CUSTOMER
OWNED
BANKING
ASSOCIATION

11 June 2021

Ms Meghan Quinn
Deputy Secretary
Markets Group
Department of the Treasury

By email: supervisorylevies@treasury.gov.au

Dear Ms Quinn,

Proposed Financial Institutions Supervisory Levies for 2021–22

COBA welcomes the opportunity to comment on the Proposed Financial Institutions Supervisory Levies (FISL) for 2021–22 (“Discussion Paper”).

COBA is the industry association for Australia’s customer owned banking institutions (mutual banks, credit unions and building societies). Collectively, our sector has $147 billion in assets, around 10 per cent of the household deposits market and more than 4.5 million customers.

Our members range in size from less than $200 million in assets to around $15 billion in assets – all significantly smaller than most of our ASX-listed peers. Customer owned banking institutions deliver competition, choice and market leading levels of customer satisfaction in the retail banking market.

Retail banking is highly regulated with multiple regulators with varying and sometimes overlapping mandates. The customer owned banking sector is regulated by the same financial regulators as the major banks, including but not limited to:

- APRA as the banking regulator
- ASIC as the consumer protection and conduct regulator
- RBA as the payments system regulator
- Treasury as the Government’s chief financial policymaker
- AUSTRAC as the financial crime regulator, and
- ACCC as the competition and Consumer Data Right regulator.

The stock of existing regulation imposes a significant cost burden and the flow of new regulation has become a flood. COBA members are being forced to devote an increasing proportion of scarce resources to regulatory compliance and away from other investment priorities. In this context, sudden material increases in regulatory costs are particularly unwelcome.

Suite 403, Level 4, 151 Castlereagh Street,
Sydney NSW 2000

Suite 4C, 16 National Circuit,
Barton ACT 2600

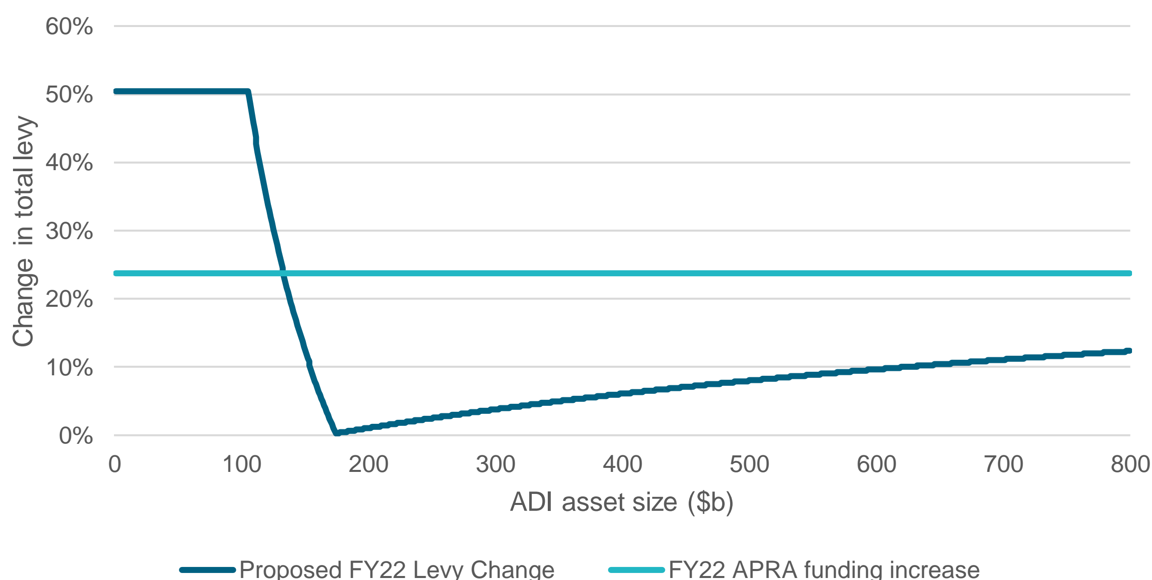
COBA does not support the proposed APRA levy parameters. We urge the Government to take the following actions:

- **Increase the maximum restricted levy for FY22 to at least $6 million to address the lack of fairness in the proposed levy outcomes.**
- **Commit to a review of the APRA levy methodology to address the lack of confidence in the existing model and its ability to fairly distribute funding changes.**
- **Increase transparency around APRA's funding.**

Addressing unfair levy outcomes

Under the proposed parameters, non-major banks are subject to significant increases in their levies in the range of 50 per cent, well above APRA's funding increase, while the major banks receive a levy increase below the APRA funding increase (Graph 1). These unfair levy outcomes should be addressed by increasing the maximum restricted levy to at least $6 million. COBA acknowledges that APRA's levies must increase to reflect increases in APRA's funding but we believe this can and must be achieved in a fairer manner. The recent legislative changes[1] have increased the maximum restricted levy cap to $10 million, which is far above the proposed maximum levy of $4.7 million.

