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Current Issues in Prudential Regulation

Overview

2.1 The Australian Prudential Regulation Authority (APRA) appeared before the committee at a public hearing on 13 September 2017 as part of the review of the APRA 2016 Annual Report.

2.2 Key issues examined at the hearing included measures to reinforce sound lending practices and ensure that Australian banks remain prudentially strong, APRA's recent decision to establish a prudential inquiry into the Commonwealth Bank of Australia (CBA), and the Government's proposed Banking Executive Accountability Regime (BEAR).[1]

2.3 The committee also questioned APRA on measures to strengthen the Australian superannuation system, particularly improving fund performance and outcomes for members.

Banking sector

2.4 In July 2017, APRA announced 'unquestionably strong' capital benchmarks for the four major banks,[2] and took additional supervisory measures to reinforce sound residential mortgage lending practices, in what it considers to be an environment of heightened risks. APRA has also

1 The Treasurer introduced the Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Bill 2017 to the House of Representatives on 19 October 2017: <http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;page=0;query=BillId%3Ar6000%20Recstruct%3Abillhome>, viewed 19 October 2017.

2 Australian Prudential Regulation Authority (APRA), 'APRA announces "unquestionably strong" capital benchmarks', Media release, 19 July 2017, <http://www.apra.gov.au/MediaReleases/Pages/17_23.aspx>, viewed 15 September 2017.

established an independent prudential inquiry into the CBA focusing on governance, culture and accountability frameworks and practices within the CBA group.

2.5 The Government announced a number of measures in this year's Budget that will broaden the responsibilities and powers of APRA. In particular:

- the Banking Executive Accountability Regime (BEAR) will make senior bank executives more accountable and subject to additional oversight by APRA;[3] and
- the Government will make it easier for new banking entrants by relaxing the legislative 15 per cent ownership cap. APRA is currently reviewing its prudential licensing arrangements as a consequence.

2.6 Both of these measures were recommended by the committee as part of its Review of the Four Major Banks.[4]

2.7 The Government is also seeking to give APRA new powers in respect of the provision of credit by entities that are not Authorised Deposit-taking Institutions (ADIs), to complement APRA's existing powers in respect of ADIs.

Measures to reinforce sound residential mortgage lending practices

2.8 In December 2014, APRA wrote to all ADIs advising of its intent to reinforce prudent residential mortgage lending practices through a number of measures, in particular increasing supervision of ADIs with annual investor credit growth materially above a benchmark of 10 per cent.[5]

2.9 In March 2017, APRA again wrote to all ADIs advising that it expects ADIs to:

- limit the flow of new interest-only lending to 30 per cent of new residential mortgage lending, and within that:
  - ⇒ place strict internal limits on the volume of interest-only lending at loan-to-valuation ratios (LVRs) above 80 per cent; and

3 The Treasury, 'Banking Executive Accountability Regime', *Consultations*, 13 July 2017, <https://treasury.gov.au/consultation/c2017-t200667/>, viewed 15 September 2017.

4 House of Representatives Standing Committee on Economics, *Review of the Four Major Banks (First Report)*, November 2016.

5 APRA, *Letter from APRA to all ADIs, 9 December 2014*, <http://www.apra.gov.au/adi/Publications/Documents/141209-Letter-to-ADIs-reinforcing-sound-residential-mortgage-lending-practices.pdf>, viewed 14 September 2017.

⇒ ensure there is strong scrutiny and justification of any instances of interest-only lending at an LVR above 90 per cent;

- manage lending to investors in such a manner so as to comfortably remain below the previously advised benchmark of 10 per cent growth;
- review and ensure that serviceability metrics, including interest rate and net income buffers, are set at appropriate levels for current conditions; and
- continue to restrain lending growth in higher risk segments of the portfolio (e.g. high loan-to-income loans, high LVR loans and loans for very long terms).[6]

2.10 The committee was interested in hearing about the effects of these benchmarks on bank lending practices, particularly with respect to investor and interest-only loans.

