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Dear Richard

### **AUSTRAC Industry Contribution**

Thank you for the opportunity to comment on AUSTRAC's June 2014 Discussion 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 \$86 billion in assets and serve more than 4.5 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.

### **The Appropriate Size of the Levy**

The Discussion Paper notes that "the AUSTRAC Industry Contribution is not subject to the Government's cost recovery guidelines."<sup>1</sup> We understand that AUSTRAC has reached this conclusion because the Industry Contribution will cover AUSTRAC's Financial Intelligence costs, for which industry does not derive a direct benefit and for which therefore cost recovery would not be appropriate.

However, this appears to be a circular argument. Surely the purpose of the cost recovery guidelines is to allow the government to make an assessment of whether cost recovery is appropriate in a particular set of circumstances. If the cost recovery guidelines are only invoked where cost recovery is already determined to be appropriate, then that undermines their usefulness in identifying and preventing inappropriate cost recovery activities.

We would argue that the decision to exempt the Industry Contribution from the Cost Recovery Guidelines is an example of this perverse outcome. While the proposal is to replace the current AUSTRAC "Supervisory Levy" with an "Industry Contribution," removing the word "levy" from the name of the payment does not

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<sup>1</sup> AUSTRAC, *Industry Contribution Discussion Paper*, June 2014, p. 4.

alter its underlying nature, namely to recover a proportion of AUSTRAC's costs from industry. This is effectively acknowledged in the original announcement of the Industry Contribution in the 2014-15 Budget, with the Budget papers referring to the Industry Contribution representing a "phased increase in the AUSTRAC industry levy," and stating that the proportion of AUSTRAC expenses "recovered" from industry "will increase" from 53 per cent to 100 per cent.<sup>2</sup> In addition, the reporting of the change as a single Budget measure is an acknowledgement that the existing levy is being amended, rather than that the current cost recovery arrangement ceasing and a new, non-cost-recovery measure is being introduced (which would more properly be reported as two separate Budget measures).

The Cost Recovery Guidelines themselves make clear that they apply where an agency is "...proposing a new cost recovery arrangement; or amending existing cost recovery arrangements."<sup>3</sup> In defining the term "cost recovery" the Guidelines state that, "Cost recovery is the recovery of some or all of the costs of a particular activity."<sup>4</sup>

Again, the Budget paper makes clear that the magnitude of the Industry Contribution is tied to AUSTRAC's costs, and that it will eventually be set at a level which covers 100 per cent of "AUSTRAC's total expenses."<sup>5</sup> It is difficult to comprehend how this could be considered anything other than cost recovery given the definition in the Cost Recovery Guidelines.

If this isn't a cost recovery measure, then the only conclusion to be drawn is that this is simply a new tax on the financial sector.

**COBA therefore strongly recommends that the appropriateness of the proposed Industry Contribution be assessed against the Government's own Cost Recovery Guidelines, given that the Industry Contribution clearly falls within its scope.**

COBA believes that any assessment of the Industry Contribution against the Cost Recovery Guidelines would clearly demonstrate that levying industry to recover 100 per cent of AUSTRAC's costs is inappropriate.

The Cost Recovery Guidelines themselves state that: "Costs that are not directly related or integral to the provision of products or services ... should not be recovered."<sup>6</sup>

COBA also notes that an independent review of the AUSTRAC Supervisory Levy conducted in 2013 found that "The cost model should support a robust and well-documented method of costing that separates regulatory from intelligence-driven costs,"<sup>7</sup> and noted that the Cost Recovery Guidelines require AUSTRAC to

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<sup>2</sup> Treasury, *2014-15 Budget*, May 2014, Budget Paper 2, p. 9.

<sup>3</sup> Department of Finance, *Australian Government Cost Recovery Guidelines*, 2005, p. 10.

<sup>4</sup> *ibid.*

<sup>5</sup> Treasury, *2014-15 Budget*, May 2014, Budget Paper 2, p. 9.

<sup>6</sup> Department of Finance, *Australian Government Cost Recovery Guidelines*, 2005, p. 2.

<sup>7</sup> Flaye, *AUSTRAC Supervisory Levy Review Report*, 2013, p. 6.

“differentiate some activities between supporting regulatory and intelligence functions, with only the former being recovered.”<sup>8</sup>

**COBA therefore recommends that, consistent with the Government’s Cost Recovery Guidelines, that the levy not be expanded beyond recovering the costs of AUSTRAC’s regulatory activities.**

It is not clear on what basis the Government has determined that it is appropriate for the levy to be expanded in the fashion proposed in the 2013-14 Budget.

Last year, the Government established an independent National Commission of Audit which was tasked with examining “...all areas of Commonwealth expenditure, and to make recommendations to achieve savings sufficient to deliver a surplus of 1 per cent of GDP...”<sup>9</sup>

The Commission’s final report was released earlier this year, and made a total of 64 recommendations across a broad range of policy areas. The Commission considered cost recovery changes as one way to deliver government savings, and recommended that greater use of cost recovery be considered in the health portfolio. However, the Commission did not recommend any changes to the cost recovery arrangements currently in place with AUSTRAC. Instead, the Commission suggested that AUSTRAC be reviewed to determine if it should form part of the Australian Crime Commission.