Graph 1: FY22 Change in total APRA levy by size vs. increase in APRA funding[2]



The Discussion Paper says the ADI levy amount to be recovered will increase 24 per cent to $103.7 million. Increases in both the restricted levy funds (24 per cent) and unrestricted levy funds (25 per cent) drive this overall increase. As a result, the restricted rate has increased by 55 per cent, while the unrestricted rate has increased by 31 per cent.

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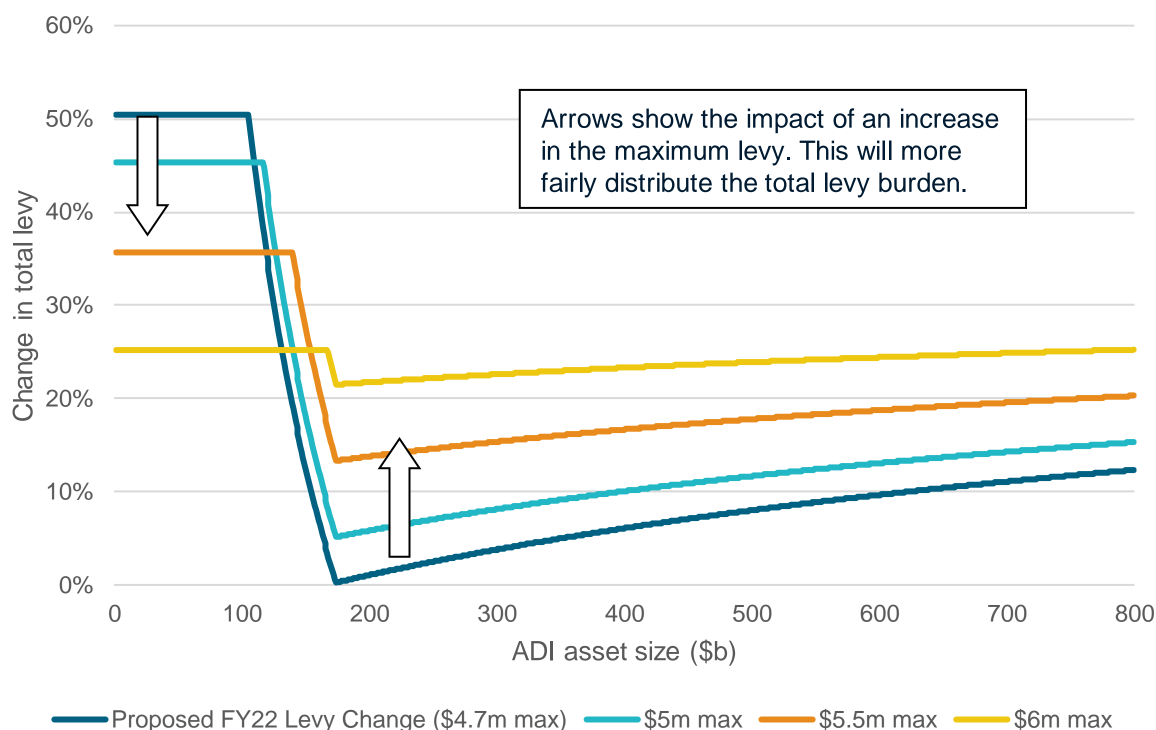
[1] Authorised Deposit-taking Institutions Supervisory Levy Imposition Amendment Bill 2020

[2] COBA estimates based on Treasury's FY22 paper. Note this does not take into account asset growth. Over the year March 2020 to March 2021, major bank assets decreased by 1 per cent while non-major bank assets increased by 4 per cent according to APRA's monthly ADI statistics.

Small ADIs' overall levy comprises mostly of restricted levies. As a result, this means that they are subject to significant levy increases due to the significant restricted rate change. Given that the only parameter that Treasury can meaningfully increase to affect the levy distribution is the maximum restricted levy, this maximum levy must increase to provide a smoother and fairer distribution for all ADIs. Graph 2 below illustrates the impact of increasing the maximum levy.

