OPENING STATEMENT

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Thank you for the invitation to appear today.

I would like to begin by acknowledging the first appearance before this Committee of APRA's new Executive Member, Margaret Cole. Margaret took up her appointment on 1 July and, in taking over responsibilities for overseeing APRA's policy and supervisory work in relation to superannuation, has continued to drive APRA's ongoing strategy to improve outcomes for superannuation members. Our efforts in this area have been significantly bolstered by the passage of the *Your Future, Your Super* reforms, including the introduction of the annual performance test and the new best financial interests duty, and we have no doubt we will see further substantial improvements in outcomes for members in the year ahead.

I will say more about this shortly, but I would like to start with an overview of APRA's Corporate Plan which we published in August.

APRA's Corporate Plan for 2021-2025 recognises APRA's important role in helping to manage the impact of the COVID-19 pandemic on the financial system. However, as a forward-looking prudential supervisor, we need to not only address the challenges of today but also ensure we are prepared for those of tomorrow.

A number of factors – technology and digitisation, climate change, and community expectations, to name a few – are changing the shape of the Australian financial system. APRA, and the regulatory framework we are responsible for, needs to adapt and evolve to ensure we can deliver a safe, stable, competitive and efficient financial system into the future.

We will, of course, continue to direct a large proportion of our resources to protecting the here and now. Ensuring bank deposits are safe, that insurers have the capacity to pay claims when they are made, and that superannuation funds are managed in members' best financial interests, remains at the heart of what we do. Australia was fortunate to enter into the pandemic with a financial system that was financially and operationally resilient, and we need to remain vigilant to make sure it stays that way. That remains our core job.

But we will also direct some of our resources to ensure we are prepared for tomorrow. That means being alert and responsive to rapid changes in the financial system, including business and activity that is increasingly occurring outside the regulatory perimeter, and also helping to find solutions to increasingly important challenges, such as superannuation retirement income outcomes; the availability and accessibility of insurance for Australians and the financial risks associated with climate change.

In doing this, we are seeking to deliver three important outcomes for the Australian community:

- ensuring resilient and prudently managed financial institutions;

- promoting financial system stability; and
- contributing to the community's ability to achieve good financial outcomes.

I will now turn to three notable activities since we last appeared before this Committee.

Addressing risks in lending for housing

The Committee would be aware that earlier this month APRA sought to address heightened risks in banks' mortgage lending by increasing the minimum interest rate buffer we expect banks to use when assessing the serviceability of home loan applications to at least 3.0 percentage points (an increase from 2.5 percentage points previously).

We believe this decision, which was supported by the other members of the Council of Financial Regulators (CFR), was a targeted and judicious action that will help to reinforce the stability of the financial system in an environment of extremely low interest rates and rapidly rising house prices.

While the banking system is well-capitalised and lending standards overall have held up, increases in the share of heavily indebted borrowers, and leverage in the household sector more broadly, meant that medium-term risks to financial stability were building.

More than one in five new loans approved in the June quarter were at more than six times the borrowers' income, and at an aggregate level the expectation is that housing credit growth will run ahead of household income growth in the period ahead. With lockdowns being lifted, and expectations that the economy will bounce back, APRA considered the balance of risks has shifted such that a timely adjustment to serviceability standards was warranted.

It is too early to say precisely what impact this change will have on lending activity, given banks were asked to implement the buffer by the end of this month. Putting aside the impact from other aspects of serviceability assessment, a 50 basis point increase in the buffer will reduce maximum borrowing capacity for the typical borrower by around 5 per cent. Given some borrowers are already constrained by the floor rates that lenders use, and that many borrowers do not borrow at their maximum capacity, the overall impact on aggregate housing credit growth flowing from the change is expected to be fairly modest. To the extent it impacts particular borrower types, we expect a larger impact on investors, given they tend to borrow at higher multiples of their income.

Finally, I do want to reiterate something I have said many times before this Committee: that in taking action in relation to mortgage lending standards, APRA is not seeking to target the level of housing prices. Rather, APRA's objective is to ensure that mortgage lending is conducted on a prudent basis, and that borrowers are well-equipped to service their debts under a range of scenarios.