2.11 The Chairman of APRA, Mr Wayne Byres, outlined why APRA imposed the initial benchmark in December 2014 of 10 per cent growth in investor lending:

> At that time, or around that time, the Reserve Bank called out what it saw as an emerging imbalance in the market and very significant growth in lending to investors. Obviously, there were concerns about the speculative nature of that, so we established that benchmark as a way of indicating to the industry that banks that were growing their portfolio in this current environment greater than that rate of growth were probably taking on, or it was likely to indicate that they were taking on, higher levels of risk. Therefore, it was, in a sense, fair warning to everybody that, if you wanted to operate in that territory, you were likely to have some kind of supervisory response—possibly higher capital in response to the high risk.[7]

2.12 The Chairman described the March 2017 benchmark on interest-only loans as 'an additional benchmark to temper the rate of or the extent of lending on an interest-only basis.'[8] The Chairman explained:

> Interest-only lending had become an increasingly prominent means by which housing finance was being provided. In our view, a more prudent way of providing that finance is through a

6 APRA, Letter from APRA to all ADIs – Further measures to reinforce sound residential mortgage lending practices, 31 March 2017, <http://www.apra.gov.au/adi/Publications/Documents/Further%20measures%20to%20reinforce%20sound%20residential%20mortgage%20lending%20practices.pdf>, viewed 14 September 2017.

7 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 2.

8 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 2.

> principle-and-interest basis in which customers are actually repaying their loans. So we didn't seek to rule out that form of finance because there are legitimate reasons why borrowers might want to have interest-only facilities, and that capacity is still available to them, but we did seek to reduce the extent of interest-only lending as a means of helping mitigate some of the risks that we saw in the environment. [9]

2.13 In response to questioning, the Chairman clarified that the 2017 benchmark related only to new loans and that it will take time to change the composition of the banks' loan portfolios:

> A bank, in a sense, can't do anything about the history that is in the stock of the portfolio. You can't change that, in any meaningful way, quickly. What banks are able to do, though, is have some influence in the shape and flow of new lending that happens, and they can do that relatively quickly.[10]

2.14 APRA was asked about geographically based restrictions following a federal Budget announcement that APRA's powers will be clarified to include the ability to use geographical restrictions on the provision of credit. APRA stated that it:

> considers that it has the ability to adopt these or other measures on a geographically targeted manner, either through the supervisory process or formal rules, should such a step be warranted. However, the proposed legislation will provide certainty as to APRA's ability to do so. APRA has carefully considered but to date has not adopted geographically based measures for several reasons.[11]

2.15 The committee notes that APRA also stated that it 'has no immediate plans to adopt geographically differentiated residential mortgage lending measures'. [12]

2.16 APRA was asked whether its supervisory guidance on investor and interest-only loans took a one-size-fits-all approach, and if this disadvantaged smaller, or rural and regional lenders. The Chairman said that while there was some scope for flexibility it was important for the rules to be consistently applied:

> …if you try and have any sort of subset within the industry where some are subject to the limits and some aren't. What you'll find is

9 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 2.

10 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 3.

11 APRA, *Response to question on notice*, QON 6, 6 October 2017, p. 1.

12 APRA, *Response to question on notice*, QON 6, 6 October 2017, p. 2.

> all of the lower-quality business, therefore, moves just outside wherever the boundary is. Whenever there's a constraint, the largest institutions compete hardest for the best quality business. The poor quality business is then left to others, and we don't want to develop a concentration of poorer quality lending in smaller institutions.[13]

2.17 The Chairman added:

> As things stand today, we think it's achieving the outcome that we set out to achieve. As I said, there are some smaller institutions that are growing faster than 10 per cent. Over time, as we have tightened, we need to make sure that there's not a group of institutions on the outer edges that are playing by a different rule book.[14]

Banks claiming interest rate rises are due to regulatory requirements

2.18 The committee questioned the Chairman about statements made by the major banks in relation to interest rate increases that followed APRA's announcement to further reinforce residential lending practices, including:

- CBA's media release on 27 June 2017 that stated: 'To meet our [CBA's] regulatory requirements, variable interest only home loan rates for owner-occupiers and investors will increase by 30 basis points.'[15]
- Westpac's media release on 20 June 2017, which stated:

> APRA's limit on new interest only lending is 30% of new residential mortgage lending, so we have to continue to make changes to our interest only rates and lending policies to meet this benchmark.[16]

- National Australia Bank's (NAB) media release on 23 June 2017, which stated:

> We need to comply with our regulatory requirements, including APRA's 30 per cent limit on new interest only lending for residential mortgages, while balancing the needs of customers

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13 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 21.