Graph 2: FY22 Fairer distributions of APRA levy increases with higher maximum levies[3]



Accounting for the multi-year collection of APRA funding

COBA recognises that the FY21[4] restricted maximum levy of $5.025 million does not reflect the cost of supervision given that it is recovering an additional $3.5 million from the five largest banks that should have been recovered in FY20[5]. This was unable to occur due to flaws in the legislated model (i.e. an inappropriate statutory cap).

However, this is not the only factor creating confusion about the maximum levy. The FY22[6] levies are collecting two years' worth of the additional COVID-related funding from the 2020-21 Budget ("Budget Measure").[7] While COBA acknowledges this was not able to be recovered in FY21 levies for reasons outside of Treasury's control, it is not clear if this has been incorporated in the existing FY22 maximum

[3] COBA estimates. Note figures are illustrative as Treasury's model is not public.

[4] Financial Year 2020-21

[5] Proposed Financial Institutions Supervisory Levies for 2019-20, page 5.

[6] Financial Year 2021-22

[7] "Prior year uncollected levies from the 2020-21 Budget measure 'Treasury Portfolio – additional funding' of $12.8 million provided to APRA in 2020-21, to be collected in 2021-22"

restricted levy. The maximum levy for FY22 must include two years' worth of increases to cover this budget measure (see Table 1).

Table 1: Components of the maximum restricted levy

FY20 Max Restricted Levy	FY21 Max Restricted Levy	FY 22 Max Restricted Levy
FY20 BAU Maximum levy	FY21 BAU Maximum levy	FY22 BAU Maximum levy
(FY20 Additional Supervision)	FY20 Additional Supervision	
	(FY21 Budget Measure)	FY21 Budget Measure
		FY22 Budget Measure
$3 million	**$5.025 million**	**$4.7 million?**

(brackets means not collected)

These perverse levy outcomes in the last three years show that the 'mix and match' approach of multi-year restricted funding recovery is not working and further levy reform is needed.

Addressing a lack of confidence in APRA levy model

We urge the Government to commit to a review of the FISL methodology to address the lack of confidence in the existing model. The previous concerns about the levy model in 2018-19 have not subsided given that the partially fixed model in FY22 has delivered another unfair outcome.

The current APRA levy methodology comprises of two components:

- A restricted amount that covers supervisory costs calculated as a rate on assets that is subject to both minimum and maximum amounts. This maximum amount is capped by legislation.
- An unrestricted amount that covers systemic costs calculated as a rate on assets that is not subject to any restrictions.

In June 2020, the Government increased the legislated maximum levy cap to $10 million (adjusted for inflation) given it was not able to set an adequate FY20 maximum levy under the previous legislation. While the bill has addressed concerns about the limit on the maximum levy, this adjustment has only papered over the cracks in the model and the FY22 experience has shown that something needs to be done to prevent this from happening again.

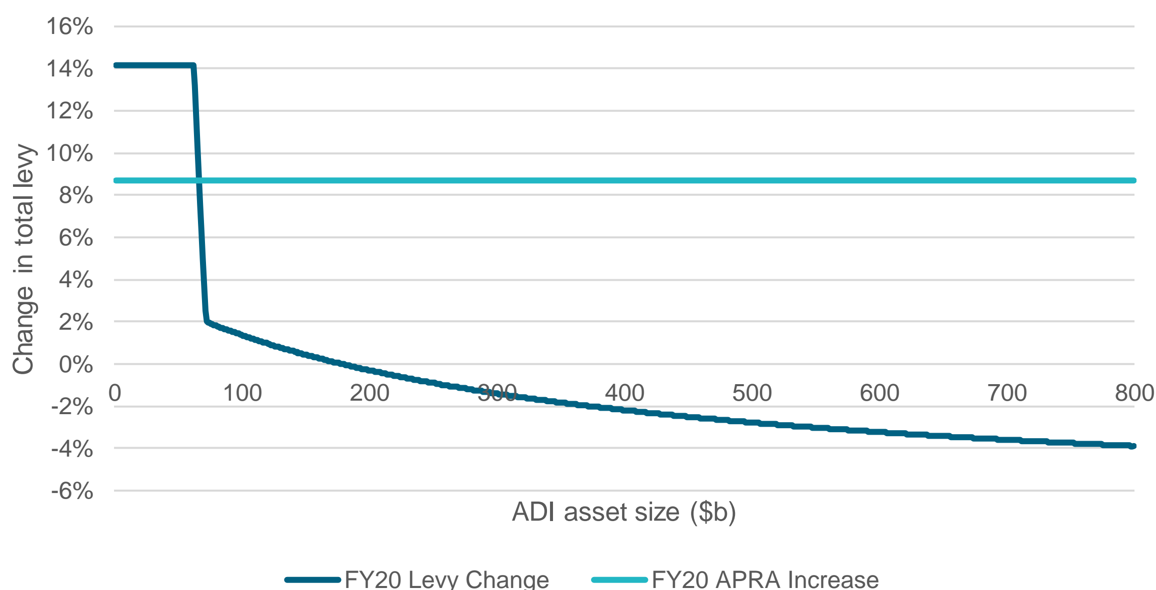
Accounting for new supervisory developments