Driving improved outcomes for superannuation members

I'd like to turn now to superannuation.

As I noted earlier, important new legislative provisions were introduced to the superannuation industry with the passage through Parliament of the *Your Future, Your Super* reforms. These substantially raise the bar for superannuation trustees to ensure they are delivering good financial outcomes for their fund members in all that they do.

One critical reform is the introduction of an annual performance test, applied initially to MySuper Products but ultimately to be expanded to include trustee-directed products.

APRA released the results from the first MySuper Product Performance Test at the end of August. The test found 13 products (out of 76 products assessed) failed to meet the prescribed benchmark. These funds have been publicly identified, and were required to communicate to their members that they failed the test.

The trustees of those 13 products now face an important choice: they can urgently make the improvements needed to ensure they pass next year's test or start planning to transfer their members to a fund that can deliver better outcomes for their members. APRA is now scrutinising their actions. Each has been asked to provide us with a report identifying the causes of underperformance and how they plan to address them. Trustees have to monitor their products closely and report important information to APRA – including weekly information relating to the movement of members and the outflow of funds. Unsurprisingly, all funds have been losing members since the test results were published.

A second critical reform has been the introduction of the best financial interests duty, and the associated reverse onus of proof. This reform will, amongst other things, require trustees to change the way in which they manage their expenditure such that they can demonstrably provide evidence that it is in the best financial interests of their members.

This point was made clearly earlier this week, when APRA released the findings of three thematic reviews undertaken over the past 18 months covering strategic and business planning; fund expenditure; and unlisted asset valuation practices.

Collectively, the three reviews outline important issues that trustees must have front of mind to drive better practices and improve outcomes for members.

The expenditure thematic review, which has been of interest to this Committee, examined expenditure on advertising, sponsorships and promotions by 12 trustees representing a cross-section of the industry. It examined whether expenditure was in the best interests of members (the prior legislative standard), and whether trustees had applied appropriate governance and oversight to their decisions. Among the findings, APRA observed many trustees failed to rigorously measure and assess anticipated and achieved benefits for members of expenditure on marketing campaigns and related activities. Broadly speaking, there was too much reliance on qualitative judgement, and insufficient quantitative analysis. In APRA's view, a number of the practices observed would not pass the new legislative standard set by the *Your Future, Your Super* reforms.

Notably, in a number of instances where APRA identified an absence of robust analysis, the expenditure has ceased or not been repeated since the new law was introduced. Where certain expenditures have continued beyond 1 July this year, APRA has challenged trustees to demonstrate how they comply with the new law. Once their responses have been assessed, APRA will consider what, if any, further action is necessary.

APRA Connect

An important new piece of financial sector infrastructure went live in September with the introduction of APRA's new data collection solution, APRA Connect.

The plan to replace APRA's existing data collection system with a flexible solution based on modern technology was announced to industry in December 2017. Almost four years later, with substantial input and cooperation from industry participants, APRA Connect is now operational. New data collections will be designed using the more flexible and granular data models that APRA Connect enables, and will ultimately replace many existing reporting obligations. The delivery of APRA Connect is, for example, a critical enabler in APRA's Superannuation Data Transformation project, allowing APRA to collect much more detailed information from the superannuation sector and hence more effectively scrutinise its performance.

Aside from providing APRA with more fit-for-purpose and better quality data, APRA Connect should reduce regulatory burden by providing more seamless reporting processes for industry, including through the use of modern regtech solutions. APRA Connect has also been designed with the ‘collect once, use many times’ principle that enables APRA to collect data once that can be shared with other agencies.

Finally, I note that APRA’s 2020/21 Annual Report was tabled in Parliament last week. In that Report, we highlighted that while 2020/21 was a very challenging year for the Australian community, the financial sector, and APRA, the performance of the Australian financial system was positive. Not only did the financial sector remain financially and operational resilient during a period of immense disruption, but because of that resilience regulated institutions – banks, insurers, and superannuation funds – were all able to play important roles supporting the broader Australian community through an extremely difficult time.

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