

**House of Representatives  
Standing Committee on Economics, Finance and Public  
Administration**

**Inquiry into Bank Prudential Supervision**

Submission by  
PricewaterhouseCoopers  
August 2001

## **Submission by PricewaterhouseCoopers**

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PricewaterhouseCoopers acts as external auditor of 17 banks in Australia, comprising one of the four majors, one ASX listed bank, and 15 international banks that operate in Australia through branches or locally incorporated subsidiaries.

We also provide internal audit services to one bank.

We provide from time to time, informal advice to APRA our various topics (and while it had a bank supervision role, the Reserve Bank of Australia) as well as participating in the development of matters pertaining to the role of external auditors in reporting to APRA.

To keep our submission brief and to the point, we have formatted it into a number of recommendations, each followed by a short explanatory narrative. Our recommendations to the Committee are split into five sections, four being those outlined in the Committee's indicated scope (namely levy arrangements, risk based supervisory methodology, resourcing and compliance with international supervisory standards). In the fifth section, we address a number of issues the Committee might like to consider.

Certain of our recommendations serve to support a number of existing bank supervision practices in Australia.

## 1. Levy arrangements

### Recommendations

#### 1.1 **For simplicity, maintain the current philosophy of charging a levy percentage, based on the asset value of each ADI, with a minimum and maximum cap.**

Although alternative approaches – such as levies based on time sheets by APRA staff supervising each bank – may appear attractive, we consider the additional cost of compliance would outweigh any benefit.

“We note that implementation of the Auditor General’s recommendations contained in “Auditor General’s Audit Report No 42 2000-2001: Bank Prudential Supervision” is likely to increase marginally APRA’s overall costs, as will the cost of filling the acknowledged resource gaps.

#### 1.2 **Introduce a one off standard application fee for an entity seeking a banking licence in Australia.**

APRA does not currently charge an application fee for an entity seeking a banking licence. Accordingly, the time and costs incurred in reviewing potential applicants and their licence application process are borne broadly by the current licenced ADIs.

While charging a fee is not a common practice overseas, we consider this matter worthy of consideration, given APRA’s requirement to be self funded without serious cross subsidy.

For administrative simplicity the fee should be the same for each applicant and charged when the formal written application is made.

## 2. Risk based supervisory methodology

### Recommendations

#### 2.1 **Maintain, through refinements to its risk based supervision methodology, the philosophy of APRA's current consultative offsite supervision regime.**

We have not reviewed the details of APRA's risk based supervision methodology, so cannot comment on its veracity. However, we consider that APRA's current approach:

- risk based with selected and limited on site visits
- reliance on statistical and other data supplied by ADIs
- reliance on external audit work specially commissioned to meet APRA requirements
- more frequent visits to systemically important institutions, institutions with higher risk profiles or those encountering risk management difficulties

is appropriate for the Australian market place.

We do not consider that extensive on site visits by APRA staff (as carried out by other regulators) would improve materially the quality of bank supervision or enhance depositors protection. The extra costs incurred are likely to outweigh the benefits.

#### 2.2 **Improve the mechanisms for providing consistent advice to all ADIs on certain banking matters eg: interpretations of capital adequacy requirements.**

Given the evolving nature of banking regulation and the different supervisory teams interacting with ADIs, anecdotal evidence indicates that, on interpretive matters, consistent advice may not always be given by APRA, with the result that banks may treat certain transactions marginally differently for capital adequacy measurement purposes, causing a degree of competitive inequality.

Internal improvements within APRA's own mechanisms (eg a precedent database) would assist minimising this likelihood.

### **2.3 Maintain APRA’s current policy setting mechanism.**

We consider APRA’s current policy setting mechanism for banks works well.

Prudential standards (and other policy papers) are drafted and circulated to industry members and others for comment. Consultation takes place and final papers are published.

Longer term, given APRA’s broader responsibilities for other areas in the financial market place, we consider APRA’s existing centralised policy making arm covering all prudential matters will result in a more efficient financial services operating environment in Australia.

### **2.4 Finalise and publish the large exposures policy**

Given the critical importance of this facet of managing the risk profile of a bank, we consider finalisation of this policy a top priority, particularly if the credit cycle turns more negative and there emerges an expectation in the community that banks “support” certain sectors.

### **3. Resourcing**

#### **Recommendation**

#### **3.1 Continue to enhance the number and skill sets of those responsible for directly supervising banks.**

We appreciate the difficulty in filling all the resource gaps. Given the considerable restructuring within APRA about two years ago, it was inevitable that we noted a decline in experience of certain “front line” staff as a result of new people being introduced.

We are unable to gauge the staff training effort undertaken by APRA but recommend the Committee ensures that adequate funds are made available for appropriate ongoing training and that APRA rates of remuneration do not inhibit recruitment of appropriate talent.

The Committee will be aware that the private sector financial services industry is highly remunerated, and, unless steps are taken to rectify this pay deficiency, APRA is unlikely to be able to attract sufficient appropriate talent.

Additional benefit will no doubt arise through the use of “outside experts” in the supervision process who have worked in the commercial bank environment.

#### **4. Compliance with international supervisory standards**

##### **Recommendation**

##### **4.1 Continue to maintain high supervisory standards**

The Auditor General's report found that, by and large, APRA had adhered to virtually all the practices recommended in the 1997 Basle Core Principles for Effective Banking Supervision. We consider APRA is intent on maintaining the highest standards of prudential supervision for banks.

**5. Other matters**

**Recommendations**

- 5.1 Consider whether the mechanisms that are in place for handling the situation of banks getting into temporary difficulty (eg: short of liquidity or a major computer malfunction) or major difficulty (eg: major customer default or a “run on the bank”) are sufficiently robust.**

From a supervisory perspective, in a doomsday scenario, this is a key area that does not appear to have been included in the scope of the Auditor General’s report.

Clearly, however, given its very sensitive nature, the Committee may wish to consider this matter “in camera” and make no public announcement on the issue.

- 5.2 Consider whether there is still merit in excluding from APRA’s supervisory regime foreign bank owned “merchant banks”.**

At present, a number of foreign banks operate in Australia through locally incorporated subsidiaries. Although they borrow and lend money and conduct other banking type activities they are not required to be licenced as ADIs under the Banking Act. Merchant banks therefore obtain a competitive advantage over ADIs as they do not have to observe APRA’s supervisory regime and incur its associated costs.

- 5.3 Maintain APRA’s Banking Act responsibilities towards bank depositors; we do not support the introduction of a levy or guarantee mechanism for bank deposits.**

Although not actively canvassed as an option for Australia, we consider Australia should not adopt the policy in place elsewhere whereby bank deposits are specifically guaranteed by the government up to a certain amount (say \$100,000). Nor should a levy mechanism be introduced, whereby banks are levied an amount that is accumulated in an industry fidelity fund to meet a bank failure.

Responsibility for full protection of each bank’s depositors should remain with that bank and APRA, levies introduce an element of unnecessary extra cost for well run banks and a cross subsidy.

Proper supervision and supervisory powers, together with proper management are the key.

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