OPENING STATEMENT

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Senate Economic Legislation Committee
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I would like to make some remarks on a range of matters relevant to APRA's current and future activities.

Before I do, however, I should note that although the Commission has assigned some important new responsibilities to APRA, our primary responsibility remains the safety and stability of the financial system, to protect the financial well-being of the Australian community. APRA is the only regulator with a primary focus on ensuring the safety and soundness of the financial system.

It is therefore important to reiterate at the start of this morning's hearings that Australia's financial system remains fundamentally sound. While there are areas where the financial sector clearly needs to make significant changes and improvements, the soundness and stability of the financial system has never been called into question by the Royal Commission.

Royal Commission into Misconduct

Let me first address the Royal Commission. As we said publicly when the Royal Commission's Final Report was released, we believe it provides a fair and considered assessment of failings in the financial system and a welcome roadmap for reform. It rightly notes that financial institutions, their executives and directors, must take responsibility for their actions. We also acknowledge the strong message of the Commission that regulators must also do better to identify and forcefully address misconduct.

In that regard, it is important to note that the key matters identified by the Royal Commission as needing greater regulatory attention are consistent with APRA's 2018-2022 Corporate Plan. We identified a broadening of our supervisory focus (including in the important area of governance, culture and remuneration), stronger inter-agency collaboration, and improved performance measurement and accountability as some of our strategic priorities a year ago. That means we already have work underway in these areas and are not responding to the issues identified by the Royal Commission from a standing start.

More broadly, many of the recommendations made within the Report, and supported by the Government, are consistent with submissions APRA made to the Commission. This includes:

- the importance of preserving the 'twin peaks' regulatory architecture, and APRA's prudential mandate;
- a broadening of the Banking Executive Accountability Regime (BEAR) to other industries; and

- a strengthening and realignment of regulatory powers by the Parliament to provide a greater role for ASIC in superannuation.

Within the Commission's recommendation, 10 were specifically directed to APRA to action. To demonstrate our commitment to deliver on these as expeditiously as possible, we published on 11 February our planned actions in relation to each, noting that four of the recommendations can be addressed this year, and a further five can be completed in 2020. The remaining item is the Royal Commission's recommendation that APRA build a much more extensive program of supervision in relation to culture and remuneration within financial institutions. This will be a major program of work, and APRA is in discussions with the Government on the resourcing needs to deliver on this.

Within the Final Report, 12 specific entity matters were also referred to APRA for potential further enforcement action. After the Commission's Interim Report, APRA began reviewing evidence on these matters as it came to light and, where necessary, commencing additional enquiries and investigations. I note that none of the potential breaches of the law or prudential standards that have been referred to APRA carry civil or criminal penalty provisions directly, although other avenues to impose sanctions may be available depending on the specific circumstances.

The Royal Commission report also reinforces the importance of establishing appropriate accountability mechanisms for regulatory agencies. APRA has always acknowledged that high degrees of independence must be matched with strong accountability. At present, APRA is subject to a range of accountability mechanisms that allow the Parliament to oversee APRA's activities.[1] The proposed new permanent oversight body for APRA (and ASIC) provides an opportunity to reflect on the manner in which the performance of regulators is assessed and reported to the Parliament, and ideally will allow for existing mechanisms to be made both more effective and more efficient.

FSAP

Another report card on APRA will shortly be provided by the recent review of financial system stability by the International Monetary Fund (IMF).

During the course of 2018, the Fund's Financial Stability Assessment Program (FSAP) conducted an extensive review of Australia, focussed heavily on APRA's regulatory and supervisory approaches with respect to its core prudential mandate. Amongst other things, the review benchmarked APRA against internationally-accepted benchmarks for effective supervision, and is expected to be published shortly.

Superannuation

APRA's work to improve member outcomes in superannuation continues apace. With increased pressure to deliver outcomes comes the increased expectation for trustees to continuously reflect upon whether their ongoing operation in is the best interests of their fund members.

Further consolidation in the superannuation system, particularly to weed out underperformers, will be undoubtedly beneficial. But it is important to recognise that the current population of the industry is the product of a long period of rationalisation and consolidation. Over the past 10 years, the asset pool being managed by the industry has dramatically increased, from $1.1 trillion to $2.7 trillion, whilst the number of APRA-regulated funds has more than halved

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1 See APRA's website for a list of these - https://www.apra.gov.au/accountability-and-reporting.

over the same period, from 466 in 2008 to 198 in 2018. The bulk of this consolidation has occurred in the corporate and retail segments of the industry.

Number of APRA-regulated funds with more than four members

	Corporate	Retail	Industry	Public Sector	Total
Jun 2008	143	239	62	22	466
Jun 2009	106	227	59	22	414
Jun 2010	85	203	58	22	368
Jun 2011	71	190	53	22	336
Jun 2012	64	179	51	21	315
Jun 2013	50	163	46	20	279
Jun 2014	42	145	43	19	249
Jun 2015	34	141	42	19	236
Jun 2016	29	133	41	19	222
Jun 2017	26	120	40	18	204
Jun 2018	24	118	38	18	198
Change	-119 (-83%)	-121 (-51%)	-24 (-39%)	-4 (-18%)	-268 (-58%)

The significant consolidation of the industry is not entirely APRA's. But one driver of the consolidation has undoubtedly been the strengthening of the prudential regime, as well as ongoing supervision, which has consistently and persistently raised the bar on expectations in the way trustees look after members' savings. Even though APRA has had limited powers to direct particular outcomes, many trustees have come to accept that they cannot meet these higher expectations, and passed over the trusteeship of their funds to those better equipped to do so.

