Proposed Industry Funding Model for ASIC: Treasury Consultation Paper

COBA submission

October 2015

Executive Summary

COBA supports the objectives of:

- Ensuring that the costs of the regulatory activities undertaken by ASIC are borne by those creating the need for regulation;
- Establishing price signals to drive economic efficiencies in the way resources are allocated in ASIC; and
- Improving ASIC's transparency and accountability.

However, the full cost recovery industry funding model proposed in the consultation paper will not achieve these objectives.

COBA does not support the introduction of an industry funding model at this time.

While this was a recommendation of the Financial System Inquiry, the Inquiry's Final Report also made a number of complementary recommendations aimed at ensuring that any industry funding model was supported by an appropriately transparent and accountable governance framework.

COBA believes that until these broader recommendations are implemented, any discussion around the merits of cost recovery is premature.

Full cost recovery is not an effective and efficient funding model for ASIC. By shifting fiscal responsibility from government to industry, there is a real risk that government will lose its incentive to ensure that the regulator's costs are efficient, that ASIC's resources are appropriately prioritised to areas of greatest need, and that over-regulation and cost-padding does not occur.

While an inadequately funded regulator is in no one's interest, it is equally important that a mechanism exists which reduces the incentive for the sector to be over-regulated. Maintaining a partial cost recovery model addresses these risks. Continued government funding of ASIC also recognises that the beneficiaries of ASIC's activities are not just regulated entities but all consumers, investors and borrowers.

COBA also believes that some elements of ASIC's costs, and in particular enforcement costs, should not be recovered from industry.

Proposed levy framework

COBA agrees that there is a strong correlation between scale and supervisory intensity, and that this should be reflected in any final levy methodology adopted. However, COBA also believes that consideration should be given to other proxies. In particular, COBA believes that an institution's business model can be a key factor in determining likely levels of supervision.

Unlike listed banks, customer-owned banking institutions exist to meet the needs of their customers rather than to maximise returns to a separate group of shareholders. Under our model, the interests of customers and owners are perfectly aligned, rather than being in conflict as is the case under the listed model. The customer-owned model poses a much lower risk to consumers and therefore poses a much lower call on the time and resources

of ASIC. This is an important fact to take into account in ensuring that regulatory costs can be allocated to those that create the need for regulation.

The levy framework should also take into account actual industry structure, including concentration and vertical integration, and the Financial System Inquiry's warning that "the banking sector is concentrated" and "concentration creates risks to both the stability and degree of competition in the Australian financial system."

COBA is very concerned that the current approach makes no effort to take these factors into consideration and will deliver grossly inequitable outcomes. In some areas, the current proposal will lead to customer owned banking institutions paying the same levies as the vastly larger major banks, a result which would be totally out of proportion with ASIC's regulatory efforts. A number of regulatory settings already give the major banks an artificial cost advantage over smaller competitors, and a poorly designed levy would only compound this.

COBA notes the consultation paper's concerns about minimising complexity and administrative burden in setting the levy framework, but an overly simple tiered approach creates the risk of much bigger problems of disruption, volatility and grossly disproportionate cost impacts. Replacing the current three tier structure for deposit product providers and credit licensees with an uncapped graduated levy would deliver far more equitable outcomes without adding excessive complexity.

COBA Recommendations

1. **A decision on whether to introduce an industry funding model for ASIC should be deferred until the FSI recommendations on regulator accountability, capability and competition are implemented.**
2. **Full cost recovery should not be adopted as it would increase risks of inefficiency and would not recognise the 'public good' element of ASIC's role.**
3. **Enforcement costs should not be subject to cost recovery.**
4. **An industry funding model should recognise that the customer-owned business model poses lower risks to consumers than the listed banking model.**
5. **An industry funding model should avoid exacerbating current problems of increasing concentration and vertical integration in the financial system.**
6. **The proposed levy for deposit product providers should be graduated, scaled and have no minimum or maximum cap.**
7. **The proposed levy for credit providers and credit intermediaries should also be graduated, with no minimum or maximum cap.**
8. **Operators of low-value financial markets should be exempt.**
9. **Adopt a three-year funding model with an adequate consultation period for changes to levies and levies methodology.**

Cost recovery and the Financial System Inquiry

The Financial System Inquiry (FSI) recommended that the Government "introduce an industry funding model for ASIC."[1] However, this recommendation is somewhat qualified by the FSI's subsequent statement that the Inquiry "expects the benefits of industry funding to exceed the costs, subject to … implementation and inclusion of an appropriate transparency and accountability framework."

