



Senate Economics Legislation Committee

5 March 2021

Mr Wayne Byres
Chair
Australian Prudential Regulation Authority



Dear Mr Byres

Inquiry into the Australian Business Growth Fund Bill 2019

In February 2020, the Senate Economics Legislation Committee held an inquiry into the provisions of the Australian Business Growth Fund Bill 2019. As part of this inquiry, the Committee examined the regulatory treatment for contributions to the fund.

As you will be aware, APRA adjusted its capital framework for authorised deposit-taking institutions to support the establishment of the fund. In effect, the reduction in risk weighting allowed participating institutions to treat high-risk equity investments made through the fund as loans and improved the commercial return to institutions participating in the fund. This adjustment was not made for other funds or non-participating institutions.

In a media release, APRA provided two reasons for the special treatment: there would be wider financial system benefits from increasing access to financing for SMEs; and the Australian Government was a founding shareholder in the fund.

During a public hearing on Thursday 13 February 2020, the following evidence was provided:

Senator Patrick: We were talking before about some of these risk ratios and how much money the bank has to put in. The government has a competitive neutrality policy. Is it APRA's role to examine that—or is that a question outside of your remit?

Ms Richards: I think it's outside of our remit. It was the government that determined the structure and the approach for this fund and conducted consultation on it, so our view is that those issues are more a matter for them.

In relation to this evidence, I would draw to your attention to the following provisions of the *Australian Prudential Regulation Authority Act 1998*:

Section 8—Purpose for establishing APRA

(1) The main purposes for which APRA exists are as follows:

- (a) regulating bodies in the financial sector in accordance with other laws of the Commonwealth that provide for prudential regulation or for retirement income standards;

(b) administering the financial claims schemes provided for in the Banking Act 1959 and the Insurance Act 1973;

(c) developing the administrative practices and procedures to be applied in performing that regulatory role and administration.

(2) In performing and exercising its functions and powers, APRA is to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and, in balancing these objectives, is to promote financial system stability in Australia

On behalf of the Committee, could APRA please provide an explanation of the apparent discrepancy between the evidence given at the hearing and section 8(2) of the *Australian Prudential Regulation Authority Act 1998*, specifically with regard to the competitive neutrality provisions relating to the establishment of the Australian Business Growth Fund.

This response is requested by midday on Wednesday 17 March 2021. Should you wish to discuss this further, please contact Dr Fiona Allen on [REDACTED] or [REDACTED]

Yours sincerely

[REDACTED]

Mark Fitt
Committee Secretary



JOHN LONSDALE

Deputy Chair

17 March 2021

Mr Mark Fitt

Secretary

Senate Economics Legislation Committee

By email: [REDACTED]

cc: economics.sen@aph.gov.au

Dear Mr Fitt

Thank you for your letter dated 5 March 2021 regarding the Senate Economics Legislation Committee's inquiry into the Australian Business Growth Fund Bill 2019.

In your letter you asked for an explanation of the apparent discrepancy between evidence given by APRA at the hearing and section 8(2) of the *Australian Prudential Regulation Authority Act 1998*, specifically with regard to the competitive neutrality provisions relating to the establishment of the Australian Business Growth Fund (the fund).

As the Committee knows, the Australian Business Growth Fund was a joint initiative between the Australian Government and financial investors to address a gap in equity funding for small and medium-sized enterprises (SMEs) in Australia. The corporate structure and operating model of the fund were established by these founding shareholders. As Ms Richards indicated in evidence, the structure and approach of the fund were matters for Government. APRA understands that the Treasury has provided advice to the Committee on these matters.

APRA does not regulate the fund. APRA's involvement was limited to considering the appropriate capital treatment for investments in the fund by authorised deposit-taking institutions (ADIs) under APRA's prudential framework.

Under this framework, an ADI is required to hold capital as a buffer against the financial risks from its exposures (capital requirements do not apply to non-ADIs). The higher the financial risk, the higher the amount of capital that must be held, calculated by 'risk-weighting' the amount of the exposure. For equity investments in the fund, APRA determined that a risk weight of 250 per cent was appropriate. APRA also set a maximum limit on an ADI's overall investment in the fund, determined as a proportion of its regulatory capital.¹

APRA's capital requirements for investments in the fund – applying a risk weight of 250 per cent up to a maximum amount – is consistent with a discretionary option for equity investments in financial institutions under the internationally agreed Basel III capital framework. It is also broadly consistent with the approach taken in other jurisdictions that have comparable business growth funds, such as the UK and Canada.

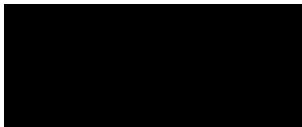
¹ The limit is 2 per cent of an ADI's Common Equity Tier 1 capital.

In APRA's view, this capital treatment is commensurate with the risks involved and strikes an appropriate balance between the inherent risks to ADIs from participating in the fund and the broader financial system benefits of increasing access to financing for SMEs. This treatment is consistently applied to any ADIs that invest in the fund.