14 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 22.

15 Commonwealth Bank of Australia (CBA), 'Commonwealth Bank changes home loan interest rates', *Media release*, 27 June 2017, <https://www.commbank.com.au/guidance/newsroom/Commonwealth-Bank-changes-home-loan-interest-rates-201706.html>, viewed 14 September 2017.

16 Westpac, 'Westpac adjusts home loan interest rates', *Media release*, 20 June 2017, <https://www.westpac.com.au/about-westpac/media/media-releases/2017/20-june/>, viewed 14 September 2017.

> across our entire portfolio and continuing to provide competitive rates.[17]

2.19 In response, the Chairman said that 'many banks make similar statements and we've been blamed for all sorts of things'. [18] The Chairman described the CBA's statement as 'ambiguous' and noted that the banks have used price as one way to influence customer behaviour in response to APRA's regulatory requirements:

> It's not a specific requirement that APRA has imposed, that they need to change interest rates. Both when we did the investor lending benchmark originally and more recently with the interest-only benchmark that we introduced, we were deliberately silent on the means and ways in which banks might seek to change their portfolio flows, to the extent they needed to, to meet those benchmarks. They haven't entirely relied on price. There have been changes to lending standards, reductions in maximum LVRs and other things. But there is no doubt that banks have used price as one way in which they have influenced customer behaviour.[19]

2.20 The committee asked APRA whether it was concerned that the banks may be increasing their profitability by claiming interest rate increases are due to regulatory requirements. The Chairman responded that it was not APRA's objective to increase bank profitability; rather APRA's objective was to 'change the volume in this particular case of interest-only lending'.[20] The Chairman stated:

> We put in place an interest-only benchmark. If they use price to achieve that benchmark then, all other things being equal, it will have a positive impact on profitability.[21]

2.21 The Chairman added that APRA's 'objective is to encourage better lending—what we're essentially saying is that higher risk lending should have a higher price attached to it.'[22]

2.22 In a letter to the committee, APRA advised that it 'did not undertake specific analysis to determine a precise estimate of the likely impact on the mortgage lending rates of individual lenders in response to specific

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17 National Australia Bank (NAB), 'NAB announces changes to variable home loan interest rates', *Media release*, 23 June 2017, <http://news.nab.com.au/news_room_posts/nab-announces-changes-to-variable-home-loan-interest-rates/>, viewed 14 September 2017.

18 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 3.

19 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 3.

20 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 24.

21 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 25.

22 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 25.

regulatory measures'.[23] APRA indicated that its assessment was based on '*a priori* expectations of likely responses by lenders', which was informed by considerations that included:

- the extent of change in borrower behaviour required and the timeframe in which it was being sought (i.e. the material reduction in interest-only lending being sought in a relatively short timeframe);
- the potential capacity of non-price measures to generate the required change in borrower behaviour;
- the relative cost and repayment requirements of interest-only and principal and interest loans; and
- learnings from earlier repricing decisions by lenders, and borrower responses, following previous measures to reinforce lending standards.[24]

2.23 APRA further commented that:

> It is also important to note that these announcements were being made in the context of other coincident regulatory changes (e.g. the imminent announcement of 'unquestionably strong' capital requirements, and the introduction of the Net Stable Funding Requirement). These regulatory changes will likely increase banks' funding costs, all other things being equal.[25]

2.24 This is an area that the committee will review at future hearings.

2.25 In relation to the big banks' Return on Equity (ROE) improving[26] despite APRAs supervisory measures, the Chairman said that regulatory capital requirements will weigh on the banks' ROE in the future:

> …to the extent banks are building their capital base now, and are anticipating that capital requirements will go up, those return-on-equity numbers that you quoted will not necessarily transpire in the future when there is a requirement to have more capital against those portfolios.[27]

2.26 APRA has flagged that capital requirements in other areas will be increasing, which will impact on ROE in the future.[28]

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23 APRA, *Response to question on notice*, QON 1, 6 October 2017, p. 1.