Over the past year, APRA has upped the ante in this area through our Member Outcomes project. This has two complementary streams of work: using data analytics to direct greater supervisory intensity on those funds identified as underperforming, and enhancements to the prudential framework more broadly that aim to continually raise performance across the industry.

The former uses a range of metrics to identify funds that seemed to be delivering poor outcomes for members across a number of dimensions. An initial group of funds – 28 in total – were identified for more intensive review, and the trustees of these funds were challenged directly to justify how they were delivering value for members. Of these, 13 have looked at the evidence and have exited or are exiting the industry, and another seven have changed product pricing or fees in some way to make their offerings more competitive. Of the remainder, five were deemed on further exploration to have better performance than first appeared, and actions in relation to the other three are expected to be agreed shortly.

In December 2018, APRA released new prudential requirements that set a higher bar for RSE licensees by requiring a robust assessment of the outcomes delivered for members to be reflected in their strategic and business planning. Importantly, the reforms apply equally to MySuper and choice products. They are aimed at looking beyond fund-level performance, to cohorts of members – a deeper dive into the way an RSE licensee operates and how its decisions impact members.

Against that backdrop of continuous work to improve member outcomes in superannuation, APRA very much welcomes the Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017. The Bill provides a much needed and long-awaited strengthening of the legislative framework by, amongst other things:

- introducing an outcomes test for both MySuper and choice products;
- introducing the potential for civil and criminal penalties on directors of RSE licensees who in future fail to act in the best interests of members;
- enabling APRA to prevent a change in ownership of an RSE licensee;
- aligning APRA's directions powers in the superannuation industry with its broader directions powers in the banking and insurance industries; and
- providing APRA with the power to obtain much more information on expenses incurred by RSEs and RSE licensees in managing their funds.

These reforms will provide an essential foundation for APRA to more forcefully pursue instances where trustees may not be delivering high quality outcomes for members.

Further consolidation in the industry is a likely product of this work. It is difficult to argue that Australia needs as many as 200 superannuation funds or 40,000 plus investment options. But that well-worn adage remains true: past performance is not necessarily a good guide to future performance. We also need to ensure that new competitors to the marketplace, who will inevitably start without a track record and potentially high costs until they can generate scale, are not prohibited from entering the system. For those reasons, we continue to advocate an approach that looks at performance of trustees across a number of dimensions, and does not rely solely on measures of historical returns over a particular time horizon as the only determinant of success or otherwise.

BEAR

APRA continues to devote significant resources to the roll-out of the BEAR to the non-major ADIs. Following the BEAR coming into force for the four major banks from 1 July 2018, other authorised deposit-taking institutions (ADIs) will be subject to the regime from 1 July 2019. To be ready for this requires APRA and the industry to manage the development of good quality accountability statements for all registered Accountable Persons, as well as accountability maps for each ADI. When fully in force for all ADIs, it is expected that around 1,500 executives and directors in the banking sector will be registered and subject to accountability obligations under the BEAR.

As noted earlier, APRA is supportive of the Royal Commission's recommendation that the BEAR be extended to apply to all APRA-regulated entities. Consistent with our submissions to the Royal Commission, APRA is also supportive of expanding the regime to more explicitly address misconduct, and in doing so provide for an explicit role for ASIC under the regime. This will largely mirror the Senior Manager Regime in the UK, and provide a clearer and more comprehensive set of accountability obligations across the financial sector.

Housing

There continues to be much attention given to housing markets around the country. Housing prices in Sydney and Melbourne are undergoing a downward adjustment after a long period of rapid growth. Prices in other capital cities are also generally experiencing declines, although generally at a slower rate, while regional areas around the country have been less impacted by the market correction, having not experienced the same run-up in prices in earlier years.

As the Reserve Bank Governor noted recently, a correction in prices in the major markets was probably inevitable after a period of such rapid increases. That it is happening at a time of solid economic growth and relatively low unemployment is undoubtedly helpful. While housing credit growth is slowing, it is not, as sometimes presented, solely a matter of supply. It also reflects a range of other factors, including a natural reduction in the demand for new credit at a time of declining prices, and when existing household debt levels are already very high. Banks remain willing to lend, and continue to provide competitive offers to the market: as a number of banks have noted, while approval timeframes may have lengthened and maximum loan amounts reduced, neither approval rates nor loan sizes have materially declined.

APRA's focus in recent years has been to ensure that prudentially regulated lenders were well-positioned in advance to manage the inevitable softening of the market. The sounder lending standards and robust capital positions that have been put in place in recent years have positioned the banking system to withstand the adjustment process. As we have said on many occasions, sound lending standards need to be applied through the cycle, regardless of whether housing prices and rising, falling or moving sideways.

Much of the heavy lifting on lending standards was done in 2015-2017, as a stronger focus on serviceability assessments was progressively built into the system. During 2018, we therefore removed the two temporary benchmarks we had established on investor lending growth, and the share of interest only lending, as they had served their purpose. Only a few ADIs, who have yet to give the necessary assurances we sought regarding their lending standards, remain subject to these benchmarks (although in most of those cases they are not binding).

With those opening remarks, my colleagues and I are happy to take your questions.