**Senate Economics Legislation Committee**

ANSWERS TO QUESTIONS ON NOTICE

**Treasury Portfolio**

Supplementary Budget Estimates

2016 - 2017

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|---|---|
| **Department/Agency:** | Australian Prudential Regulation Authority |
| **Question:** | 161 |
| **Topic:** | APRA responsibility for FSI recommendations |
| **Reference:** | Hansard page no. 16-17 - 20 October 2016 |
| **Senator:** | Bushby, David |

**Question:**

**Senator BUSHBY: [**…] The tightening of the lending standards is part of the overall approach that the government is taking to implement the FSI recommendations. It links in to some degree. The responsibilities that APRA has in terms of the FSI recommendations—

**Mr Byres:** We have an interest in many of them, but many, for example, in the superannuation space actually require legislation to enact. So we have an interest in those, but ultimately Treasury has to work up the legislation and then parliament has to decide whether to pass it. The ones which we have direct responsibility for and which the government has said APRA needs to implement are the first few recommendations about bank capital, risk rates, loss-absorbing capacity, leverage ratio, transparency about bank capital and things that related to our own prudential standards.

**Senator BUSHBY:** Are they all in place?

**Mr Byres:** Some are in place. For example, we did raise the risk weight on mortgages. We announced it last year and it came into effect this year. That was recommendation 2. I am just trying to think of all the recommendations. We did some work on transparency.

[…]

**Senator BUSHBY:** If you could take that on notice, please, and let us know.

**Mr Byres:** Will do.

**Answer:**

The Government has endorsed implementation of several recommendations in the final report of the Financial System Inquiry (FSI) for which APRA has direct responsibility. The status of APRA's implementation of these recommendations is set out in the table below.

| FSI Recommendation | Status of APRA implementation |
|---|---|
| **1. Capital levels** | **Underway – update planned in early 2017**<br>The recommendation is for APRA to set capital standards such that ADI capital ratios are 'unquestionably strong'; the FSI suggested this could be thought of as being in the top quartile of internationally active banks. In July 2015 APRA published *International capital comparison study* which brought clarity to the degree by which the major banks were below the top quartile. Also in July 2015 APRA announced a change to risk weights (see "2. Narrow mortgage risk weight differences" immediately below) and the major banks responded by increasing capital, materially improving their position on an international comparison. APRA published an update of its original *International capital comparison study* in July 2016 that estimated the major banks' capital ratios are broadly in line with the target set by the FSI. In 2017, APRA will have regard to the Basel Committee on Banking Supervision's (Basel Committee) broad review of the capital framework, due to be completed around the end of 2016, as well as how other measures of resilience can assist in achieving the FSI's objective with a view to finalising this objective. |
| **2. Narrow mortgage risk weight differences** | **Interim measure implemented**<br>In July 2015 APRA announced changes to the treatment of residential mortgages for banks able to use internal models for capital adequacy purposes, in order to increase the average risk weight from approximately 16 per cent to at least 25 per cent. These changes came into effect from 1 July 2016. Whilst this addresses the FSI recommendation, APRA views it as an interim measure and will consider whether further changes are necessary after the Basel Committee's broad review of the capital framework is complete. |
| **3. Loss absorbing and recapitalisation capacity** | **In progress – completion will be beyond 2016**<br>Consistent with the FSI's recommendation of not moving ahead of international developments, this is an issue that APRA intends to address over the medium term. In the meantime, APRA is monitoring initiatives being taken by overseas jurisdictions in this area, and has been engaging with other members of the Council of Financial Regulators on this issue. |
| **4. Transparent reporting** | **Complete**<br>APRA published its *International capital comparison study* (July 2015). APRA's study (and subsequent update in June 2016) are considered to have addressed the stated objective of this recommendation: 'Reduce disadvantages that may arise for Australian ADIs due to difficulties in comparing Australian ADI capital ratios to international peers'. |
| **7. Leverage ratio** | **In progress - completion will be beyond 2016**<br>The Basel Committee is finalising its proposal for the introduction of a leverage ratio and APRA plans to consult on the introduction of a minimum leverage ratio requirement after the Basel Committee's proposal is finalised, which is expected around the end of 2016 (with implementation anticipated in 2018 or later). Leverage ratio disclosure requirements for the largest ADIs have been implemented. |
| **35. Finance companies** | **Complete**<br>In order to undertake banking business in Australia, a body must be incorporated and authorised by APRA as a deposit-taking institution. Under the *Banking Act 1959*, APRA may give an exemption from the need to be authorised. Consistent with the recommendation made by the FSI APRA has amended the relevant exemption arrangements to prohibit finance companies (including Religious Charitable Development Funds) from offering at-call deposit products or other transactional banking functionality that is typically associated with the product offerings of ADIs. |