24 APRA, *Response to question on notice*, QON 1, 6 October 2017, p. 1.

25 APRA, *Response to question on notice*, QON 1, 6 October 2017, p. 1.

26 For example, Price, Waterhouse, Coopers (PwC) reported in May 2017 that the major banks' ROE increased by 13.96 per cent for the first half of 2017, with cash earnings of $15.7 billion. See: PwC, *Major Banks Analysis*, May 2017, <http://www.pwc.com.au/publications/major-banks-analysis-may-half-year-17.html>, p. 1.

27 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 4.

28 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 4.

Banking Executive Accountability Regime

2.27 The BEAR was announced in response to this committee's recommendations to improve accountability and transparency within financial institutions. The Treasury's BEAR Consultation Paper provides the following key aspects of the BEAR:

- Registration — prior to the appointment of directors and senior executives, ADIs must register these individuals with the Australian Prudential Regulation Authority (APRA) and provide maps of their roles and responsibilities.
- New powers and penalties — APRA will have stronger powers to remove directors and senior executives from APRA-regulated institutions, subject to review; expectations of ADIs and their directors and senior executives will be established; where ADIs do not meet these expectations, there will be civil penalties; and APRA will have power to impose penalties on ADIs not appropriately monitoring the suitability of executives.
- Remuneration — variable remuneration for ADI senior executives will be deferred for at least four years; and APRA will have stronger powers to require ADIs to review and adjust remuneration policies.[29]

2.28 In his opening statement, the Chairman said that the proposed BEAR was 'not new territory' for APRA, and remarked:

> The core objective of the BEAR, which is establishing clearer accountabilities for and expected standards of behaviour by senior executives within banks, is being constructed in a manner that is consistent with APRA's prudential mandate. While there are a range of new elements in the proposed reforms, the BEAR should essentially be seen as a strengthening of the existing prudential framework. Indeed, once the new framework's put in place for banks, APRA will consider whether some of the concepts within the regime have wider application. To the extent that they can add to community trust and confidence that all prudentially-regulated institutions are well governed and prudently managed, they might have significant benefit more broadly.[30]

2.29 The committee asked APRA whether it was confident the BEAR would be adequately empowered to carry out its mandate, compared to similar regimes overseas, including the United Kingdom's Senior Manager and Certification Regime (SM&CR), which was established in 2016. In

29 The Treasury, *Banking Executive Accountability Regime Consultation Paper*, July 2017, p. 1.

30 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 2.

response, APRA said that the BEAR proposed enhanced powers for APRA to disqualify individuals, in addition to pursuing civil penalties in court.[31]

2.30 The Chairman provided the following example of a circumstance where the BEAR would empower APRA to take action against a banking executive:

> If there was a senior executive, there would be a set of behavioural standards that are set out in the act and then the bank would be required to assign certain responsibilities to those executives—what's termed accountability mapping. And if there is a failure to fulfil those accountabilities or there is behaviour that's inconsistent with those behavioural standards, then that executive would open themselves up to being removed or disqualified.[32]

2.31 In responding, the Chairman also drew a distinction between the BEAR and the SM&CR in the United Kingdom, stating 'ours is, as initially proposed, a banking regime for prudential matters'.[33] The Chairman explained that the SM&CR 'has recently been extended to cover insurers, and it covers a range of other financial institutions, including ones that are not regulated by our equivalent regulator in the UK.'[34]

Inquiry into the CBA

2.32 On 28 August 2017, APRA announced it would establish a prudential inquiry into the CBA. According to APRA, this inquiry is a response to several issues that relate to the governance, culture and accountability frameworks within the CBA group, which APRA says 'have damaged the bank's reputation and public standing'.[35]

2.33 In its opening statement the Chairman said:

> Our decision to make the inquiry reports public provides an opportunity for the broader community to understand what common themes may have been behind these incidents, and provide assurance that they have been identified and will be addressed. In that sense, we very much see the inquiry making a constructive contribution to strengthening the reputation and public standing of the bank.[36]

31 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 13.

32 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 18.

33 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 9.

34 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 9.