The FSI Final Report made a number of broader recommendations in relation to the regulatory system which provide further context around what the Inquiry Panel would consider to constitute an appropriate "transparency and accountability framework." In particular, the FSI Report included:

- Recommendation 27, which called for enhanced regulator accountability through the creation of "…a new Financial Regulator Assessment Board to advise Government annually on how financial regulators have implemented their mandates," and encouraged the Government to "provide clearer guidance to regulators in Statements of Expectations and increase the use of performance indicators for regulator performance";[2]
- Recommendation 28, which advocated the introduction of "periodic capability reviews" of regulators;[3]
- Recommendation 30, which called for reviews of "…the state of competition in the sector every three years," and for improved "…reporting of how regulators balance competition against their core objectives"; and
- Recommendation 31, which encouraged greater use of post implementation reviews.

These recommendations are all strongly supported by COBA. Any recommendations which improve regulator accountability and transparency should be encouraged. We also believe that the adoption of all of these recommendations is a necessary precondition for any decision which could see ASIC transition towards greater use of cost recovery. In the absence of a strong transparency and accountability framework, as envisaged by the FSI, the shift to greater cost recovery presents significant risks.

In particular, shifting ASIC's costs to industry would leave the Government with less incentive to ensure that the regulator operates in an efficient manner and appropriately prioritises its resourcing. As the Department of Finance's 2005 Cost Recovery Guidelines note: "… poorly designed [cost recovery] arrangements can create incentives for 'cost padding' and inefficiency." COBA is concerned that the proposed cost recovery arrangements do not appear to contain any mechanisms to help avoid such an undesirable outcome. As such, there is a real risk that moving ASIC to an industry funding model could undermine regulator accountability and lead to excessive regulation.

In contrast, under the current funding arrangement, the realities of crafting a Budget provide the Government with a strong incentive to ensure that the regulator's costs are efficient, that ASIC's resources are appropriately prioritised to areas of greatest need, and that over-regulation and cost-padding does not occur.

---

[1] Murray, *FSI Final Report*, November 2014, p. 250.
[2] ibid., p. xxvi.
[3] ibid.

Customer Owned Banking Association Limited ABN 98 137 780 897

Arguably, government's current approach to the budgets of APRA and ASIC at least partly reflects the fact that APRA has all of its costs recovered from industry while ASIC does not. As such, increases in ASIC's budget have a direct impact on the size of the Federal Budget deficit (or surplus), while changes to APRA's Budget do not. In recent years, government appears to have been more comfortable approving increases in APRA's costs than it has ASIC's, and this could in part reflect their differing impact on the overall Budget position. If ASIC was to recover all its costs from industry, the fact that ASIC's funding no longer came from government may make the government less concerned about controlling increases in the regulator's costs.

While an inadequately funded regulator is in no one's interest, it is equally important that a mechanism exists which reduces the incentive for the sector to be over-regulated.

Given the relevance of accountability and transparency to any discussion of cost recovery, COBA believes it is premature to consider the appropriate funding model for ASIC ahead of the Government announcing its position on the FSI's Final Report, and confirming its intention to implement these key recommendations.

COBA recommendation: A decision on whether to introduce an industry funding model for ASIC should be deferred until the FSI recommendations on regulator accountability, capability and competition are implemented.

The appropriateness of full cost recovery

The current proposal is that the full costs of ASIC would be recovered from industry, with industry levied 100 per cent of the cost of all ASIC activities not explicitly carved out from the levy.

In putting forward this proposal, the Consultation Paper notes that industry funding "…would ensure that ASIC's regulatory costs were borne by those that drive the need for regulation."[4] While it is true that regulated entities benefit from the regulatory framework, they are far from the only beneficiaries, and it is clear that consumers also receive a significant benefit from ASIC's activities. This is particularly true given the consumer focus of ASIC's number one strategic objective, namely to "promote investor and financial consumer trust and confidence."[5] Given the significant benefits that consumers and investors derive from ASIC's regulatory activities, it would be unusual to move to a cost recovery model which fails to recognise this consumer benefit.

ASIC already collects significant amounts from industry. While the Consultation Paper states that the levies and fees already applied to regulated institutions currently cover approximately 15 per cent of ASIC's total costs,[6] it is also true that the total amount of fees, charges and fines collected by ASIC is significantly higher than this. In fact, in aggregate, ASIC already collects more than enough from industry to fully cover its costs. In 2012-13,[7] ASIC's total collections on behalf of the Commonwealth was $717 million,[8] significantly more than its total expenses of $411 million in that financial year. These existing ASIC collections need to be taken into consideration in determining the appropriateness of shifting any further costs from government to industry.

The current partial cost recovery model operating in ASIC provides efficiency benefits. As previously noted, by ensuring that government is ultimately responsible for financing a portion of the regulator's costs, government has a strong incentive to ensure that the regulators costs are efficient. This incentive is significantly muted when increases in regulator costs have no fiscal impact.

