11 June 2024

Ms Nghi Luu
A/g First Assistant Secretary
Financial System Division
Markets Group
Treasury

Via email: SupervisoryLevies@treasury.gov.au

Dear Ms Luu

Proposed Financial Institutions Supervisory Levies for 2024-25

The Customer Owned Banking Association (COBA) welcomes the opportunity to comment on the Proposed Financial Institutions Supervisory Levies (FISL) for 2024–25 ("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 $175 billion in assets and is the fifth largest holder of household deposits. Our members range in size from less than $200 million in assets to around $25 billion in assets – all significantly smaller than our ASX-listed peers. Customer owned banks (i.e. mutual ADIs) account for around two thirds of the total number of domestic Authorised Deposit-taking Institutions (ADIs) and deliver competition and market leading levels of customer satisfaction in the retail banking market.

Key points

The highly variable nature of APRA levy setting continues to adversely impact COBA members, particularly when our sector is subject to larger levy increases than major bank peers.

As immediate action, Treasury should increase the maximum restricted levy in line with CPI to ensure that they pay a fair share of these additional costs.

As immediate action, Treasury must review costs assigned to the restricted levy component, with a view to moving costs into the unrestricted component given unrestricted cost changes are distributed more equitably across the levy population.

Concerns about the levy model are expected to be magnified if the possible ANZ-Suncorp merger proceeds. Under the current model without any change in maximum levies or resourcing, this will lead to a shift of around $2.7 million in levies onto smaller banks, which is a clearly unacceptable outcome.

Impact on COBA members – mutual ADIs bearing a proportionately larger cost burden

COBA supports well-resourced and efficient regulators. Where this funding is taken from industry, cost burden must be equitable across industry. Under the proposed FISL, COBA members are expected to see increases in their levy obligations, with particularly large increases felt by mid- and large- sized mutual ADIs (circa 30% increase). This is due to increases in both the restricted and unrestricted levy rates, however due to the levy structure, mid- and large- sized mutual ADIs will bear a proportionately larger cost burden than the largest Australian banks. While we acknowledge there are increasing costs at the Australian Prudential Regulation Authority (APRA), the Government should ensure that any increases to cost on industry are transparent, proportionate and gradual.

Timeliness of Cost Recovery Impact Statement

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 2024, however public access to this document prior to the close of consultation on each year's FISL would 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 Discussion Paper. COBA continues to call for 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.

Timeliness of Discussion Paper

It is imperative that any regulatory levy increases be advised in a timely manner to allow for any changes to be appropriately factored in by regulated entities. The release of the Discussion Paper in late May does not allow for this to occur, as the budgeting process at many COBA members is at its late stages, in some cases having already been approved by the Board of Directors. Any significant, unanticipated increases to APRA levies, such as those proposed in this Discussion Paper, result in significant inconvenience and potential budgetary pressure when they are not advised in a timely manner. While members do budget for potential levy increases, they would not do so for assuming increases of a significant magnitude such as those seen this year.

As such, COBA calls on the Government to release the Discussion Paper as soon as is practicable after the Federal Budget process has concluded to provide more notice to regulated entities of proposed changes than is currently the case.

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

COBA provides further information on our ongoing concerns with the levy model in **Appendix A.**

Yours sincerely

MICHAEL LAWRENCE
Chief Executive Officer

Appendix A: APRA levy concerns

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 (as has been realised for the coming financial year as well as previous years) or a change in the structure of the banking sector.

Changes to APRA's funding requirements

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. The coming financial year sees APRA funding increase by 10.3%, the levies on ADIs increase by 16%, however due to the existing model's deficiencies small and medium sized ADIs (i.e. non-majors) are burdened with the relative bulk of the increase (up to 30% increase).