35 APRA, 'APRA announces panel members and terms of reference for prudential inquiry into CBA', *Media release*, 8 September 2017, <http://www.apra.gov.au/MediaReleases/Pages/17_38.aspx>, viewed 15 September 2017.

36 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 2.

2.34 The committee asked APRA to detail the reasons why the CBA inquiry was necessary. The Chairman responded:

> The issues are fairly well known. You can go back to Storm Financial, and then you can go to the financial planning issues and you can go to the CommInsure matter and most recently the AUSTRAC matter. They're four fairly prominent and well-known issues. I don't think there's any doubt that those issues have damaged the reputation of the bank. The collective nature of those was I think the issue that triggered us to think that we need to do something different here.[37]

2.35 In response to questioning, APRA stated that the government did not encourage or instruct APRA to conduct the CBA inquiry.

2.36 The Chairman remarked that the inquiry provided the CBA with 'a circuit-breaker' to restore public confidence in the bank:

> …the objective behind what we proposed and set up in the end is to give a little bit more transparency, to provide something of a circuit-breaker and give a bit more visibility to the broader public about what issues are at the heart of these incidents that have occurred, to try to get to the bottom of that and give the community confidence that actually they are being addressed.[38]

2.37 APRA was asked how the inquiry related to APRA's mission, as outlined in its 2016 Annual Report.[39] The Chairman said that while he could not 'point to the specific words in the mission', the inquiry was justified and within APRA's mandate:

> I think it is, more broadly, the issue that we sit here with the largest bank in the country with its reputation badly damaged. It's unhealthy for the bank, it's unhealthy for the banking system and it's unhealthy for the country and the broader community that the bank finds itself in this situation. We have talked more generally about how important it is not just that banks are well capitalised but that people understand and trust that they are well governed and prudently managed.[40]

2.38 On 8 September 2017, APRA appointed Dr John Laker AO, Chairman of the Banking and Finance Oath, Professor Graeme Samuel AC, Professorial Fellow in the Monash Business School, and company director Jillian

37 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 6.

38 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 6.

39 APRA, *Annual Report 2015-16*, p. 3.

40 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 17.

Broadbent AO to undertake the inquiry and announced the inquiry's terms of reference.[41]

2.39 The committee questioned APRA about the independence of the inquiry panel, particularly in relation to the appointment of Dr Laker, a former APRA Chairman, and Ms Broadbent, who is the chairman of a large reinsurance company. The Chairman defended the appointment of the panel members, and stated that 'at the end of the day, this is an APRA inquiry. It is our inquiry. We are setting it up, we are appointing the people and we set the terms of reference'.[42]

2.40 Committee members raised concerns that the Chairman did not acknowledge the potential conflict of interest posed by having a Board member of a competing insurer on the CBA Inquiry Panel.[43]

2.41 The committee asked APRA if using independent experts on this type of inquiry panel was unique. The Chairman responded:

> This is fairly unique. Certainly in the form we have established it in it is unique. We have done investigations in the past into things like the FX options losses at the National Australia Bank a decade or so ago. We have in the past used external experts to help us in our supervision but not in a way that's been public or where the reports have been published, as they are going to be, on this occasion. So I wouldn't pretend that it is completely new territory for us, but as we have set this up it is a unique structure we haven't used before.[44]

2.42 When asked, in response to the statements of the Chairman at 2.33 and 2.34, whether the outcome of the inquiry might be predetermined, the Chairman replied:

> The key will be whether, in the community's mind, when the reports are there, people feel that, okay, we have finally got to the bottom of whatever issues may or may not have been there. My concern is the perception that exists that the issues aren't being addressed and are lingering on for some time, and it is very difficult for the Commonwealth Bank itself, given where it finds itself, to be able to say to the community, 'Don't worry, we are looking after these things'. The idea is to provide a report that gives transparency. If the Commonwealth Bank, and I will take

41 APRA, 'APRA announces panel members and terms of reference for prudential inquiry into CBA', *Media release*, 8 September 2017, <http://www.apra.gov.au/MediaReleases/Pages/17_38.aspx>, viewed 15 September 2017.

42 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 12.

43 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 12.

44 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 6.