Partial cost recovery is an effective way of recognising the 'public good' elements of ASIC regulation. The Financial Sector Advisory Council (FSAC) has previously recommended that, "the Government ... reconsider its position on co-funding the financial system regulators given the significant public good aspects of well-functioning markets (in addition to the benefits to firms in the regulated markets)."[9] It is more efficient to finance public goods through consolidated revenue than industry levies.

Partial cost recovery is also a model commonly adopted in other jurisdictions. As the Consultation Paper notes, 11 global securities regulators currently use a combination of government and industry funding to meet their costs.[10] New Zealand's recently established Financial Markets Authority (FMA) is one of the regulatory bodies where a joint funding model has been adopted.

[4] Australian Government, *Proposed Industry Funding Model for ASIC,* August 2015, p. 4.
[5] ASIC, *Corporate Plan: 2015-16 to 2018-19,* August 2015, p. 2.
[6] Australian Government, *Proposed Industry Funding Model for ASIC,* August 2015, p. 2.
[7] Senate Economic References Committee, *Performance of the Australian Securities and Investments Commission,* June 2014, p. 407.
[8] ASIC, *Annual Report 2012-13,* p. 19.
[9] FSAC, *Review of the Outcomes of the Financial System Inquiry 1997,* August 2003, p. 12.
[10] Australian Government, *Proposed Industry Funding Model for ASIC,* August 2015, p. 11.

In summary, the Consultation Paper does not make the case for a shift from current arrangements to a full cost recovery model. COBA agrees that an underfunded regulator is an undesirable outcome, but government reluctance to provide ASIC with sufficient funding should not be used as a justification to shift these costs onto industry.

We believe that a final decision about ASIC cost recovery should be deferred until more fundamental changes to the current ASIC model have been implemented, including any recommendations made by the current ASIC capability review, and the transparency and accountability recommendations made by the FSI. Once these changes have been finalised, stakeholders and policy makers will be better placed to make a more informed judgement about the appropriateness of moving ASIC to an industry funding model.

COBA recommendation: Full cost recovery should not be adopted as it would increase risks of inefficiency and would not recognise the 'public good' element of ASIC's role.

Which ASIC costs could be subject to cost recovery?

The Discussion Paper proposes that several of ASIC's activities be excluded from cost recovery.[11] COBA supports these exclusions. COBA also notes that it may be appropriate to consider excluding additional activities from the cost recovery framework.

In particular, we note that under the current proposal, the operation of, and funding to support, the Enforcement Special Account (ESA) would not be cost recovered. However, other enforcement activities of ASIC would be cost recovered through the industry funding model. It is unclear why the proposed industry funding model would see cost recovery introduced for some enforcement activities and not others, especially given the somewhat arbitrary and subjective nature with which a determination is made to fund an enforcement action through the ESA.

If the proposed cost recovery arrangements were adopted, there is certainly a risk that government would encourage ASIC to make less use of the ESA going forward, and that the government would then supplement any shortfall with additional budget allocations, which would then be cost recovered from industry. Such an approach would represent a further shifting of costs from government to industry.

The Government has already signalled a reluctance to support funding of the ESA, given its rejection of a Senate Committee's recommendation that the ESA balance be increased significantly.[12]

The ESA was established to "give ASIC the flexibility to conduct major investigations into, and bring legal and/or administrative proceedings against individuals and corporations in relation to, possible corporate or financial services misconduct when required, without the need to seek additional Budget funding."[13] Given the important role that the ESA plays in providing ASIC with the scope to, in Mr Medcraft's words "fight the big cases,"[14] it would be undesirable to introduce an industry funding model which undermines this.

Excluding all enforcement costs from any industry funding model would avoid this risk. Such an approach would be consistent with the Cost Recovery Guidelines, which state that It is "usually inappropriate" to recover law enforcement costs.[15]

More generally, having government ultimately responsible for enforcement costs, rather than industry, may also provide some broader efficiency benefits. In particular, such an arrangement would provide government with a significant incentive to ensure that ASIC's enforcement activities are focussed on issues where they are more likely to secure a positive outcome.

COBA recommendation: Enforcement costs should not be subject to cost recovery.

[11] Australian Government, *Proposed Industry Funding Model for ASIC,* August 2015, p. 6.
[12] Australian Government, *Response to the Senate Economics References Committee Report: Performance of ASIC,* 2014, p, 12.
[13] Senate Economic References Committee, *Performance of the Australian Securities and Investments Commission,* June 2014, p. 273.
[14] Mr Greg Medcraft, Chairman, ASIC, *Committee Hansard*, 19 February 2014, p. 28.
[15] Department of Finance, *Australian Government Cost Recovery Guidelines,* July 2014, p. 6.

