

# AUSTRALIAN ASSOCIATION OF PERMANENT BUILDING SOCIETIES

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

Dear Sir

## **INQUIRY INTO BANKING SUPERVISION**

Please find attached our submission on behalf of the building society sector.

Yours sincerely

(SIGNED)

J V LARKEY  
EXECUTIVE CHAIRMAN

Att

**SUBMISSION BY THE BUILDING SOCIETIES ASSOCIATION TO THE HOUSE OF  
REPRESENTATIVES STANDING COMMITTEE ON ECONOMICS, FINANCE AND PUBLIC  
ADMINISTRATION**

**INQUIRY INTO BANKING SUPERVISION**

**Background**

The Audit Report by the Auditor-General (No. 42 2001-1) on the Australian Prudential Regulatory Authority refers to the prudential supervision of banks. Under the Banking Act ,and in most other regulatory respects, authorised deposit taking institutions (ADI) comprising banks, building societies and credit unions are grouped together. Many of the comments of the Auditor-General in respect of bank supervision accordingly apply to building societies.

The Financial System Inquiry (Wallis Committee) recommendations referred to ADI as a category of financial institutions which would be subject to the highest level of prudential standards and supervision. This category (on the risk spectrum) is required for protecting the integrity of the payments system and the special nature of deposit products.

**Regulatory History and Funding**

As noted in the Auditor-General's Report, building societies transferred in July 1999 from the State based uniform Australian Financial Institutions Scheme (FI Scheme). The FI Scheme had commenced operations in July 1992. In the intervening seven years, the FI Scheme established modern and uniform prudential standards very similar to those applied by the Reserve Bank to banks. A system of uniform supervision, inspections and regular statistical reporting was established. As a result of this rigorous programme all the supervised institutions attained high prudential ratios and strong balance sheets. Weak institutions left the industry, usually via merger.

The Board of the Australian Financial Institutions Commission (AFIC) was established under the Chairmanship of Professor Geoffrey Carmichael (now chairman of APRA). The first Chief Executive Officer of AFIC was Mr David Knott (now chairman of ASIC). The FI Scheme's annual operating budget was fully funded by a levy on assets of the supervised institutions, i.e. building societies, credit unions and friendly societies. In the seven years of its operation AAPBS estimates at least \$75 million was expended by financial institutions on the FI Scheme.

## **Inherited ADI Sector**

Prior to the transfer of prudential supervision to APRA in 1999 minor differences in prudential standards between AFIC and the Reserve Bank were brought into line with Reserve Bank standards. The FI Scheme had a modern set of detailed prudential law and as a consequence a considerable volume of FI Scheme legislation is now contained in the revised banking legislation applicable to all ADI. The statistical returns developed and applied in the FI Scheme have assisted the establishment of APRA prudential statistical collections.

APRA inherited a group of ADI which were well up to speed in terms of sound prudential compliance and standards. In the first 2/3 years APRA has given priority to a programme of harmonisation of the standards applying to ADI. Requirements following from this process have been particularly exacting for the ADI sector.

## **Auditor-General's Report**

### ***Recommendation No. 1, Para. 2.27***

*ANAO recommends that APRA improve its administration of the ADI supervisory levy by:*

- (a) periodically reviewing the basis of its cost estimation approaches;*
- (b) improving transparency and accountability by publicly reporting on the actual costs of supervision for each industry; and*
- (c) undertaking comprehensive analysis of levy receipts and supervisory costs against budget in order that the extent of any over- or under-collections can be taken into account when setting levy parameters for subsequent years.*

## **AAPBS response**

The Auditor-General made several recommendations as regards the ADI supervisory levy which we endorse but did not focus on the fundamental weakness in the APRA funding going forward nor the gross inequity and distortions of the levy system as it applies in the ADI category.

The Senate Select Committee on Superannuation and Financial Services in its report of August 2001 (Ch.6 pages 85-92) has noted the serious anomalies in this area and has made recommendations to APRA as follows:

*"The Committee recommends that APRA review the rationale for determining the quantum of supervisory levies, in order to remove inequities and ensure that levy payments more closely match the level of supervision."*

The central issue for building societies and others in the sector (other than the largest nine banks) is that legislation contains provisions which set the maximum levy of \$1 million for ADI. It is clearly not within APRA's power to change legislation but we have suggested to APRA on several occasions that they should consider other options and express an opinion to the Treasurer and the Minister as to the consequences of the legislative protection of large banks on our institutions and for APRA's own funding base.

