11 June 2021

Simon Milnes
Director
Banking Unit | Financial System Division
The Treasury
Langton Crescent, Parkes
ACT 2600
By email: supervisorylevies@treasury.gov.au

Dear Mr Milnes

Proposed Financial Institutions Supervisory Levies for 2021-22

The ABA welcomes the opportunity to make a submission regarding the Financial Institutions Supervisory Levies (FISL) that will apply for the 2021-22 financial year.

Our position

The ABA requests Treasury give further consideration both to the funding request of the financial regulator and the methodology that has been used to apply cost recovery across the sector. It is our view that the current cost recovery model imposes a significant burden on mid-sized ADIs.

ABA recommendations are:

1. **Funding of the regulator:** The ABA encourages the Government to ensure that the funding requests of the Australian Prudential Regulation Authority (**APRA)** are appropriate and proportionate. This is particularly relevant given the large year on year increases to funding that have been granted to the regulator over the last five years.
2. **Calculation of 2021-22 levies:** The Government could review the proposed 2021-22 calculation methodology to ensure an equitable allocation of cost that reflects supervisory effort across the industry. The ABA considers that the proposed methodology results in an inappropriate shift of the cost burden to mid-sized ADIs with assets of approximately $100 billion.
3. **Review of methodology:** The Financial Regulator Assessment Authority (**FRAA**), once established, should assess the suitability of APRA's calculation approach.

These issues are detailed in Appendix A to this letter. The ABA welcomes the opportunity to discuss the 2021-22 FISL with Treasury. If you have any queries in relation to this matter, please do not hesitate to contact me at Jess.Boddington@ausbanking.org.au or on 0412 646 864.

Yours sincerely,

Jess Boddington
Director, Policy

About the ABA

The Australian Banking Association advocates for a strong, competitive and innovative banking industry that delivers excellent and equitable outcomes for customers.

We promote and encourage policies that improve banking services for all Australians, through advocacy, research, policy expertise and thought leadership.

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Appendix A: Key issues

The ABA is concerned with the regulatory costs proposed to be recovered from ADIs in 2021-22 and the proposed methodology for recovering these costs.

Increasing regulatory costs

Recommendation 1:

That the Government ensure that the funding requests of APRA are appropriate and proportionate.

APRA is currently largely funded through levies recovered from regulated institutions. The funding allowance is set through two processes:

1. a budget that is included in the annual Treasury Portfolio Budget Statements; and/or
2. a New Policy Proposal (NPP) for the Government's consideration. This occurs if APRA is asked to undertake significant new activities, or considers it is inadequately funded to meet future demands.

The ABA supports appropriate cost reflective funding of APRA. An adequately resourced regulator will ensure its regulatory mandate is undertaken in a timely and effective way and contribute to a strong, stable and resilient financial system. However, the ABA is concerned that there appears to be limited discipline imposed by the Government on APRA to demonstrate that its supervision and policy programs are proportionate to the risks present.

This is particularly relevant given the large year on year increases to funding that have been granted to APRA over the last five years (see table 1).[1] The average yearly increase in funding for APRA between 2017-18 and 2020-21 was 11.1 per cent.[2] Under APRA's cost recovery model, these cost increases are ultimately borne by the institutions that it regulates.

For 2021-22, the proposed funding increase will result in additional levy costs for most of our members of more than 50 per cent. Further, it is unclear from either APRA's Portfolio Budget Statement or the FISL consultation paper what specific projects or resources necessitate the additional funds.

Table 1: Total levies funding required for APRA[3]

	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Budget ($m)	122.1	136.1	141.6	186.1	181.6	220.8
Change ($m)		*14.0*	*5.5*	*44.5*	*-4.5*	*39.2*
Change (%)		*11.4*	*4.0*	*31.4*	*-2.4*	*21.6*

Given the size of the sector, both in absolute terms and as a share of the economy, it is critical to ensure that regulation of the financial system does not inhibit the ability of ADIs to serve the Australian population or grow the economy. The ABA encourages the Government to impose discipline on the regulator, both through the Treasury Portfolio Budget Statement process and the New Policy Proposal Process, to ensure that funding requests are appropriate and proportionate going forward.

[1] Acknowledging the decrease from 2019-20 to 2020-21.

[2] RBA, Measures of Consumer Price Inflation, using March-end CPI for all groups.

[3] Treasury, Financial Institutions Supervisory Levies Methodology, Discussion Paper, August 2019; and Treasury, Proposed Financial Institutions Supervisory Levies for 2021-22, May 2021

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Unsuitable 2021-22 levies

Recommendation 2:

That the Government review the 2021-22 calculation methodology proposed, with a view to reducing the costs imposed on mid-sized ADIs with assets of approximately $100 billion.