Allocating costs between regulated entities

In apportioning any ASIC levy between regulated institutions, the overarching principle should be that those entities which require greater levels of regulatory oversight pay higher levies. The Consultation Paper recognises this, stating a desire to "…ensure that the levies payable by each entity match the cost of their regulation."

Proxies for supervisory intensity have been proposed in the Consultation Paper which would be used to scale the amount of levy paid by different institutions operating in the same industry sub-sector. In almost all cases, the proxies proposed differentiate institutions on the basis of their size, or the amount of business they do in an ASIC regulated area.

COBA agrees that there is a strong correlation between scale and supervisory intensity, and that this should be reflected in any final levy methodology adopted. However, COBA also believes that consideration should be given to other proxies.

In particular, COBA believes that an institution's business model can be a key factor in determining likely levels of supervision.

Unlike listed banks, customer-owned banking institutions exist to meet the needs of their customers rather than to maximise returns to a separate group of shareholders. Under our model, the interests of customers and owners are perfectly aligned, rather than being in conflict as is the case under the listed model. This alignment is reflected in the market-leading customer satisfaction ratings, highly competitive pricing and community focus of customer-owned banking institutions.

The customer-owned model poses a much lower risk to consumers and therefore poses a much lower call on the time and resources of ASIC. This is an important fact to taken into account in ensuring that regulatory costs can be allocated to those that create the need for regulation.

The objective of listed institutions to maximise returns to shareholders frequently leads to poor outcomes for consumers. These poor outcomes for consumers ultimately (if sometimes belatedly) become ASIC's regulatory priorities.

For example, the 2014 Senate Economics Committee inquiry into the performance of ASIC found that between 2002 and 2010 some financial advisers, brokers and lenders systematically targeted more vulnerable members of the community, especially older Australians, with assets, but without high levels of financial literacy.

According to the Committee:

- CBA financial advisers and other staff deliberately neglected their duties and placed their personal interests far above the interests of their clients.
- assets of clients with conservative risk positions, such as retirees, were allocated into high-risk products without their knowledge to the financial benefit of the adviser, who received significant bonuses and recognition as a 'high performer'.
- There was forgery and dishonest concealment of material facts.
- Clients lost substantial amounts of their savings when the global financial crisis hit.

The committee found that CBA deliberately played down the seriousness and extent of problems in Commonwealth Financial Planning Limited in an attempt to avoid ASIC's scrutiny, contain adverse publicity and minimise compensation payments. "In effect, the CBA managed, for some considerable time, to keep the committee, ASIC and its clients in the dark," the Committee found. The Committee also noted 'systemic failings of compliance' and the 'poor compliance culture' of Macquarie Equities Limited trading as Macquarie Private Wealth.

Reflecting on this inquiry in February this year, Senator John Williams told the Senate:

> *"CBA has identified 400,000 people who could have received shoddy advice. Macquarie Bank is writing to some 160,000 people. We are talking about more than half a million Australians who may have received bad advice."*

Senator Deborah O'Neill told the Senate:

> *"Individuals' lives were ruined and, sadly, some of the largest institutions in this country were implicated."*

ASIC's *Corporate Plan 2015-16 to 2018-19* points to continuing risks to consumers from financial advice and product complexity.

> *"Funds management is increasingly being bundled with other financial services under the wealth management umbrella. The big four banks, who have significant funds management operations, have increased their share of the wealth and advice sectors over the past few years. The move towards vertical integration along the financial product distribution chain may pose risks to investors and consumers around the independence and appropriateness of financial advice. It can make conflicts of interest worse and heighten the risk of inappropriate in-house products being sold to consumers."*

The FSI Final Report warned that some sectors of the Australian financial system are concentrated and that high concentration and trends towards increasing vertical integration have the potential to limit the benefits of competition in the future.

> *"In particular, the banking sector is concentrated, with the four major banks being the largest players in many aspects of the financial system and having significant market influence. Such concentration creates risks to both the stability and degree of competition in the Australian financial system."*

Given the risks outlined above, it is important that the design of a new funding model for ASIC:

- avoids imposing disproportionate costs on smaller players; and
- recognises that some business models present greater risks to investors and consumers.

COBA recommendation: an industry funding model should recognise that the customer-owned business model poses lower risks to consumers and should avoid exacerbating current problems of increasing concentration and vertical integration in the financial system.

Specific comments on the proposed funding model

COBA notes that the limited amount of information provided in the consultation paper has made commenting on some specific aspects of the levy distribution methodology difficult. In future, COBA recommends that a greater amount of information be disclosed to stakeholders to allow for more informed feedback.

