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Dear Richard

## **Consultation Paper #2 – AUSTRAC Industry Contribution**

Thank you for the opportunity to comment on AUSTRAC's second consultation paper regarding the proposed introduction of an Industry Contribution.

COBA is the industry body for credit unions, mutual building societies and mutual banks and, on behalf of Friendly Societies of Australia, friendly societies. Collectively, the institutions we represent have more than \$87 billion in assets and serve more than 4 million customers. The customer owned model is the proven alternative to the listed model, delivering competition, choice, and consistently market leading levels of customer satisfaction.

### **Key concerns with Industry Contribution**

COBA and other peak bodies share the following key concerns about the Industry Contribution concept:

- The Industry Contribution is inconsistent with both the Government's own Cost Recovery Guidelines, and the findings of a 2013 independent review of AUSTRAC's cost recovery arrangements;
- Legislation to enable the Industry Contribution was rushed through Parliament despite the consultation process not having concluded; and
- The Industry Contribution has been granted "an exemption" from the requirement to prepare a regulatory impact statement.

In addition, COBA raises the following specific issues about the proposed methodology for allocating the Industry Contribution amongst regulated entities.

### **The calculation of the earnings component**

Under the current Supervisory Levy, regulated institutions are divided into a number of earnings bands, and institutions which fall into the same band pay the same earnings component.

The problems created by the current approach are well understood, with the 2013 Independent Review (the Flaye Review) drawing attention to the inequitable outcomes that the levy was leading to with the following hypothetical example:

“...an entity that submits earnings of \$690 million would pay a large entity component of \$130,000, but if another entity had submitted earnings of \$710 million it would have paid a larger entity component of \$300,000 i.e. an increment of 3 per cent in earnings has resulted in a 130 per cent increase in levy.”<sup>1</sup>

Similarly, AUSTRAC’s General Manager of Compliance, Ms Amanda Wood, in recently commenting on the tiered approach noted that “There were problems with that,” and that in particular:

“...if you were at the margin of a tier—and this is not exactly right—and say the tier finished at \$200 million, if your earnings were \$199 million then you would be in one band, but if they tipped over to \$201 million you would have a large increase in your levy that was not proportionate or linear in terms of the increase in your earnings.”<sup>2</sup>

It is therefore encouraging that as part of the transition from the Supervisory Levy to the Industry Contribution, AUSTRAC has proposed the replacement of the earnings bands with an amount instead set as a fixed percentage of earnings.

As noted in AUSTRAC’s first discussion paper, “The reason for moving to a rate is that using different earnings ‘bands’ under the Supervisory Levy had the potential for a disproportionate impact on those entities whose earnings were at the margins of the bands.”<sup>3</sup>

While the change addresses this issue to some extent, it also creates additional problems. In particular, under the proposed methodology, there will now be a very disproportionate impact on institutions which lie either side of the \$100 million earnings threshold. As currently proposed, an institution with earnings of \$99 million would pay an earnings component of \$0, while an institution with earnings of \$101 million would pay an earnings component of \$50,500.

In addition to having a disproportionate impact on institutions either side of the \$100 million benchmark, the proposed change would also represent an inequitable increase in the current levy paid by these institutions. AUSTRAC is proposing to collect roughly \$41.6 million from industry in 2014/15,<sup>4</sup> up from \$29.1 million in 2013/14,<sup>5</sup> an increase of 43%. In considering how best to distribute this increase among the institutions it regulated, AUSTRAC has stated that “...the overall approach that we have taken with the levy amounts is to try to keep it within a similar range as to the overall amount increase that we are collecting.”<sup>6</sup>

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<sup>1</sup> Flaye, *AUSTRAC Supervisory Levy Review Report*, 2013, p. 12.

<sup>2</sup> Legal and Constitutional Affairs Legislation Committee - Senate Hansard, 20 October 2014, p. 5.

<sup>3</sup> AUSTRAC, *Industry Contribution Discussion Paper*, June 2014, p. 8.

<sup>4</sup> Treasury, *2014/15 Budget*, BP2 – Part 1, p.9, & COBA calculations

<sup>5</sup> AUSTRAC, *2013/14 Annual Report*, p. 43.

<sup>6</sup> Legal and Constitutional Affairs Legislation Committee - Senate Hansard, 20 October 2014, p. 5.

However, the reality is that AUSTRAC's proposal will see institutions at the smaller end of the leviable spectrum face a far more significant increase in AUSTRAC collections than the largest institutions:

- Institutions with earnings of \$100 - \$150 million, will see their earnings component increase from \$20,000 to \$50-75,000, an increase of 150-275 per cent;
- The largest institutions will see their total payment to AUSTRAC increase from \$4.1 million in 2013/14,<sup>7</sup> to \$5.9 million in 2014/15, an increase of 43 per cent.

While COBA recognises that it will not be possible for all institutions to face exactly the same proportionate increase, the dramatic disparity between the treatment of the institutions at each end of the spectrum appears highly inequitable.

The shortcomings of AUSTRAC's current proposed changes to the earnings component could be addressed by introducing the earnings component more gradually as institutions pass the \$100 million earnings threshold. Options to achieve a more graduated introduction include:

- Only applying the 0.05% earnings component to earnings above \$100 million (i.e. an institution with earnings of \$102 million would pay an earnings component of \$51,000 rather than \$51,000); or
- Shade the earnings component in for institutions earning, for example, between \$100 million and \$200 million, by charging these institutions an earnings component of 0.1 per cent of their earnings above \$100 million.

Of course, there would be many other ways that the earnings component could be recalibrated, but the objective should be to avoid the dramatic jump in levy faced by institutions as they move over time from an earnings base of just below \$100 million to one just above this threshold.

COBA acknowledges that making either of these changes would result in a reduction in the aggregate amount collected by AUSTRAC. To offset this shortfall, COBA also recommends increasing the \$1 million cap on the earnings component. The cap undermines much of the benefit associated with moving from the current steps to a fixed rate, as the cap means that all institutions with earnings of \$2-\$5 billion will pay the same earnings component.

Please contact me on \_\_\_\_\_ or \_\_\_\_\_ on \_\_\_\_\_ to discuss this submission.

Yours sincerely

**Acting Head of Public Affairs**

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<sup>7</sup> Legal and Constitutional Affairs Legislation Committee - Senate Hansard, 20 October 2014, p. 5.