> them at their word, are willing to cooperate with this and willing to accept the findings and deal with them as they are, then hopefully it does provide that comfort that the issues have been investigated and wherever needed there is rectification happening.[45]

2.43 The committee questioned APRA why it had not picked up on any issues with the CBA in accordance with APRA's *Prudential Standard CPS 220 Risk Management* (CPS220). The Chairman responded by explaining the purpose of CPS 220, and what it requires from banks:

> CPS 220 is a standard on risk management and it sets out requirements for banks—what we expect in terms of good risk management in banks—and requires banks to give us declarations on an annual basis that they are adhering to those principles.[46]

2.44 When asked whether APRA was satisfied with CBA's most recent CPS 220 declaration, the Chairman replied:

> One of the things a prudential regulator never says is, 'We're satisfied', because there wouldn't be a financial institution where we don't have recommendations and requirements to do things better in some shape or form. We had a range of issues, as we have with every organisation where we think they need to lift their game. We had that with the Commonwealth Bank, as we have with others.[47]

2.45 In response to a question on notice, APRA stated that the CBA's most recent CPS 220 Risk Management review was conducted in July 2017 by Ernst and Young.[48]

2.46 The committee asked APRA if the Australian Transaction Reports and Analysis Centre's (AUSTRAC) investigation of allegations of money laundering involving the CBA was one of the issues the Chairman mentioned and, if so, why APRA had not conducted its own investigation. The Chairman responded that APRA had not focussed on those matters 'because we were aware that AUSTRAC was looking at those issues.' [49] The Chairman added that, in addition to not duplicating AUSTRAC's work, APRA did not have the expertise to conduct the necessary

45 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 12.

46 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 6.

47 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 7.

48 APRA, *Response to question on notice*, QON 2, 6 October 2017, p. 1

49 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 7.

investigations, and reiterated that APRA's focus is 'on the prudential standing of the bank.' [50]

2.47 APRA was asked how it will ensure that the CBA implements the inquiry's findings. The Chairman pointed to the report being made public, and said 'I think it'd be very difficult for the Commonwealth Bank not to respond to the recommendations that are given.' The Chairman added that APRA will need to develop 'some sort of mechanism that allows for transparency around the extent to which the recommendations are being addressed, and are being addressed in a timely manner.' [51]

Improving banking competition: reducing barriers to entry

2.48 A key recommendation of the committee's Review of the Four Major Banks was to reduce the high barriers to entry into Australia's concentrated banking sector. The Government agreed with the committee's recommendation in its government response, stating:

> We will relax the legislative 15 per cent ownership cap, whether through the existing ministerial discretion or legislative change. We are supportive of a phased approach to licencing new and innovative banking entrants. We note that the Australian Prudential Regulation Authority (APRA) is reviewing its prudential licensing arrangements in 2017, including those for ADIs. APRA is also reviewing and updating its publicly available materials on licensing to ensure they are useful and accessible to potential new entrants as well as more traditional applicants such as foreign banks.
>
> In addition, we will also legislate to remove the prohibition on the term 'bank' by ADIs with less than $50 million in capital, to allow them to benefit from the reputational advantages of the term.[52]

2.49 The Government is seeking to give APRA new powers in respect of the provision of credit by entities that are not authorised deposit-taking institutions (non-ADI lenders), to complement APRA's existing powers in respect of ADIs:

> This includes a version of the two-phased licensing regime that was recommended by the committee, designed to make it easier for applicants, particularly those with innovative or otherwise

50 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 7.

51 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 16.

52 The Treasurer, The Hon Scott Morrison MP, *House Economics Committee's Review (Coleman Report) of the four major banks – Government response*, May 2017, <http://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/FourMajorBanksReview2/Government_Response>, viewed 15 September 2017, p. 2.

non-traditional business models, to navigate the ADI-licensing process while at the same time maintaining overall entry standards.[53]

Superannuation

2.50 The Government has announced measures to enhance governance and transparency in the superannuation industry. These measures include 'empowering APRA to take preventive and corrective action if it has prudential concerns about a [superannuation] fund or if a fund is not acting in the best interests of members'.[54]