The ABA considers that the current methodology results in inappropriate cross-subsidisation between financial firms. The current levies methodology has two components:

- **A restricted levy component** that is meant to reflect the cost of supervision for an industry. This is structured as a percentage rate on assets, subject to minimum and maximum amounts.
- **An unrestricted levy component** that covers costs relating to 'systemic' regulation, rather than costs that can be allocated to an individual institution or industry. This is also structured as a percentage of total assets, without a limit on minimum or maximum amounts.

In June 2020, Parliament introduced an amendment to increase the statutory upper limit on the restricted levy component that can be charged to regulated firms.[4] This increased the maximum limit from $1.5 million to $10 million per year (adjusted for inflation).

The ABA questions why the Government has chosen to decrease the restricted maximum amount for ADIs in 2021-22 from $5 million to $4.7 million, noting that there has been no justification provided in the consultation paper. Further, this decision appears to go against the intent of the legislative amendment passed last year, which increased the statutory cap on the restricted levy in recognition of the issue of cross-subsidisation that exists to the detriment of mid-sized ADIs.

The ABA is concerned that the overall proposal for 2021-22 will place a disproportionate cost burden on mid-sized financial ADIs. As illustrated in the charts below, the proposed increase to levies for ADIs with approximately $100 billion in total assets are larger in dollar terms than for those ADIs that have significantly larger asset bases.

Charts 1 & 2: 2021-22 levy increase for ADIs

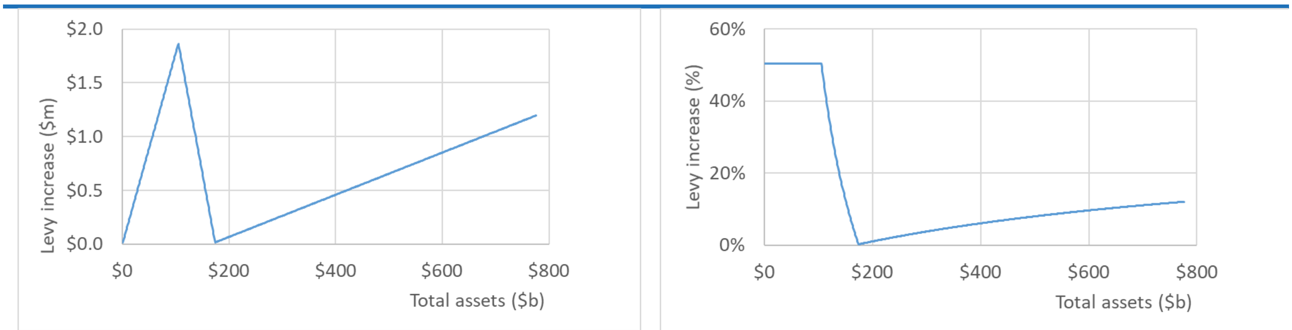

Table 2: Proposed 2021-22 ADI levies[5]

	Asset base	Restricted levy component	Unrestricted levy component	Total levy	Increase in levy
Bank A	$1 tr	4,700,000	8,270,000	12,970,000	1,635,000
Bank B	$100 bn	4,470,000	827,000	5,297,000	1,776,000

The unusual levy distribution this year appears to be driven by the proposal to set the restricted maximum cap at $4.7 million. As shown in table 2, the restricted levy amounts imposed on two hypothetical firms (one mid-size and one large) are almost the same. The ABA is unclear what

[4] Australian Prudential Regulation Authority Amendment (APRA Industry Funding) Act 2020

methodology Treasury would have utilised to arrive at this cost recovery result, given that the restricted amounts are meant to reflect the relative costs of supervision imposed by the firms.

This issue has a particular impact on the mid-sized regional banks in the industry who are concerned that this decision will place a disproportionate cost burden on them.

The proposed cost allocation is difficult to justify given both the increase to APRA's funding for 2021-22, as well as the relative resourcing that APRA places on different sized ADIs. The restricted component of the levy is broadly designed to reflect the direct cost of supervision. APRA has dedicated supervisory teams for the largest ADIs, while resources are shared for smaller ADIs. This is appropriate given the relative systemic risks posed by the ADIs; however, it should also be reflected in the costs imposed on ADIs for the purposes of financial regulation.

The ABA therefore encourages the Government to review the FISL methodology to arrive at a calculation that better reflects the systemic and supervisory costs imposed by different ADIs and minimises cross-subsidisation within the industry sector. In doing so, we also ask that the Government confirm that the uncollected levies from the 2020-21 Budget measure 'Treasury Portfolio – additional funding' of $12.8 million has been factored into the consideration of the formula parameters.

Review of methodology

Recommendation 3:

The FRAA should review APRA's calculation methodologies to assess their appropriateness.

The ABA is supportive of the Government's intention to implement recommendation 6.14 of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. This recommendation was to establish an independent assessment authority to review the effectiveness of APRA and ASIC, and to report on its findings to the Minister.

We understand that legislation to implement the FRAA will be introduced into Parliament by the middle of 2021. The ABA considers that it would be appropriate for the FRAA, once established, to review the soundness of the methodologies that APRA utilises in determining the supervisory levies.