers as well as being subject to the full levies due from credit providers. However, the LMI provider has no role and therefore no contact with the consumer in the establishment nor the ongoing management of the home loan credit contract. LMI providers work directly with the lending institutions through the establishment and during the management of the mortgage, and not with the borrower.

The LMI provider moves into a direct role with the consumer (the borrower) only after:

- there has been a default on the home loan;
- the lender has taken possession;
- the property has been sold;
- the LMI provider has paid the shortfall to the lender; and
- the lender has assigned to the LMI provider (or the LMI provider is subrogated for the lender in relation to) any ongoing rights of the lender against the consumer for the personal debt still outstanding under the home loan contract.

At the time that the regulation of consumer credit was being developed, Treasury and ASIC recognised the limited role of LMI providers and special provision was made in the credit licences applying to them. If the decision is taken to levy financial services licensees in order to fund ASIC, the Insurance Council submits that appropriate treatment should again be accorded LMI providers. The Insurance Council suggests that in addition to any levy amounts payable as general insurers, LMI providers could each pay a flat fee to cover the cost of the limited supervision which ASIC needs to maintain when, upon default, LMI providers step into the shoes of the original credit provider.

The Insurance Council requests that Treasury and ASIC consult with it and its members on the details of any levy requirements to be placed on LMI providers.

3.3. Other Issues

Insurance Product Distributor
Under the proposed AFS Licensee levy, a fee will be payable by an entity which is an Insurance Product Distributor. Our understanding is that insurers will have to pay a fee where it is a distributor itself, but would not have any levy liability for the agents through which they distribute. We would appreciate confirmation that insurers would only be directly liable to pay an Insurance Product Distributor fee where they are themselves a distributor, and not for any agents that distribute on their behalf.

While "Insurance Product Distributor" is not defined in the Consultation Paper, our understanding is that the levy will only be payable by an entity that holds an AFS Licence. If an insurer's agents were liable to pay the levy, we anticipate that many of these agents would ask the insurer to compensate them for that cost. This would become expensive for the industry and would be administratively complex, for instance, in relation to multi-agents.

The Insurance Council would appreciate confirmation that the Insurance Product Distributor levy will only apply to distributors that hold an AFS Licence. If the scope of the levy is intended to be broader, the Insurance Council submits that the $1500 fee should be reduced, and/or tiered by reference to the type of distributor (e.g. a business that sells a single line of insurance incidental to its primary business should not be paying the same fee as a multi-product, multi-insurer insurance underwriting business).

Licence Authorisations
Under the proposed funding arrangements, the AFS Licensee levy will comprise a "base AFS licensee levy" plus a levy for each "authorisation" held (which, as we understand it, correlates with the authorisation categories listed in Table C1). The "base AFS licensee levy" itself is comprised of a flat $250 fee for the license and an additional $250 for each licensee authorisation.

We understand that this calculation will reference the authorisations stated in each AFS license. However, the Consultation Paper does not make clear what is considered to be an authorisation. (See A**ttachment** for an example of a member's AFS Licence taken from ASIC's website. It is unclear from the wording of the License how many authorisations should be counted). There needs to be further clarity around how the number of authorisations is to be determined.

Levy on Companies
A significant contribution to the overall funding cost for members that are publicly listed in Australia is the proposed levy for companies. For the larger members, as the levy is calculated by reference to market capitalisation, their levy payable for the company component alone will reach the maximum of $320,000.

The Consultation Paper notes that "larger entities generally pose a higher risk to the Australian economy as the number of investors and the entity's significance to the market is high". However, this is an oversimplification and does not adequately take into account a number of factors including for example the composition of the investor base, the geographical location of the entity's business operations, the financial regulatory frameworks applying to the entity's operations and the entity's systems of risk management and control.

An alternative methodology for a listed entity within an insurance group or an insurer itself may be to base the levy on a measure of Gross Written Premiums/liabilities in Australia overlayed with an overall rating of risk (similar to APRA's PAIRS & SOARS framework). This suggestion could be expanded to cover parent entities of conglomerates as it has merit for conglomerates utilising Enterprise Risk Management Frameworks, which are applied throughout their structure, as do most of the conglomerates (with a listed entity as ultimate parent) operating in financial services in Australia. This alternative would still require further cost/benefit analysis and assessment.

Run-off Insurers
Some general insurers listed as being in run-off are restricted by the Australian Prudential Regulation Authority (APRA) from writing new or renewal insurance business. For these entities, which require minimal ASIC supervision, we submit that there should be an exemption from the AFS Licensee insurer levy.

Tier 1 Personal Advice
We also note that the structuring of the per adviser fee for Tier 1 personal advice will create incentives for the industry to cease the provision of personal advice for personal sickness and accident (PSA) insurance, the only general insurance product that is classified as Tier 1. The Insurance Council has consistently argued that PSA insurance, like all other general insurance products, should be classified as a Tier 2 product. An outcome that reduces the availability of advice to consumers will not be a positive one.

Thank you for this opportunity to provide feedback. If we can be of further assistance, please contact John Anning, the Insurance Council's General Manager Policy, Regulation Directorate, on (02) 9253 5121 or janning@insurancecouncil.com.au.

Yours sincerely

Robert Whelan
Executive Director and CEO

ATTACHMENT – "X" AFSL AUTHORISATIONS

1. This licence authorises the licensee to carry on a financial services business to:
   (a) provide financial product advice to both retail and wholesale clients for the following classes of financial products:
      (i) general insurance products;
      (ii) life products limited to:
         (A) life risk insurance products as well as any products issued by a Registered Life Insurance Company that are backed by one or more of its statutory funds;
      (iii) financial products limited to:
         (A) miscellaneous financial risk products limited to extended warranty products; and
   (b) provide financial product advice to wholesale clients only for the following classes of financial products:
      (i) deposit and payment products limited to:
         (A) basic deposit products;
         (B) deposit products other than basic deposit products;
      (ii) derivatives;
      (iii) foreign exchange contracts;
      (iv) debentures, stocks or bonds issued or proposed to be issued by a government;
      (v) interests in managed investment schemes including:
         (A) investor directed portfolio services;
      (vi) financial products limited to:
         (A) miscellaneous financial investment products;
      (vii) securities; and
   (c) deal in a financial product by:
      (i) issuing, applying for, acquiring, varying or disposing of a financial product to both retail and wholesale clients in respect of the following classes of financial products:
         (A) general insurance products;
         (B) life products limited to:
            (1) life risk insurance products as well as any products issued by a Registered Life Insurance Company that are backed by one or more of its statutory funds; and
         (C) financial products limited to:
            (1) miscellaneous financial risk products limited to extended warranty products; and

(ii) applying for, acquiring, varying or disposing of a financial product to both retail and wholesale clients on behalf of another person in respect of the following classes of products:

(A) general insurance products;

(B) life products limited to:

(1) life risk insurance products as well as any products issued by a Registered Life Insurance Company that are backed by one or more of its statutory funds;

(C) financial products limited to:

(1) miscellaneous financial risk products limited to extended warranty products; and

(iii) applying for, acquiring, varying or disposing of a financial product on behalf of another person to wholesale clients only in respect of the following classes of products:

(A) deposit and payment products limited to:

(1) basic deposit products;

(2) deposit products other than basic deposit products;

(B) derivatives;

(C) foreign exchange contracts;

(D) debentures, stocks or bonds issued or proposed to be issued by a government;

(E) interests in managed investment schemes including:

(1) investor directed portfolio services;

(F) securities; and

(G) financial products limited to:

(1) miscellaneous financial investment products.