### **2000/2001 Situation**

The 2000/2001 ADI levies to fund APRA and ASIC have recently been set by the Minister and they regrettably perpetuate the gross unfairness of the funding system on middle-sized ADI.

The following points and the tables below illustrate the concerns we have:

- (1) The building society sector levy cost will increase in 2001/2002 by over 6%, whilst for the biggest banks operating in Australia and protected by the Levies Act, the increase is marginal at only 0.5%.
- (2) For leading individual building societies which have grown at a greater rate than their sector, the levy increases will be over 18% above last year. For the fastest growing large bank the levy amount remains the same.
- (3) Based on official asset statistics (April) the ten largest banks in 2000/2001 paid \$10 million in levies. In 2001/2002 the ten banks (now nine - merger of Colonial/CBA) will pay \$9.045 million, a reduction of 10%.

- (4) For the small players organic growth arising from innovation, better services and products is punished. In contrast, mergers and growth by the biggest in the business of banking is rewarded by lower levies.
- (5) Of the total ADI levy required for 2001/2002 the protected largest banks will meet 40% of APRA costs and building societies 6%, yet the protected banks represent some 77% of ADI assets and societies less than 2%.

### **Public Benefit/Cost**

An argument advanced by APRA and the Government in support of the status quo is that "after a point" the cost of supervising a \$1 billion asset bank or building society is no greater than supervising a \$150 billion bank. We contend that the levy principles should also reflect size and the public benefit to depositors arising from the scheme. The implications of size for taxpayers if failure occurs is demonstrated in the case of the failure of the second largest general insurance company in Australia. Taxpayers will fund a rescue package of the order of \$1.5 billion. This rescue operation demonstrates that the failure of a very large institution and the protection of very large numbers of the public will be a more significant and costly exercise than for a small institution. Currently, Australian legislation relating to financial levies denies this reality as well as the public benefit/cost argument.

### **Peer Group Models**

In the United Kingdom (and we believe in the US and Canada also), for a similar scheme there is no maximum. For the purposes of the establishment of the Financial Services Authority (FSA), fresh policy is now being made in the UK.

It has been decided that:

- (1) the FSA will have blocks or groupings of financial institutions (similar to APRA) with deposit taking institutions grouped together;
- (2) the policy framework established has general principles which include that there should always be a minimum and never a maximum fee (lacking in Australia);

- (3) within the groupings the annual funding requirements of the FSA are to be distributed according to the size of the business (lacking in Australia);
- (4) the levies are to be set in a straight line but with lower variable rates for large deposit takers and some tapering yet to be finalised (lacking in Australia); and
- (5) the minimum fees in the United Kingdom as between banks (£10,000) and building societies (£4,000) (lacking in Australia).

Clearly, both in policy principle and application the new and pending United Kingdom approach is concerned for equity and will recognise that larger institutions gain much from the imprimatur of prudential regulation, and that the cost is fairly borne by their depositors/customers who benefit from the FSA system.

### **APRA Future Funding**

Additionally, the future funding base of APRA on which levies are made is threatened by the trend in mergers amongst the top nine banks. Each bank merger at this level reduces levy income by \$1 million. In addition to this, increases in future APRA costs (e.g. arising from the HIH Royal Commission) will entirely fall on the shoulders of building societies, regional banks and other financial institutions. Our vulnerability to these increasing costs is an unacceptable risk to us and similarly so, we would think, to regional banks and larger credit unions.

To summarise:

- (1) the distortions and inequities arising from the maximum levy legislation,
- (2) the public benefit/burden issue,
- (3) the recent demonstrated need for levies to reflect risks to taxpayers,
- (4) the thoughtful policy approach in the United Kingdom, and
- (5) securing the future funding base of APRA

warrant (more so, we think, than even the recommendations of the Auditor-General) an urgent change to the current approach to funding APRA's supervision of ADI.