If this new levy is pursued, it will simply be another cost imposed on business by the government. This would appear to be completely at odds with the government’s desire to reduce business costs and cut unnecessary regulations. We also note the government’s election commitment to:

“...require Ministers, departments and agencies to identify (in dollar terms) measures that offset the cost imposed to business of any new regulations.”<sup>10</sup>

However, it does not appear that any regulatory offsets have been put forward in this case.

### **The Appropriate Distribution of the Levy**

The Discussion Paper proposes that the Industry Contribution be broken into three components:

- An earnings component;
- A transaction report volume component; and
- A transaction report value component.

These are the same the three components which currently exist under the Supervisory Levy. However, the Discussion Paper proposes changes to the current rates in order to increase the total amount collected from industry.

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<sup>8</sup> Flaye, *AUSTRAC Supervisory Levy Review Report*, 2013, p. 12.

<sup>9</sup> National Commission of Audit, *Terms of Reference*, 2013, p. 1.

<sup>10</sup> <http://www.liberal.org.au/boosting-productivity-and-reducing-regulation>

COBA believes it is important that the burden of any increase in the overall levy be reasonably and equitably shared amongst all levied entities.

#### *Transaction reporting components*

Under the Industry Contribution, the proposed “report volume” component would remain unchanged at 1 cent per report. However, we note that the transaction value component makes up a much larger proportion of their overall levy.

With respect to the “transaction value” component, the Discussion proposes increasing the rate from the current level of \$6,130 per billion dollars of reports lodged, to approximately \$7,512 per billion dollars of reports lodged, an increase of roughly 23 per cent.

While the current approach ensures that institutions with a larger transaction volume pay a higher levy, COBA recommends that AUSTRAC also consider the relative AML risk that different transaction types present. Charging a higher levy rate for transactions which present a higher risk would provide for a more equitable levy distribution methodology.

#### *Earnings component*

The Earnings Component is linked to the size of an entity’s earnings (or profits in the case of ADIs). Under the current Supervisory Levy, there are a number of earnings bands, with institutions falling into the same asset band paying the same earnings component.

The independent review of the Supervisory Levy identified some shortcomings with this approach, and in particular drew attention to the inequitable outcomes faced by two institutions which stand on either side of a “step.” The review noted 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>11</sup>

COBA agrees that the current stepped approach is producing inequitable outcomes and should be updated.

The Discussion Paper proposes replacing the current bands with a fixed percentage of earnings, set at 0.05%. However, this percentage only applies to institutions with earnings of less than \$1 billion. For institutions with earnings of between \$1 billion and \$5 billion, the earnings component is capped at \$500,000, and for institutions with earnings higher than this the earnings component jumps to \$2.5 million.<sup>12</sup>

This arrangement produces several undesirable outcomes. Firstly, the proposed arrangement replicates the problem identified by the independent review.

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<sup>11</sup> Flaye, *AUSTRAC Supervisory Levy Review Report*, 2013, p. 12.

<sup>12</sup> AUSTRAC, *Industry Contribution Discussion Paper*, June 2014, p. 9.

Specifically, an institution with earnings of \$5.1 billion pays an earnings component of \$2.5 million while an institution with earnings of \$4.9 billion pays an earnings component of \$500,000.

Secondly, and more importantly, the new earnings component appears to be shifting some costs from larger institutions to smaller institutions. Institutions with earnings between \$100 million and \$1 billion will see their earnings component increase significantly under the proposed change, while for many larger institutions their earnings component will fall.

For example, an institution with earnings of \$100 million will see this component of their levy payment increase from \$20,000 to \$50,000, an increase of 150 per cent. At the same time, an institution with earnings of \$2 billion will actually see their earnings component fall from \$950,000 to \$500,000. This does not appear to be an equitable or fair outcome, and the Discussion Paper does not set out any rationale for what would appear to be a significant change in the approach to the apportionment of this part of the levy.

While it is true that the transaction component is increasing for these larger institutions, that component is increasing for all institutions, and it is not clear why a different approach is being proposed for the earnings component.

**COBA therefore recommends that the \$500,000 cap be removed and the 0.05% rate be lowered, to more equitably spread the levy while keeping the total amount collected through this component unchanged.**

Separately, COBA notes that entities with earnings of less than \$100 million are excluded from the earnings component. COBA supports the continuation of this, noting that the earnings component should only be applied to large institutions reflecting "...the additional supervision required where reporting entities became complex with a large number of designated services offered, numerous distribution channels and high volumes and values of transactions."<sup>13</sup>

### **Ongoing transparency**

COBA notes that AUSTRAC currently produces an Annual Cost Recovery Impact Statement (CRIS). As noted in the AUSTRAC CRIS:

"The purpose of the CRIS is to document the way in which the AUSTRAC supervisory levy complies with the cost recovery policy and to demonstrate that charges imposed on industry are reflective of the cost of AUSTRAC supervision."<sup>14</sup>

We believe it is important that transparency around the AUSTRAC levy is retained, and we are concerned that the CRIS may be discontinued given the view expressed in the Discussion Paper that the proposed levy is not subject to the Cost Recovery Guidelines.

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<sup>13</sup> Flaye, *AUSTRAC Supervisory Levy Review Report*, 2013, p. 16.

<sup>14</sup> AUSTRAC, *Cost Recovery Impact Statement*, 2012, p. 3.