2.51 APRA Deputy Chairman, Mrs Helen Rowell, explained the new measures:

> They are around enhancing the criteria that need to be met by the default MySuper products, and APRA's ability to address issues in relation to those products and, ultimately, cancel authorisations; and providing a higher hurdle for authorisation of default products that needs to be met. There are proposed changes to powers around transfers of ownership and the ability of APRA to make directions, which will strengthen our ability to respond to and have entities deal with the issues that we identify through our supervision; there are some weaknesses in our current powers in that regard. The transparency area is another area that we have identified, where the information that we are able to collect and analyse and report on around the operations of the superannuation industry is not as granular and consistent as we would like, and there are measures in the proposals that go to those elements as well.[55]

2.52 A key element of the Government's superannuation reforms is to require funds to report and publish annually transparent information on how the fund is being managed. This includes information on how the fund sets fees, and how it spends members' money.[56] The committee asked APRA

53 Mr Wayne Byres, APRA Chairman, *Transcript*, 13 September 2017, p. 1.

54 Minister for Revenue and Financial Services, the Hon Kelly O'Dwyer MP, 'Reforms to give consumers more power at the heart of a stronger superannuation system', *Media release*, 24 July 2017, <http://kmo.ministers.treasury.gov.au/media-release/070-2017/>, viewed 15 September 2017.

55 Mrs Helen Rowell, APRA Deputy Chairman, *Transcript*, 13 September 2017, p. 10.

56 Minister for Revenue and Financial Services, the Hon Kelly O'Dwyer MP, 'Reforms to give consumers more power at the heart of a stronger superannuation system', *Media release*, 24 July 2017, <http://kmo.ministers.treasury.gov.au/media-release/070-2017/>, viewed 15 September 2017.

whether political advertising, for example Industry Super's 'fox and the henhouse' advertising campaign, would be considered in the interest of its members.[57] APRA responded that it had reviewed the case, and considered that the expenditure was in the interests of its members because the fund was performing well: 'Their membership has gone up year on year for the last three years, and the returns are in the top quartile for that period.' [58]

2.53 In relation to the performance of industry super funds, the Deputy Chairman stated:

> There is no doubt that the net investment performance of the top industry funds has been very strong in recent years, and for some time. Our view is that you need to look beyond just fund-level return to assess performance and delivery for members. There is a range of performance across the industry, across all segments, and our focus is on the bottom performers and lifting practices and performance and outcomes for members in those that are not delivering well for their members, and that is a very mixed picture across all segments of the industry and something we are working hard on.[59]

2.54 The committee asked APRA what data it collected on Registrable Superannuation Entity (RSE) licence holders. The Deputy Chairman responded:

> APRA collect a quite wide range of information on the superannuation industry, primarily at an RSE level but also at a more granular level. We use that information to support our prudential supervision of the industry. We undertake our own analysis at a trustee level, at an RSE level and more granularly to understand where the risks and issues are and where we need to focus our supervisory attention. We also publish a lot of the information that we collect in our regular statistical publications. That is both aggregate industry information on assets, returns and the like and also at an individual fund level. We make that

57 See, for example: E Bagshaw,'"Foxes in the hen house": new industry super ad takes on the banks', *Sydney Morning Herald*, 20 March 2017, <http://www.smh.com.au/business/foxes-in-the-hen-house-new-industry-super-ad-takes-on-the-banks-20170317-gv0o9s.html>, viewed 15 September 2017.

58 Mr Stephen Glenfield, General Manager, South West Region, Specialised Institutions Division, APRA, *Transcript*, 13 September 2017, p. 11.

59 Mrs Helen Rowell, APRA Deputy Chairman, *Transcript*, 13 September 2017, p. 17.

> publicly available so that other stakeholders can do their own analysis.[60]

2.55 APRA was asked whether it published the analysis and assessments used to support its prudential supervision of individual superannuation entities or their products. The Deputy Chairman responded:

> It's important to distinguish between APRA collecting data on different aspects of funds, including investment returns, expenditure and the like, and putting that information out in the public domain—publishing it via making it publicly available in our statistical tables and the like—versus APRA actually undertaking analysis and making commentary on relative performance or making judgements about the performance of individual funds, because it is APRA's opinions, assessments and judgements that have the potential for adverse consequences if we make a negative comment about the performance of an individual fund. Statistics versus analysis, in our mind, are quite different.[61]