**AUSTRALIAN ASSETS AND LEVIES  
BANKS**

**PROTECTED BY MAXIMUM LEVY PROVISIONS**

	<b>Assets April 2001 \$ billion</b>	<b>Levy 2001/2002 \$ million</b>	<b>Assets April 2000 \$ billion</b>	<b>Levy 2000/2001 \$ million</b>
CBA	152	1.005	112	1.0
Colonial	-	-	23	1.0
NAB	145	1.005	128	1.0
Westpac	118	1.005	104	1.0
ANZ	107	1.005	98	1.0
St George	47	1.005	46	1.0
Suncorp-Metway	23	1.005	21	1.0
BankWest	19	1.005	17	1.0
Macquarie	16	1.005	14	1.0
Deutsche	10	1.005	9	1.0
<b>Totals</b>	<b>637</b>	<b>9.045</b>	<b>572</b>	<b>10.0</b>

## AUSTRALIAN ASSETS AND LEVIES

### BUILDING SOCIETIES

		Assets March 2001 \$ million	Levy 2001/2002 \$0,000	Assets March 2000 \$ million	Levy 2000/2001 \$0,000
<b>NSW</b>	Armidale	45	5,352	41	4,980
	GIO	509	61,068	612	73,464
	Greater	1,341	160,956	1,256	150,768
	Hume	255	30,664	235	28,212
	Illawarra	1,765	211,764	1688	202,560
	Maitland	136	16,368	121	14,484
	Newcastle	2,264	271,704	2,043	242,964
	NRMA	1,418	170,148	1,447	173,616
<b>VIC</b>	Australian Unity	79	9,528	119	14,292
<b>SA</b>	Lifeplan	58	6,948	49	5,928
<b>QLD</b>	Heritage	1,410	169,248	1,189	142,668
	Mackay	284	34,044	272	32,640
	Pioneer	333	40,020	258	31,008
	The Rock	350	42,000	356	42,732
	Wide Bay	608	72,900	544	65,244
<b>WA</b>	Home	685	82,188	664	79,656
<b>TAS</b>	Bass & Equitable	209	25,080	181	21,672
<b>Totals</b>		<b>11,749</b>	<b>1,409,980</b>	<b>11,075</b>	<b>1,326,889</b>

### Recommendation No.3, Para. 3.67

*ANAO recommends that APRA:*

- (a) *conducts periodic on-site visits to all banks with the level of assessed risk determining the appropriate frequency and intensity of visits; and*
- (b) *considers the merits of a structured program of visits to the offshore operations of Australian banks.*

### AAPBS response

In the context of equity and costs it is noted that under existing funding arrangements the cost of these visits to the offshore operations of Australian banks would be met entirely by small domestic Australian ADI. This illustrates that the current legislation is perverse to any semblance of fairness.



***Recommendation No.4, Para. 4.32***

*ANAO recommends that APRA reviews prudential restrictions on bank exposures to single borrowers or groups of related borrowers in accordance with the Basel Committee's best practice guidelines.*

**AAPBS response**

Whilst endorsing the intention of the Auditor-General's recommendations it needs to be kept in mind that APRA and the Australian Government may need to disagree at times with the Basel Committee on Banking Supervision. APRA and industry have recently made high-quality and cogent representations to the Basel Committee in respect of the proposed "The New Basel Capital Accord" which, if unheeded, will require a different approach for domestic Australian institutions.

***Recommendation No.5, Para. 5.32***

*ANAO recommends that APRA enhances its supervision of the international operations of Australian Banks and the Australian operations of foreign banks by:*

- (a) documenting, and regularly updating, assessments of the quality of supervision provided by overseas supervisors drawing, as appropriate, on assessments completed by internationally recognised agencies;*
- (b) establishing formal information sharing arrangements with relevant overseas supervisors;*
- (c) seeking periodic confirmation from overseas supervisors that there are no issues of concern relating to foreign parent banks and overseas operations of Australian banks that APRA needs to be made aware of; and*
- (d) where there are concerns about the Australian operations of foreign banks or the international operations of Australian banks, promptly informing the relevant overseas supervisor of these concerns.*

**AAPBS response**

As indicated in comments in relation to Recommendation 3, the additional cost of these recommendations would be met by ADI other than the largest banks. Additionally, it is noted that foreign bank branches in Australia pay levies at 50% discount to the rate applying to domestic institutions such as building societies. If implemented, it would be a still further subsidy of the international operating banks by small domestic Australian ADI.