Maximum restricted levy component

The FISL proposal sees a significant increase in the restricted levy, however due to the lack of any adjustment to the maximum restricted levy this results in a disproportionate amount of the increased levy being borne by entities subject to the variable 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. This disproportionate increase acts to further reduce competition in a sector that is already burdened with ever increasing regulatory complexity and cost. This approach does not align with the intent espoused in the Discussion Paper where it stated that APRA is not to be "unnecessarily hindering…competition or otherwise impeding the competitive neutrality or contestability of the financial system."[1]

COBA provides two examples in Table 1 and Table 2 where the 'upswing' in APRA funding has been disproportionately shared.

The current FY 2024-25 proposal sees the restricted levy increase by over 32% while the unrestricted levy increases by only 21%. Small ADIs' overall levy comprises mostly of restricted levies which results in significant overall levy increases due to the restricted rate rise. Furthermore, given the maximum restricted levy has not changed, this results in ADIs subject to the variable restricted levy bearing a 30% increase in total ADI levies while the major four banks which are subject to the maximum levy only see an overall levy increase of 10% (see Table 1). This raises a fundamental question of equity and highlights a deficiency in the current model.

[1] See Treasury Discussion Paper Proposed Financial Institutions Supervisory Levies for 2024-25, page 3

Table 1: Estimated Proposed ADI levies for 2024-25[2]

Asset base	$50m ($'000)	$500m ($'000)	$5b ($'000)	$25b ($'000)	$100b ($'000)	$1,000b ($'000)
2023-24	22.8	25.6	138.0	690.3	2,761.0	12,710
2024-25 (proposed)	22.9	26.3	179.1	895.8	3,583.0	14,030
Change	0.3%	3%	30%	30%	30%	10%

The FY 2021-22 levy setting experience has shown that this is an ongoing issue and a permanent solution is needed. Table 2 sees small- and mid- size ADIs shouldering a significantly higher percentage increase to levies paid as a result of the increase in the restricted levy component exceeding that of the unrestricted component, and large ADIs being subject to the restricted levy cap.

Table 2: Estimated Proposed ADI levies for 2021-22[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
2021-22 (proposed)	17.9	26.5	265.0	1,324.8	5,299.3	11,314
Change	17%	46%	50%	50%	50%	12%

These levy proposals highlight the need to reconsider the imposition of the maximum restricted levy as it currently stands. Alternative solutions which result in more equitable outcomes include the removal of the maximum restricted levy and a movement to an unrestricted only levy (further discussion is below) or an ongoing adjustment of the maximum restricted levy cap, for example in line with increased funding requirements or indexation to CPI or another relevant measure.

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 anticipated merger of Suncorp and ANZ. Currently ANZ pays the maximum restricted rate and Suncorp would pay approximately $2.74 million in the restricted levy at the proposed FY 2024-25 rate, based on an asset base of $97 billion.[4] 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 $2.74 million. Without an increase in the maximum

[2] See Treasury Discussion Paper Proposed Financial Institutions Supervisory Levies for 2024-25

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

[4] APRA Monthly Authorised deposit-taking institution statistics April 2024, released 31 May 2024

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 continue to 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.

The case for removing the restricted levy

Further to the point above, in FY 2021-22, 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."[5] 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.[6] This should see smaller institutions regulated in an appropriate and proportionate 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.

Minimum restricted levy component

COBA acknowledges that Treasury have not made changes to the minimum restricted levy in the Discussion Paper, after significant increases in previous years. Since 2014-15, the minimum restricted levy has increased from $490 to the current $22,500, an almost 4,500% increase.

Given the significant additional burden that any future increase in the minimum levy imposes on the smallest ADIs, COBA calls on the Government to clarify and justify the expected future path of minimum levy increases.

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 – as will occur in the upcoming financial year.

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,

[5] See APRA's SRI Model guide

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

- removing the legislated statutory upper limit on the maximum restricted levy to provide further flexibility to increase the costs on the largest institutions,
- increasing the ‘minimum’ maximum restricted levy on systemically important banks in line with funding increases or another measure such as CPI 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 more equitably across the levy population. This flexibility could be used during periods of significant levy increases to smooth out costs.