In FY21, APRA changed its supervision model by introducing the new Supervision Risk and Intensity (SRI) model. The SRI introduces the concept of tiering which influences risk assessment and the expected level of supervisory intensity. APRA's SRI Model guide states: "An entity's tiering will determine the depth of risk assessment undertaken. It also helps drive an expected level of supervisory intensity, to allow APRA to apply a sufficient level of attention to all entities in line with APRA's risk appetite." Given the development of this new model, it is appropriate to examine whether the rationale for the capped linear supervisory cost levy (i.e. the restricted levy) remains.

A model that cannot handle significant funding shifts

While the current APRA levy model can mathematically handle significant increases in the restricted levy, COBA does not believe that the current APRA levy model was designed to deal with such significant shifts in APRA funding. The current methodology relies on a historical measure of supervisory cost (time recording) to distribute future supervisory costs. In an increasing cost environment, it is not clear if the maximum levy parameters adequate incorporate this uplift into these estimates. In some instances, where this levy cannot change, like in FY20 (see Graph 3), or does not change enough, like in FY22, this leads to situations where smaller ADIs have larger increases in their levies than much larger ADIs. As a result, a disproportionate amount of the increased funding is borne by entities subject to the restricted rate (i.e. those not paying the minimum or maximum restricted levies). In Australia, this is everyone but the market-dominating largest four or five banks and the smallest ADIs.

Graph 3: FY20 APRA levy change by institution size



An overly complex model

COBA notes it is becoming more and more difficult to explain these unpredictable levy shifts to levy payers. In a world where supervisory costs are predictable, the model is relatively straightforward. However, as soon as there is any significant variation that is not reflected in the maximum levy, there are perverse outcomes as outlined above. We are now at the point where the current model is so complex that it is very poorly understood and there is no confidence in the calculations in annual levy paper given the difficulty in replicating these figures. This overt complexity is creating unnecessary frustration among the levied community.

We believe there could be several ways to address these deficiencies. This can include a combination of:

- revamping the levies model to a more ‘progressive’ system with an increasing levy rate for larger institutions
- scrapping the restricted levy component for an uncapped levy model
- removing the legislated statutory upper limit on the maximum restricted levy to provide flexibility to increase the costs on the largest institutions
- significantly increasing the minimum restricted levy on systemically important banks to ensure that they pay a fair share of these additional costs, and/or
- reviewing costs assigned to the ‘restricted’ levy component, with a view to moving these into the ‘unrestricted’ component given that these unrestricted costs are distributed differently across the levy population. This flexibility could be used during periods of significant levy increases to smooth out costs.

Addressing the lack of transparency in APRA’s funding

As noted on COBA’s 2019 submission on the APRA levy methodology, the Cost Recovery Implementation Statement (CRIS) is usually released after the close of the consultation period on the APRA levies. The CRIS provides valuable information about APRA’s costs. This lack of transparency due to the absence of a CRIS creates confusion about the proposed levies. It also does not provide industry sufficient information to comment on more than a superficial level on the levy proposals. For example, the levies consultation documents generally refer to cross-subsidisation of entities. However, the evidence on this is provided in the CRIS. It is difficult to provide substantive feedback if the justification for changes is released after the fact.

Greater transparency is likely to minimise potential conflict points. While this has been an inconvenience during more benign levy growth periods, it is a much more significant issue in an environment where significant increases are proposed in levies on smaller ADIs.

Thank you for the opportunity to provide these comments. If you wish to discuss any aspect of this submission, please contact Mark Nguyen (mnguyen@coba.asn.au).

Yours sincerely,

MICHAEL LAWRENCE
Chief Executive Officer