AIST

27 October 2022

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Australian Securities and Investments Commission Industry Funding Model Review

Brief

AIST supports the purpose of the Australian Securities and Investments Commission (ASIC) Industry Funding Model (IFM), which is to recover ASIC's regulatory costs from entities in the industry sub-sectors that cause the need for regulatory effort by ASIC, rather than general taxpayers.

AIST continues to advocate that ASIC should adopt a risk-based approach to levy raising. A risk-based approach would consider an IFM based on sub-sectors and classes within sub-sectors and the volume of regulator activities spent on various entities to ensure compliance. Doing so would support the objectives of the IFM, ensuring those entities that generate regulatory action bear the cost while also encouraging compliance. AIST recommends a more granular approach to sub-sectors for APRA-regulated entities, mirroring APRA classes of sub-sectors such as profit-to-member and retail superannuation funds.

For the purposes of our submission, AIST has focussed on responding to questions 3 – 8 and question 12 presented in the ASIC IFM Review (the Review). These questions align with AIST's position that a risk-based approach will best support equity and transparency in the IFM.

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About AIST

Australian Institute of Superannuation Trustees is a national not-for-profit organisation whose membership consists of the trustee directors and staff of industry, corporate and public sector superannuation funds.

As the principal advocate and peak representative body for the $1.7 trillion profit-to-members superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

AIST advocates for financial wellbeing in retirement for all Australians regardless of gender, culture, education, or socio-economic background. Through leadership and excellence, AIST supports profit-to-member funds to achieve member-first outcomes and fairness across the retirement system.

Submission

AIST would like to thank Treasury for the opportunity to provide a submission to the ASIC IFM Review.

Simplification and enforcement – Responses to questions 3 – 8

Q3. Is it more important to have a simpler model that can be more readily understood by entities and administered by ASIC which may result in increased cross-subsidisation, or a more equitable model (similar to the status quo) that closely links the recovery of costs to the groups of entities causing the need for those costs?

Simplicity should not come at the expense of equity or transparency. AIST does not support a simpler charging model that results in increased cross-subsidisation. Levies are currently charged on an ex-post basis to 52 sub-sectors, with costs recovered based on the regulatory effort incurred by ASIC in respect of each sub-sector.

Retaining a levy charged based on risks and compliance activities generated by sub-sectors achieves the objectives of the IFM. However, AIST calls for greater transparency of the IFM framework, with the risk-based approach considering classes within those sub-sectors that align with the Australian Prudential and Regulation Authority (APRA), such as 'profit-to-member' and retail superannuation sectors.

Doing so would achieve the following objectives:

Equity: only those entities that cause the need for regulation should pay for it. If the intent of the IFM is to ensure that taxpayers and other regulated entities do not disproportionately pay for regulatory activities related to those licensees which represent increased risk, the IFM must consider a risk-based approach that recognises that sub-sectors such as the profit-to-member superannuation sector may generate less compliance activity than other sub-sectors.

Superannuation funds will generally fund levies such as ASIC's IFM through charging members administration fees. If the IFM adopts a simplified approach to cost charging, such as one of the three options suggested on page 15 of the report, this may impact fees charged to members.

Encouraging regulatory compliance: A simplified IFM will dilute transparency of poor regulatory compliance by entities and sub-sectors. A simplified levy that cross-subsidises other sectors may disincentivise proactive adoption of best practice initiatives in some sectors, particularly those that have historically been slow to adopt best practice initiatives for the benefit of consumers and will lead to reduced transparency of systemic behaviours in specific sub-sectors. As evidenced by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, conflicts within the 'for profit' superannuation sector cannot be managed by disclosure alone and require the additional focus of regulators. The Royal Commission stated below in relation to this conflict:

> *'The number of retail trustees who have failed to manage conflicts effectively, despite having elaborate written frameworks in place, suggests that this is not an isolated issue.'*
>
> *'Evidence showed that there are some recurring issues and difficulties to which trustees and the regulators need to give close and continuing attention.'*[1]

Reduced transparency will result in increased risks to consumers. The collection of data regarding how ASIC conducts its regulatory focus and supervisory effort is important for protecting members, ensuring that ASIC accountability and efficiency and appropriate cost recovery are proportionate with compliance activities.

Improving ASIC's resource allocation, by providing it with richer data to better identify emerging risks: AIST disagrees that a simplified IFM will result in improving ASIC's resource allocation in a way that improves sub-sector accountability and compliance. While less resourcing may be allocated to the calculation of the levy, ASIC may be required to re-allocate resources to undertake enforcement activities.

A simplified levy that cross-subsidises other sectors may disincentivise proactive adoption of best practice initiatives in some sectors, particularly those that have historically been slow to adopt best practice initiatives for the benefit of consumers.

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[1] Royal Commission, Misconduct in the Banking, Superannuation and Financial Services Industry, Final Report, Volume 1, p.228 https://www.royalcommission.gov.au/banking/final-report

A simplified IFM that is not granular, and does not adopt a risk-based approach, will ultimately lead to reduced transparency and accountability for those poor performing sub-sectors. Over the long-term without transparency and accountability, these sub-sectors will not be incentivised to improve regulatory compliance, ultimately impacting ASIC by requiring a reallocation of resources to continued compliance oversight.