2.56 APRA was asked whether like-for-like information on superannuation funds would be available for consumers and shareholders as part of the superannuation reforms. The Deputy Chairman said:

> There are a number of different changes that are in train, some of which are being implemented by ASIC and some of which are being implemented by APRA. In total, we would think that at the end of the process those issues should be addressed.[62]

2.57 The committee asked APRA whether any of the superannuation changes only targeted MySuper[63] products. The Deputy Chairman replied:

> The main elements of the package that only apply to MySuper are the outcomes assessment and the criteria around authorisation which, in part, is about having enhanced focus on investment returns and costs and the like. APRA is proposing to amend its prudential standards to apply similar requirements to other RSEs and RSE licensees so that there is a level playing field.[64]

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60 Mrs Helen Rowell, APRA Deputy Chairman, *Transcript*, 13 September 2017, p. 8.

61 Mrs Helen Rowell, APRA Deputy Chairman, *Transcript*, 13 September 2017, p. 9.

62 Mrs Helen Rowell, APRA Deputy Chairman, *Transcript*, 13 September 2017, p. 14.

63 MySuper products are low cost and simple superannuation products that employers choose as their default super fund. See: Australian Securities and Investments Commission, 'MySuper', *Moneysmart*, June 2017, <https://www.moneysmart.gov.au/superannuation-and-retirement/how-super-works/choosing-a-super-fund/mysuper>, viewed 15 September 2017.

64 Mrs Helen Rowell, APRA Deputy Chairman, *Transcript*, 13 September 2017, p. 14.

Climate change

2.58 The committee questioned APRA on its public messages around climate change risks. Mr Geoff Summerhayes, APRA Member, said that APRA identified three categories of risks in relation to climate change: physical, transition and liability risks.[65] He explained that it was important for APRA to communicate those risks to its regulated entities and 'promote an improved understanding of those risks, have board-level conversations about those risks and, where appropriate, [take] organisation[al] action on those risks.' [66]

2.59 When asked if the two degree target for global warming under the Paris Agreement was a reliable guide for companies to assess climate change risks, APRA responded 'we are not being directive. It's up to the organisations to make their own decisions.' [67]

2.60 The committee was interested in hearing how various industries were responding to climate change risks. APRA noted that 'there are a range of behaviours and maturities' in relation to addressing climate change risks, and remarked that 'insurers both domestically and globally have some of the more evolved thinking on this issue'.[68]

Conclusion

2.61 In relation to APRA's measures to reinforce sound residential mortgage lending practices, the committee notes that APRA does not require banks to increase their interest rates in response to its regulatory requirements. Rather, APRA's intention has been to limit new investor and interest-only loans to ensure Australian banks remain prudentially sound. However, as the Chairman makes clear, one of the ways in which banks have responded to regulatory changes has been to increase rates. This has, in turn, increased bank profitability.

2.62 The committee considers the ACCC's new roles and powers to investigate interest rate decisions will have a positive impact on competition in the banking sector and in making bank decisions more transparent to Australian consumers. The committee looks forward to the outcomes of the ACCC's investigation on this matter.

65 Mr Geoff Summerhayes, APRA Member, *Transcrip*t, 13 September 2017, p. 19.

66 Mr Geoff Summerhayes, APRA Member, *Transcript*, 13 September 2017, p. 19.

67 Mr Geoff Summerhayes, APRA Member, *Transcript*, 13 September 2017, p. 20.

68 Mr Geoff Summerhayes, APRA Member, *Transcript*, 13 September 2017, p. 20.

2.63 The government has responded to the recommendations of the committee's Review of the Four Major Banks, in particular the establishment of the BEAR. The BEAR will set out clear accountabilities and expected standards of behaviour for banking executives, will make it easier for APRA to disqualify executives, and impose financial penalties on ADIs that do not meet expectations

2.64 The committee notes that significant changes are proposed to improve governance and transparency in the superannuation industry, and that APRA is supportive of these changes. The committee expects that, once the measures are implemented, APRA's supervision of superannuation funds will be greatly enhanced. The committee will monitor closely APRA's performance in this area in the future.

Mr David Coleman MP
Chair
25 October 2017