9 June 2023

Ms Alesha Bhan
A/g Director
Regulator Engagement and Powers Unit
Treasury

Via email: SupervisoryLevies@treasury.gov.au

Dear Ms Bhan

Proposed Financial Institutions Supervisory Levies for 2023-24

COBA welcomes the opportunity to comment on the Proposed Financial Institutions Supervisory Levies (FISL) for 2023–24 ("Discussion Paper").

COBA is the industry association for Australia's customer owned banks (mutual banks, credit unions and building societies). Collectively, our sector has over $160 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 $25 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.

Impact on COBA members

Under the proposed FISL, most COBA members are expected to see reductions in their levy obligations due to 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. While we acknowledge there is a minimum cost of supervision, the Government should ensure that any increases to cost on industry are transparent and gradual.

Support the maintenance of the maximum 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 $6.4 million (noting our comments below). This will continue to ensure that the amounts recovered from the FISL are more fairly distributed across the ADI sector.

Addressing the risk of inequitable outcomes

The FISL consists of both the restricted and unrestricted levy component, which Treasury notes is in place to split the cost-of-supervision and systemic impact supervision costs to industry. Although we recognise that rationale exists behind the imposition of a restricted and unrestricted levy, this structure increases the risk of a disproportionate impact on smaller ADIs in the event of a significant and sudden change to APRA's funding requirements or a change in the structure of the banking sector.

<u>Changes to APRA's funding requirements</u>

COBA remains concerned that the APRA levy model continues to be contentious due to its innate ability to create unpredictable distributive outcomes when APRA's funding requirements change. Although the FISL has decreased for ADIs in FY24, any future increase in APRA's funding requirements will see the industry pay more in levies however the existing model does not guarantee

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

Suite 4C, 16 National Circuit,
Barton ACT 2600

Customerownedbanking.asn.au

that any such increases will be equitably distributed among supervised entities. A future increase in restricted APRA levies without a corresponding increase in the maximum restricted levy can have a disproportionate impact on smaller ADIs – as a result, a disproportionate amount of the increased levy 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.

COBA provides two examples in Table 1 and Table 2 where the ‘upswing’ in APRA funding was disproportionately shared.

In June 2020, the Government was forced to increase 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, as the cost of supervision increased dramatically. 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 1: Estimated Proposed ADI levies for 2019-20 (FY20)[1]

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 2: Estimated Proposed ADI levies for 2021-22 (FY22)[2]

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%

Structural shifts in the banking sector

As noted above, the current model’s design results in a high level of inflexibility in responding to significant or unexpected changes in the banking industry. A further example of this is seen in the model’s response to a merger or acquisition of a large ADI, for example the merger of Suncorp and ANZ. In the event that an entity which is already paying the maximum restricted levy merges with or acquires a smaller entity, or two medium sized entities merge and have a resulting combined asset base which results in the maximum levy payable for the new entity, **the current model is unable to re-allocate levy obligations in an equitable manner**. Under the current model, either scenario would see an overall reduction in the restricted levy paid by the newly merged entity (as it reaches the maximum threshold) therefore increasing the levy payable by all other ADIs (except those subject to the minimum), all else being equal.

A pertinent example of this involves the possible merger of Suncorp and ANZ. Currently ANZ pays the maximum restricted rate and Suncorp would pay approximately $1.95 million in the restricted levy at

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

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

the proposed FY24 rate, based on an asset base of $91 billion.[3] Post-merger, Suncorp's assets would be incorporated into ANZ's and given that ANZ already pays the maximum restricted levy, there would be a collection shortfall of $1.95 million. Without an increase in the maximum restricted levy (or offsetting decrease in APRA funding), the shortfall would need to be made up increasing the restricted levy rate on entities subject to the variable restricted levy. This unfairly shifts the levy burden from larger ADIs to smaller ADIs.

We call on the Government to consider the impacts of such a merger or acquisition when making a determination for future year levies, and to change the model to account for these impacts by ensuring that existing ADIs do not end up paying an increased levy due to events outside of their control. An effective way of ensuring this occurs is to raise the maximum levy threshold in the event of a merger or acquisition or to move to an unrestricted levy only model which would see entities treated more equitably based on size, compared to existing practice.

<u>The case for removing the restricted levy</u>

Further to the point above, 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."[4] In addition, in the Government's updated Statement of Expectations for APRA, the Government expects APRA to take a risk-based approach and to consider proportionality in regulation setting.[5] This should see smaller institutions regulated in an appropriate way relative to their size and corresponding risk.

Given these developments, it is appropriate to examine whether the rationale for the capped linear supervisory cost levy (i.e. the restricted levy) remains.

<u>Continued increases in the minimum levy component</u>

In its discussion paper, Treasury notes that "Recent APRA analysis indicated that the minimum restricted component of the levy for each sector was generally too low, and that the maximum for each sector was broadly in line with the cost of supervision. Gradual increases in minimums for each sector began in 2015-16 to address this issue and continues for 2023-24."[6]

While COBA appreciates that the Government is attempting to ensure that the cost of supervision is cost reflective, the continued increase in the minimum levy does see the smallest ADIs bear a significant percentage increase in levies regardless of whether the overall APRA funding requirements are decreasing (as they have been in recent years). This places an additional burden on these small institutions while all other banks, including the large, listed banks see continued decreases in levies paid. Since 2014-15, the minimum restricted levy has increased from $490 to the currently proposed $22,500, an almost 4,500% increase.

A continuation of this trend indefinitely would result in unsustainable cumulative increases on very small ADIs – the Government should consider this when making such decisions and clarity on the expected future path of minimum levy increases should be provided to the sector.

<u>Lack of timely Cost Recovery Impact Statement</u>

APRA is required to produce a Cost Recovery Implementation Statement (CRIS) which sets out further transparency around the cost of APRA's activities and the corresponding impact on the levies. This is a useful document as it outlines in greater detail the impact of levies and reasoning behind decisions undertaken. We note that this statement does not have to be published until 30 June 2023, however public access to this document prior to the close of consultation on each year's FISL would

[3] APRA Monthly Authorised deposit-taking institution statistics April 2023, released 31 May 2023

[4] See APRA's SRI Model guide

[5] https://www.apra.gov.au/statement-of-expectations

[6] See Treasury Discussion Paper Proposed Financial Institutions Supervisory Levies for 2023-24

provide valuable insights into the model and any proposed changes, therefore increasing transparency in decision making.

This in turn would be very useful for stakeholders in producing useful, reasoned and relevant submissions to the FISL discussion paper. COBA calls on the timing of the APRA CRIS publication to coincide with the FISL consultation, and if this is not possible, then the publication of a draft CRIS ahead of the final version.

Conclusion

COBA notes that the current model is quite complex and struggles to take into account significant shifts in the operating environment. 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.

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.

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

Yours sincerely

MICHAEL LAWRENCE
Chief Executive Officer