House of Representatives Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Review of the Australian Prudential Regulation Authority Annual Report 2020

Division/Agency: Australian Prudential Regulation Authority
Question No: APRAQoN12
Topic: Consultation
Reference: Page 18-19 Hansard, (29 March 2021)
Member: Jason Falinski

Question:

Mr FALINSKI: Non-ADIs and smaller financial institutions complain to me on a regular basis that your criteria have an outweighed impact on them because they are smaller and their capacity to (a) pay for it and (b) have the number of people required to report and monitor it puts them at a substantial competitive disadvantage to larger players in the market. What are you doing to ensure that barriers to competition and barriers to entry are as low as possible, and that smaller players are not being burdened unduly by your prudential requirements?

Mr Lonsdale: Non-ADIs are not a sector we're regulating. For smaller prudentially regulated players, we look very carefully at the competition issues. We've got a prudential mandate on safety and resilience in the sector, but we take into account competition, efficiency and neutrality both when we examine policy changes and when we supervise the entities. A particular example I would give you is the application of the BEAR, where there was quite a graduated application of that regulation—first to the major banks and then a much lighter touch with smaller players. But we put that lens on each policy issue that we deal with. We also have a very close relationship with the ACCC, so we seek to understand the sorts of issues that they're looking at, and we also deal directly with the smaller players, so I meet personally with entities—with CEOs of credit unions and regionals— to understand what the key issues are that they're concerned about on the competition front.

Mr FALINSKI: Can I ask you to take this on notice? I want to see examples from you of where you have taken notice of that consultation and changed something so that that competition was actually enhanced and barriers were reduced, because we keep hearing from regulators over and over again that they are consulting with the sector, but consulting doesn't mean that you've changed anything.

Mr Byres: We will take that on notice, Mr Falinski. I actually gave a speech on this issue a while ago, so I'll start with that.

Answer:

As Mr Byres set out in a November 2019 speech, APRA's initiatives to support competition fall into four categories:[1]

- **Facilitative measures**: promoting more active competition by, for example:

  i. amending the definition of Common Equity Tier 1 (CET1) capital to allow mutually owned ADIs to raise funds by issuing 'mutual equity interests'. CET1 capital is the highest form of capital and typically means ordinary shares or retained earnings. Mutual

[1] Speech to the Customer Owned Banking Convention available here: https://www.apra.gov.au/news-and-publications/apra-chair-wayne-byres-speech-to-coba-2019-customer-owned-banking-convention.

equity interests are akin to ordinary shares, which mutually owned ADIs are unable to issue; and

ii. making the licensing regime easier to navigate for new entrants.

- **Graduated approaches**: avoiding undue costs on smaller competitors, including by:

  i. setting differential targets for ADIs to meet APRA's 'unquestionably strong' capital requirements. The largest banks that use their own models to quantify capital needed a 150 basis point increase in capital while the smaller banks were subject to an increase of only 50 basis points;

  ii. imposing additional loss absorbing capital requirements only on the largest ADIs, rather than all ADIs; and

  iii. tailoring proposed new remuneration requirements to impose more stringent requirements on the larger financial institutions, with more modest requirements for smaller ADIs (further details below). [2]

- **Simplification efforts**: lifting the burden on smaller ADIs by measures such as:

  i. a proposed new simplified capital adequacy framework for ADIs with assets under $20 billion (further details on this is provided below);[3]

  ii. managing the transition period for the Banking Executive Accountability Regime to give smaller ADIs more guidance and more time to meet the new requirements; and

  iii. proposing changes to reporting requirements to allow longer reporting timeframes for smaller ADIs – in some cases almost doubling the time period that small ADIs will have to submit their returns to APRA.

  iv.

- **Lower supervisory intensity**: ensuring supervisory intensity is applied where it is most needed from a systemic risk perspective by, for example:

  i. targeting housing interventions in 2015 and 2017 with respect to investor and interest-only lending first and foremost at the largest ADIs. Although ultimately subject to APRA's intervention, smaller ADIs grew their market share throughout this period; and

  ii. strategically avoiding the inclusion of smaller, mutual ADIs in many thematic and industry-wide supervision activities where possible and therefore limiting imposts on their resources.

Revisions to the capital framework

In December 2020, APRA consulted on revisions to the ADI capital framework. A key feature of these revisions was a simplified framework for smaller ADIs, which is designed to

[2] Further information on APRA's response to industry submissions is available here: https://www.apra.gov.au/consultation-on-remuneration-requirements-for-all-apra-regulated-entities

[3] Further information on APRA's response to industry submissions is available here: https://www.apra.gov.au/revisions-to-capital-framework-for-authorised-deposit-taking-institutions

deliver a material reduction in regulatory burden. APRA proposed increasing the tinitially-proposed $15 billion threshold for an ADI to be able to operate on the simplified framework to $20 billion in assets.

Features of the simplified framework include allowing smaller ADIs to apply a flat 10 per cent operational risk charge, removing the need to apply market risk charges and minimising other reporting requirements, which will significantly reduce compliance costs relative to larger entities.

This will be supported by plans to reduce requirements for capital-related disclosures for smaller entities, further reducing their compliance burden.

Revisions to remuneration requirements

APRA has also recently undertaken a second consultation on revised remuneration requirements. In response to industry feedback in the first consultation, APRA made a number of changes to key policy proposals. This included further reducing minimum requirements of smaller and less complex entities.

As part of the current proposed reforms, smaller entities would be subject to significantly less onerous requirements than larger and more complex entities. For example, smaller entities would be subject to more streamlined governance expectations and simplified remuneration design requirements. Unlike large entities, smaller entities would not be required to give material weight to non-financial measures in variable remuneration design and would not be required to put in place deferral and clawback measures.