For example, the consultation paper notes that there are 18 Australian Market Licence Holders, but the only information about the levy applied to the domestic market licence holders is that their levy will fall in the range of $116,000 - $4,000,000. In justifying this lack of transparency, the consultation paper simply states that "the proposed levy for each MIP[16] has not been included in this paper to prevent information on individual taxpayers being made publicly available." COBA believes that, at a minimum, the methodology that ASIC wishes to apply to determining the levy for these MIPs should be disclosed. In the absence of this information, it is impossible for stakeholders to make any sort of informed comment on whether or not the proposed levy is appropriate, and whether the levies applied to those institutions are proportionate when compared to the levies which would be applied to other ASIC regulated entities.

More generally, COBA is concerned about the lack of transparency behind the various levy proposals, and believes that full disclosure of the calculation of all components of the levies is essential.

The methodology used to calculate the levies paid by a financial institution should be publicly available information. This transparency is necessary to provide assurance that ASIC levies are appropriately being allocated between institutions, and that higher risk sectors are actually paying higher levies. The current "black box" approach to calculating these levy components does not provide stakeholders with any assurance that the proposed methodology is suitable.

As government Cost Recovery Guidelines state: "Nominating costing information as 'commercial-in-confidence' is not a sufficient reason for withholding it. Government activities provided on a cost recovery basis are not considered commercial in nature."[17] In commenting on the importance of transparency around levies more generally, the Cost Recovery Guidelines also state that:

> *"A well-documented costing model is fundamental to transparency and accountability. The level of detail in the costing model should be balanced against the cost of developing and maintaining the model and proportional to the size and complexity of the activity. The documentation for a specific cost recovered activity should be detailed enough to allow the Parliament, those who pay cost recovery charges, and other stakeholders to analyse the activity."*[18]

Little information is provided in the consultation paper to justify the various dollar figures which have been allocated to each component of the ASIC levy, or around the justifications behind setting tiers at the various levels chosen. Providing more information and data which explains the rationale for these decisions would help to provide

---

[16] Market Infrastructure Provider
[17] Department of Finance, *Australian Government Cost Recovery Guidelines,* July 2014, p. 12.
[18] ibid.

stakeholders with some assurance that the levies are being appropriately distributed between regulated institutions.

Deposits

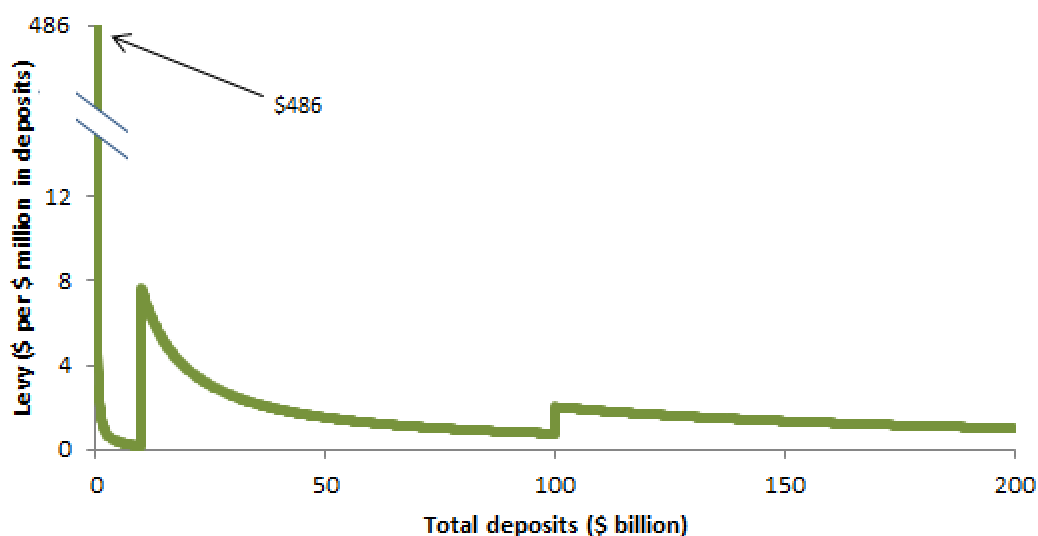
The consultation paper sets out a three tiered approach to the levies paid by deposit product provider AFS Licensees. Under this approach, those with deposits of less than $10 billion would pay $1,800 per annum, those with $10 to $100 billion would pay $76,000 per annum, and those with more than $100 billion would pay $202,000 per annum.

COBA is concerned that the three tier approach proposed will not equitably distribute the levy burden.

