CUSTOMER OWNED BANKING ASSOCIATION

10 June 2022

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 2022–23

COBA welcomes the opportunity to comment on the Proposed Financial Institutions Supervisory Levies (FISL) for 2022–23 ("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 over $150 billion in assets, around 10 per cent of the household deposits market and around 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.

Support the maintenance of the restricted levy level

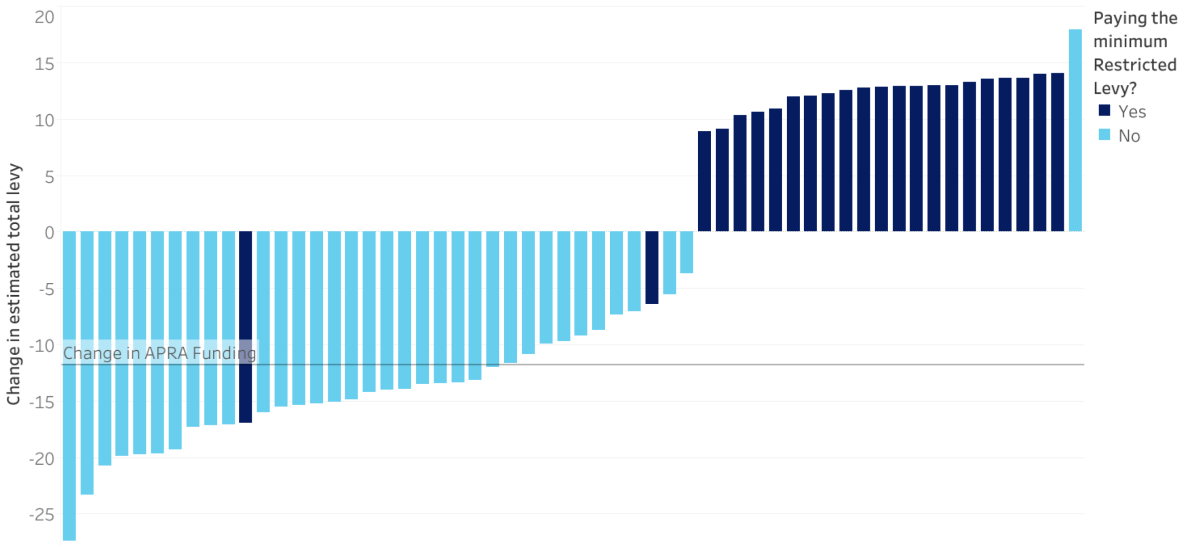
COBA supports well-resourced and efficient regulators. Where this funding is taken from industry, cost burden must be equitable across industry. COBA welcomes Treasury's proposal to maintain the restricted APRA levy at the previous year's level of at least $6.4 million (noting our comments below). This will continue to ensure that the amounts recovered from the FISL are fairly distributed across the ADI sector.

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

Suite 4C, 16 National Circuit,
Barton ACT 2600

Customerownedbanking.asn.au

Graph 1: Estimated changes in COBA member FISL vs. FY22 (including asset growth)



Under this proposal, most COBA members will see reductions in their FISL due to significant decreases in both the restricted and unrestricted levy rates. While most COBA members will see levy decreases, others will be subject to increases due to increase in the minimum levy (See Graph 1: dark blue entities are subject to the minimum restricted levy). While we acknowledge there is a minimum cost of supervision, APRA should ensure that any increases to cost on industry are transparent and gradual.

Addressing a lack of confidence in APRA levy model

We continue to urge the Government to amend the FISL methodology to address the lack of confidence in the existing model. COBA remains concerned the APRA levy model continues to be contentious due to its innate ability to create unpredictable distributive outcomes when APRA's funding requirements change. In FY23, our sector has seen an overall reduction in APRA levies due to the 'downswing' in APRA's funding. However, if APRA's funding were to increase in future and the maximum restricted levy did not increase then there would be disproportionate increase in levies on our sector. COBA provides two examples in Table 2 and Table 3 where the 'upswing' in APRA funding is disproportionately shared.

Table 1: Estimated Proposed ADI levies for 2022-23 (FY23)[1]

Asset base	$50m ($'000)	$500m ($'000)	$5b ($'000)	$25b ($'000)	$100b ($'000)	$800b ($'000)
2021-22	17.9	21.6	212.1	1,060.30	4,241.20	13,012.60
2022-23 (proposed)	20.3	23.4	168.5	842.5	3,369.90	11,837.30
Change	13%	8%	-21%	-21%	-21%	-9%

[1] See Treasury Discussion Paper Proposed Financial Institutions Supervisory Levies for 2022-23

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. This inflexibility regarding the maximum levy led to a 30 per cent increase in levies for most non-major banks and with a 6 per cent decrease for major banks. COBA acknowledges that Treasury did adjust its proposal to due to calculation issues (while still being constrained by the legislated limit), the need for a readjustment suggests an overly complex model.

Table 2: Estimated Proposed ADI levies for 2019-20 (FY20)[2]

Asset base	$50m ($'000)	$500m ($'000)	$5b ($'000)	$25b ($'000)	$100b ($'000)	$800b ($'000)
2018-19	15.5	26.1	261.1	1,305.5	4,025.5	11,203.9
2019-20 (originally proposed)	15.5	33.6	336.0	1,678.0	3,940.0	10,520.0
Change	0%	29%	29%	29%	-2%	-6%

While the Government subsequently passed a bill to address the legislated limit on the maximum levy, this adjustment has only papered over the cracks in the model and the FY22 levy setting experience has shown that a permanent solution is needed. We acknowledge that Government has temporarily addressed these concerns by increasing the actual restricted levy paid by the largest banks to $6.4 million. However, the model remains the same.

Table 3: Estimated Proposed ADI levies for 2021-22 (FY22)[3]

Asset base	$50m ($'000)	$500m ($'000)	$5b ($'000)	$25b ($'000)	$100b ($'000)	$800b ($'000)
2020-21	15.3	18.2	176.3	881.4	3,525.5	10,075.4
2021-22 (proposed)	17.9	26.5	265.0	1,324.8	5,299.3	11,314.4
Change	17%	46%	50%	50%	50%	12%

Accounting for new supervisory developments

The Financial Regulator Assessment Authority is expected to review APRA's capability later this year.[4] Given the rapidly changing risk and technological environment, it is likely that APRA's remit or how it manages its remit will change as a result of the review findings. It is important that APRA's funding model has sufficient flexibility to ensure that any changes in resourcing are not unfairly borne by the smaller ADIs. We also note that current labour shortages may also lead to increases in regulator staffing costs that would need to be recovered via the FISL.

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

[2] See Treasury Discussion Paper Proposed Financial Institutions Supervisory Levies for 2019-20

[3] See Treasury Discussion Paper Proposed Financial Institutions Supervisory Levies for 2021-22

[4] See https://fraa.gov.au/about-fraa

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."[5] 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.

Equitably distributing increases in funding requirements

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 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 Table 2), or does not change enough, like as originally proposed in FY22 (see Table 3), 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.

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 includes 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
- increasing the 'minimum' maximum restricted levy on systemically important banks in line with funding increases 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.

[5] See APRA's SRI Model guide

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,

LUKE LAWLER
Director – Policy