Q4. Is cross-subsidising costs for entities within a sub-sector or sector more appropriate than cross-subsidising costs across all of ASIC's regulated population? If so, why?

As previously stated in this submission, cross-subsidising by sub-sectors is more equitable than across sectors or ASIC's entire regulated population. As per previous AIST submissions on cross-subsidisation *the volume of ASIC's regulatory activities on various entities and sectors should be linked to the levy. We maintain this position. This approach could have been achieved through reflecting in the Act the sector definitions which APRA uses – retail, profit-to-member, etc. Instead, a combination of the Act and Regulations defines 'subsector' as 'superannuation trustees. There is no breakdown of which sectors within a superannuation system worth over $2 trillion are causing greater regulatory focus.'*[2]

Q5. Are there other opportunities to simplify the design, structure and legislative framework for levies? If so, what opportunities and what benefits would they provide?

AIST supports an IFM that considers a risk-based approach to the levy calculation. This may include assigning a risk-rating per sub-sector or classes within those sub-sectors that reflect a levy that is proportionate to the volume of work ASIC undertakes.

AIST notes that previously, the objective of proportionality had been included, but related to Funds Under Management (FUM). This alone is insufficient to reflect the volume of work which ASIC may undertake for education or enforcement. As per our previous submission, a stronger and more accountable method of raising levies against work undertaken would be, for example, volume of breaches for entities within a sub-sector, the number of complaints, the types of complaints and their outcomes, and engagement with regulators. AIST strongly advocates that ASIC should consider these metrics to adopt a risk-based approach to the IFM.

Q6. Does the design, structure and legislative framework of the levy component of the IFM have sufficient flexibility to respond to changes in the markets, sectors and products ASIC has oversight of? If not, what aspects require more flexibility and what changes could be made?

AIST considers that adopting a risk-based approach to the IFM and levy calculation will result in greater flexibility to respond to changes in markets and sub-sectors.

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[2] AIST Submission : ASICs IFM December 2017: p. 2 https://www.aist.asn.au/getattachment/Media-and-News/News/2017/Introduction-of-ASIC%E2%80%99s-Fee-for-Service-under-the-I/asic_fee_for_service_proposed_model_final_15-12-17.pdf.aspx

A per annum or half-yearly assessment of a risk-rating system would assist entities to respond to compliance activities, adopt best practice approaches and modify behaviours to improve compliance outcomes. This will result in reduced compliance activities for ASIC and best outcomes for members and ultimately the Australian taxpayer.

Q7. How can costs associated with enforcement activity be recovered most equitably? What changes could be made to the current approach, and what benefits would they provide?

As per our previous submission, a stronger and more accountable method of raising levies would be for ASIC to consider a risk-based assessment per sub-sector (or even, more granularly, classes within sub-sectors as per APRA's definitions). This would form a risk-rating per sub-sector that considers:

- Risks per sector as identified through ASIC's enforcement action, monitoring and surveillance work.
- ASIC's time spent on sector wide regulatory activities.
- The volume and outcome of internal complaints.
- Data from external dispute resolution processes.

Q8. Are there opportunities to improve the transparency and reporting of enforcement costs? If so, what changes could be made and what benefits would they provide?

AIST recommends two approaches that may improve transparency of enforcement costs:

1. ASIC currently provides an overview of its enforcement and education priorities for the year ahead. ASIC could clearly align these priorities with the IFM per sub-sector. This will assist sub-sectors, such as the superannuation sector, to better-understand the calculation of levies. Increased or decreased risks and/or compliance activities will result in a corresponding increase or decrease in fees. Sectors can better-engage with ASIC and understand the reasons for sub-sector wide engagement if they understand that risks are not being appropriately managed at a sub-sector level. For this reason, it is important that ASIC adopt a more granular approach to sub-sectors that mirrors APRA terminology.
2. Adopting a risk-based approach and publishing that information based on a risk rating system per sub-sector will assist sectors to appreciate the link between the levy and regulatory issues identified within a sub-sector. A risk-rating system could be of itself, an enforcement tool, prompting entities to proactively adopt best practice models to improve sub-sector ratings.

Recovery of costs of other regulatory activity

Q12. How can costs associated with education and policy advice be recovered most equitably and transparently? What changes could be made to the current approach, and what benefits would they provide?

Considering ASIC and APRA's twin-peaks regulatory approach, AIST recommends that ASIC provide greater transparency into what educative and policy initiatives they offer that go beyond the APRA-regulated and profit-to-member prudential standards. This would reduce regulatory costs where there is regulatory overlap and would also reduce fees applied in the superannuation sector where fees are applied under the APRA regulated model.

ASIC enforcement and compliance activities would indicate per sub-sector where greater education is required to ensure compliance with regulatory regimes. If enforcement activity influences future educative programs, the two must necessarily inform the other and be factored into a risk-based approach to the IFM.

For further information regarding our submission, please contact Sonia Hunyadi, Government Relations and Policy Advisor at shunyadi@aist.asn.au.

Yours sincerely,

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