Currently, the smallest ADI (Old Gold Credit Union Co-operative) has total deposits of $3.7 million,[19] while the largest ADI (Commonwealth Bank) holds total deposits of $470 billion.[20] Under the current methodology proposed in the consultation paper, Old Gold would pay a levy of $486 for every $1 million in deposits held, while Commonwealth Bank would pay a levy of 43 cents for every $1 million in deposits held. The proportionate levy paid by Old Gold for their deposits would be more than 1,000 times as large as that paid by the Commonwealth Bank.

While this is an extreme example, the chart below demonstrates that the inequity applies across the spectrum, with effective levies ranging from anywhere between 18 cents and $486 dollars per million dollars of deposits held.

Chart 1: Effective Levy Rates - Deposits



Replacing the proposed three tier structure with a more graduated methodology would reduce the severity of these inequities, and would better reflect the relative supervisory intensity ASIC applies to larger institutions.

[19] Figures from 2011-12 financial year.
[20] Commonwealth Bank, *2015 Annual Report,* p. 113.

While the Consultation Paper canvasses a graduated levy as a possibility for deposits, it noted that this option "…would be administratively more complex and could result in more variable levies, which could erode industry certainty as to the levies to be payable."

While we welcome Treasury's desire to minimise the administrative burden associated with the possible adoption of an ASIC levy, we believe that a far more graduated levy than the current three tier proposal could be adopted without increasing the administrative burden. Options could include:

- Introducing additional tiers. For example moving from three tiers to nine tiers would provide a lot more granularity, while at the same time allowing institutions to quickly determine which bucket they fell into.
- Shifting to asset bands, where for example, you could pay a fixed amount for every billion dollars (or part thereof) of deposits held. It should be very easy for institutions to estimate their deposit holding to the nearest billion dollars.
- All ADIs already report their deposit holdings to APRA on a regular basis using D2A reporting. ASIC could introduce a graduated levy and use this existing data to accurately calculate levies for each institution.
- Institutions could report their actual level of deposits directly to ASIC, though this may potentially be an additional administrative burden for some institutions, particularly if the definition adopted by ASIC is not the same as the definition used by financial institutions for their own internal reporting or their existing reporting to APRA.

While it is true that under a graduated approach, an institution's deposit component of their levy would change each year, it would be unlikely to shift dramatically, and changes of a minor nature like this are not problematic.

Furthermore, the potential volatility under the current three tier proposal is far more significant, and far more concerning than any variability under a graduated approach. While most institutions would pay the same deposit levy each year under the three tier proposal, where a licensee moves from one tier to another, the jump is far more dramatic and disruptive that would ever be the case under a graduated model.

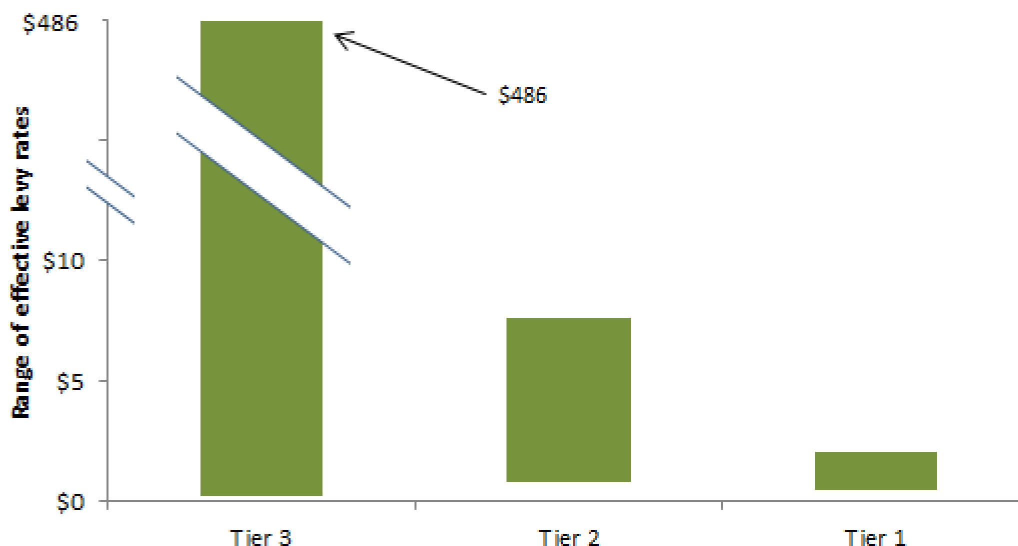
If anything, a graduated approach mitigates the variability risk which is an inherent part of the three tier proposal.

