

22 August 2001

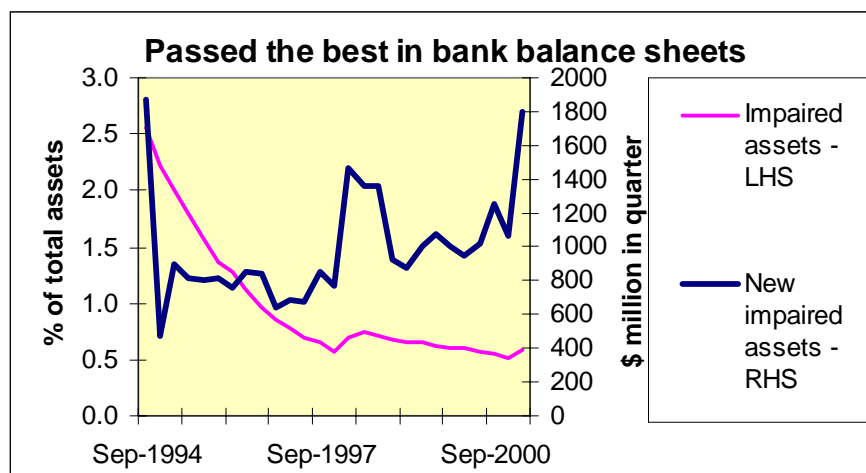
The Secretary
House of Representatives Standing Committee
on Economics, Finance and Administration
Parliament House
CANBERRA ACT 2600

Dear Secretary

**SUBMISSION TO THE COMMITTEE INQUIRING INTO BANKING
SUPERVISION**

The ANAO report and its recommendations are uncontroversial, essentially endorsing the practices of APRA in the implementation of the risk-management approach to bank supervision dictated by Government policy. There are obvious areas for APRA to tighten up, for instance on large loan exposures and directors with conflicts-of-interest, which hopefully are being effectively addressed.

A related but more forward-looking issue – for the Standing Committee, APRA, the banking community and Australians more generally – is the coming increase in bad loans amongst the assets of the banks as a result of fluctuations in the economic cycle. Will the increase be modest compared to bank capital, or of more concern? At what point will the increase become of concern to taxpayers?



Source: RBA Bulletin database.

Already it is clear that the quality of Australian bank balance sheets has passed its best.

- At the end of the first quarter of 2001, banks held more impaired assets than at any time since mid-1996, having just suffered the worst quarterly flood of new bad assets since the dog days of 1994.
- The data for the second quarter has not yet become available, but is bound to show a further deterioration in the trend, in view of the spate of company failures that have been in the news.

Given the funding and resources available to APRA – essentially only an industry levy to cover supervision costs – there is a significant risk to sound banks and to taxpayers that they will be called on to bail out any failing banks.

One of the few tools available to APRA is the conduct and publication of high quality industry-wide research. It is a cheap and effective tool, drawing attention to important issues before they become potential crises.

In order to reduce the risk of surprises, such as with HIH Insurance, and to improve the effectiveness of the pursuit of financial stability, I suggest to the Committee that it ask APRA to regularly conduct and publish research into the likely emergence of bad loans as a result of different economic scenarios. Bank asset quality could be assessed on a system-wide basis as well as segmented by type of asset or type of banking institution.

I am willing to expand on this suggestion if you wish.

Yours sincerely

Alex Erskine
Managing Director