I also refer the Committee to the information paper, *APRA's Objectives*, which sets out APRA's approach to balancing its mandate under section 8(2) of the *Australian Prudential Regulation Act 1998*, including the issue of competitive neutrality.²

I trust this information is of assistance.

Yours sincerely,



² This is available on APRA's website at: [APRA's objectives | APRA](#).



Senate Economics Legislation Committee

22 March 2021

Mr John Lonsdale
Deputy Commissioner
Australian Prudential Regulation Authority

By email: [REDACTED]
[REDACTED]

Dear Mr Lonsdale

Inquiry into the Australian Business Growth Fund Bill 2019

Thank you for your letter of 17 March 2021 responding to the committee's request for information on the Australian Prudential Regulation Authority's (APRA) competitive neutrality responsibilities as raised during committee's inquiry into the establishment of the Australian Business Growth Fund (the fund).

Thank you for explaining the nature of risk-weighting and the capital requirements for the investment fund and for noting that, in APRA's view, the capital treatment is commensurate with the risks involved, including that it strikes a balance between risk and broader financial system benefits. I would like to assure APRA that the committee is well aware of all these details.

The committee's 5 March 2021 letter highlighted, for explanation, the following apparent discrepancy:

- APRA adjusted its capital regulatory framework for authorised deposit-taking institutions participating in the fund. The adjustment was not made for other funds or non-participating institutions.
- At the public hearing on Thursday 13 February 2020, Ms Richards stated competitive neutrality considerations were outside APRA's remit.
- The *Australian Prudential Regulation Authority Act 1998* requires APRA in performing and exercising its functions and powers, to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality.

Specifically, the committee is seeking an explanation as to how APRA was able to meet its statutory competitive neutrality responsibilities whilst offering preferential prudential capital treatment to ADIs participating in the fund and not to other funds or non-participating institutions.

If this request is unclear, I would invite your representative to speak with me directly so any clarification may be made. A response is respectfully requested by close-of-business, Wednesday 24 March 2021.

Yours sincerely

[REDACTED]

Mark Fitt
Committee Secretary



JOHN LONSDALE

Deputy Chair

24 March 2021

Mr Mark Fitt
Secretary
Senate Economics Legislation Committee
By email: [REDACTED]
cc: economics.sen@aph.gov.au

Dear Mr Fitt

Thank you for your letter of 22 March 2021 regarding APRA's recent response to the Senate Economics Legislation Committee's questions on the Australian Business Growth Fund.

I understand yesterday that Gideon Holland (General Manager, APRA Policy) and Anthony Leong (Advisor, APRA Policy) reached out to you and Dr Allen via telephone to discuss this matter further. I trust this was helpful in providing further clarification on how APRA has approached its statutory obligations, including in relation to competitive neutrality.

APRA's objectives

APRA's objectives are set out in an Information Paper, published on 11 November 2019. This paper notes that: *"APRA's prudential objectives are clear: the financial safety of institutions and the stability of the Australian financial system. In meeting these objectives, however, APRA has a number of supplementary considerations — efficiency, competition, contestability and competitive neutrality. These objectives are interlinked. Sometimes they can be mutually reinforcing; at other times, a balance between competing objectives needs to be found."*

In relation to setting the capital treatment for authorised deposit-taking institutions (ADIs) that invest in the Australian Business Growth Fund (the fund), APRA had regard to all of these objectives. This included considerations of competitive neutrality.

Competitive neutrality

The committee has asked how "APRA was able to meet its statutory competitive neutrality responsibilities whilst offering preferential prudential capital treatment to ADIs participating in the fund and not to other funds or non-participating institutions." APRA is satisfied it met its statutory responsibilities. To help the committee understand how APRA has approached its responsibilities, we would note:

- APRA's capital treatment for participating ADIs was designed to reflect the particular risk profile and structure of the fund. We would not regard the capital treatment as preferential, as in our view it appropriately reflects the risk that ADIs would be taking in this particular circumstance.
- APRA's approach was consistent with our broader risk-based framework, which is the basis for determining prudential capital requirements for ADIs. Had APRA not provided a

capital treatment that reflected the risk profile of the fund, the capital requirements for ADIs would have been higher than that required for the risk of these investments.

- In reaching this view on the appropriate capital treatment, APRA considered competitive neutrality. APRA notes that ADI investments are limited through an APRA-imposed cap and that the capital treatment is consistent with that applied by peer jurisdictions internationally. In addition, APRA has published the capital treatment for transparency and applied this approach consistently to any ADI that invests in the fund. As per Ms Richards' evidence on 13 February 2020, competitive neutrality considerations related to the design of the fund itself, including the Government's decision to invest, were outside of APRA's remit.

The committee has also requested a summary of APRA's input to Treasury as they designed the fund. APRA was involved in preliminary discussions with Treasury and potential participating ADIs as Treasury designed the fund. APRA's discussions with Treasury and ADI industry participants were limited to discussions on the risks of SME equity investment to inform any potential capital treatment. APRA was not involved in decision making on the establishment and arrangements of the fund.

I hope this information is of assistance.

Yours sincerely,