COBA does not believe a minimum cap is needed for the deposit component of the levy. ASIC takes a risk-based approach to determining where to apply its resources, meaning that ASIC will often expend no resources on the regulation of a small ADI in any given financial year. A purely graduated levy, which commences at zero and scales up gradually in proportion with an institution's deposit holdings would be a sensible methodology to apply in these circumstances.

COBA would also emphasise that minimum caps, by definition, result in the smallest institutions paying a proportionately higher amount than larger institutions. We urge Treasury to consider the competition impact of imposing relatively higher levies on the smallest institutions.

COBA also notes that the current three tier structure appears to have a bias towards smaller institutions paying proportionately higher levies. This is illustrated in the chart below, which shows the range of levy rates paid by institutions in each levy tier.

Chart 2: Effective Levy Ranges for each Tier - Deposits



While some may argue that there are economies of scale present in the regulation of deposit holdings, COBA would argue that the converse is true, and that if anything, it is the largest deposit holders that should be paying the largest levy in both absolute and proportionate terms.

This is certainly the approach that has been adopted in the UK. As the Financial Conduct Authority (FCA) noted in their consultation around the 2015/16 levy:

> *"The A.1 fee-block (Deposit acceptors) is an exception from straight-line recovery. Within this fee-block, the firms who fall within the medium-high and high bands of our moderation framework pay a premium fee-rate. This reflects the particular targeting of our overall supervision to the high-impact, systemically important firms in this sector. We apply a premium of 25% and 65% to the fee rates for firms in the medium-high and high-impact bands of the A.1 fee-block."*[21]

Under this model, the 65% premium loading is applied to institutions with "Modified Eligible Liabilities" of more than £13.4 billion (approximately $28 billion).

Given all these considerations, COBA believes that the deposit component of the ASIC levy should be reworked to incorporate the following elements:

- A graduated levy, which uses deposit data which is already publicly reported as the basis for calculation;
- Scaled levy rates, imposing higher rates on the largest financial institutions;
- No minimum cap, or a minimum cap which is considerably lower than the current proposed level of $1,800; and
- No maximum cap, given the systemically important nature of the largest deposit holder institutions.

For illustrative purposes, a hypothetical example of a graduated levy which meets these criteria is provided below. However, in the absence of data regarding the number of deposit providers, and the size of their holdings, it is impossible for COBA to calculate an

[21] Financial Conduct Authority, *CP15/14: FCA Regulated fees and levies: Rates proposals for 2015/16,* March 2015, p. 21.

alternative levy structure which raises the same amount as the one currently proposed in the consultation paper.

Component	Rate
Minimum levy	No minimum cap
Tier 3 (deposits less than $50 billion)	$0.80 per $1 million deposits
Tier 2 (deposits of $50-$200 billion)	$1 per $1 million deposits (a 25% loading on Tier 3 rate)
Tier 1	$1.20 per $1 million deposits (a 50% loading on Tier 3 rate)
Maximum levy	No maximum cap

COBA recommendation: the proposed levy for deposit product providers should be graduated, scaled and have no minimum or maximum cap.

Credit Licensees

Similar to the approach for deposits, the Consultation Paper has proposed a three tier approach to credit. Our concerns about this proposal are similar to those set out above regarding the deposit component of the levy.

The current three tier proposal in the consultation paper appears particularly inequitable. As currently drafted, the highest tier would cut in once an institution provides $1 billion of credit in a financial year. This is far too low a level for a maximum cap. COBA notes that a number of our largest members already provide this amount of credit, meaning the levy they would pay for this component would be the same as the levy paid by a major bank. This would be grossly inequitable, given that the credit portfolios of the major banks are many times larger than those of our largest members.

COBA recommends that the current three tier structure be replaced with a more graduated approach. In this regard we note that:

- The credit component of the levy is based on a regulated entity's annual compliance certificate (ACC). The ACC already contains nine different categories regarding levels of credit activity. At a minimum, COBA believes that differentiated levies should be applied to each of these nine categories rather than aggregating them into three tiers.
- Given the potential administrative burden associated with having to report an exact level of credit provided in a given year, the option of relatively narrow asset bands should be considered. For example, if each asset band was $100 million wide, it should be relatively simple for an institution to calculate which asset band it falls into.

We also note that the current proposal sets different levy rates for credit providers and credit intermediaries, and where an institution is both a provider and intermediary it pays both components. This approach raises two potential concerns.

Firstly, requiring an institution to pay both an intermediary and originator component of the levy could lead to perverse outcomes. Take, for example, the comparison between

hypothetical institutions A and B, where A originates $3 billion in credit, and B originates $1.5 billion while also being an intermediary for a further $1.5 billion. Despite both institutions providing the same amount of aggregate credit, the levy applied to institution B would be more than twice the size of the levy applied to institution A.

Secondly, it is not clear how the different levy rates for providers and intermediaries have been derived, and the numbers currently proposed paint a somewhat contradictory picture of ASIC's supervisory efforts in this space. For small institutions, the credit intermediary levy is roughly half that of the credit provider, while for large institutions the credit intermediary levy is almost 50 per cent larger than the credit provider levy. It is hard to comprehend how small intermediaries require less supervision than similarly sized originators, while at the same time large intermediaries require significantly more supervision than similarly sized originators. At a minimum, it would be useful if further context could be provided around how these figures were derived.

COBA recommendation: the proposed levy for credit providers and credit intermediaries should be graduated, with no minimum or maximum cap.

Exempt markets

The Consultation Paper currently proposes charging a flat levy of $45,000 to all market infrastructure providers (MIPs) that are exempt from the requirement to hold a licence (exempt markets). In addition to a number of exempt markets that are approved by the relevant Minister and gazetted, MIPs can also be exempted under the Corporations (Low Volume Financial Markets) Exemption Notice 2003.[22] This notice provides a standing exemption for all low volume financial markets, where this is defined as a market "…through which no more than 100 completed transactions, that have a total value (measured by sale price) of not more than $500,000, are entered into in any 12 month period."

There are currently 175 markets registered as exempt low volume financial markets under the 2003 Notice. ASIC's supervisory oversight in these markets is generally limited to receipt of an annual return by operators of these markets, reporting that volumes and values are within the thresholds noted above.

Given the low volume of trading conducted on these markets (in terms of both volume and value), it would be uneconomic and highly disproportionate to impose a flat $45,000 levy on each of them. These markets are smaller and less complex than the other markets that are provided with exempt market status via Ministerial approval and gazettal.

COBA therefore recommends that operators of low value financial markets be exempt from this component of any proposed ASIC levy.

COBA recommendation: operators of low-value financial markets should be exempt.

[22] *Corporations (Low Volume Financial Markets) Exemption Notice 2003,* s 3.

Other flat rate items

There are a number of other levy components where a simple flat rate is proposed, irrespective of the amount of that activity an institution is undertaking. For example, all insurance product issuers would pay a flat $31,000 levy irrespective of the amount of insurance issued.

Similar to other areas of ASIC's supervision, it is likely that institutions that are larger and more active in a particular area are likely to consume a larger proportion of ASIC's resources. In principle, that would suggest that those institutions should also pay a proportionately higher amount for that component of their levy, rather than the flat rate currently proposed.

Further consideration should therefore be given to whether any scaling of tiering could be introduced for some of these items, while balancing the need to deliver a more equitable outcome against the need to limit the administrative burden that calculating a levy imposes on regulated institutions.

Consultation timeframes

If ASIC moves to an industry funding model, it is essential that industry be provided with an adequate timeframe to provide feedback on the proposed levy calculation methodology each year. While the APRA levy has now been in place for a number of years, inadequate consultation timeframes have been a consistent concern, and should ASIC choose to move to an industry funding model, the adoption of similarly short consultation timeframes would fall well short of best practice.

Under the current proposal, ASIC's funding level for the year ahead would not be announced until after the Federal Budget in May, with the levy determination then issued in June. This does not provide an adequate timeframe for stakeholders to provide informed feedback on the proposal. COBA notes that in the case of the UK the FCA has adopted far more reasonable timeframes, with consultation commencing in October for levies which will take effect from the following July.[23]

While we acknowledge that the Budget process places an external constraint on consultation timeframes, the FSI has recommended that the regulators move to a more certain funding model, whereby funding would "…be set by Government based on the recommendation of three-yearly funding reviews. These reviews should include consultation with industry and consumer stakeholders."[24]

If ASIC was to move to an industry funding model, COBA would support the adoption of a three year funding model, as a way of providing industry with greater certainty around likely levies, and also as a way of removing ASIC's funding level from the Budget process and thereby eliminating this artificial constraint on consultation timeframes.

COBA recommendation: adopt a three-year funding model with an adequate consultation period for changes to levies and levies methodology.

---

[23] Financial Conduct Authority, *CP15/14: FCA Regulated fees and levies: Rates proposals for 2015/16,* March 2015, pp. 5-6.
[24] Murray, *FSI Final Report*, November 2014, p. 246.

To discuss any aspect of this submission please contact:

Luke Lawler Head of Public Affairs 02 8035 8448 llawler@coba.asn.au	Micah Green Senior Adviser, Policy & Public Affairs 02 8035 8447 mgreen@coba.asn.au

CUSTOMER
OWNED
BANKING
ASSOCIATION

www.customerownedbanking.asn.au