

20 April 2018

Manager  
Banking and Capital Markets Unit  
Financial System Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600

via email: [bear@treasury.gov.au](mailto:bear@treasury.gov.au)

Dear Sir/Madam

**Banking Executive Accountability Regime (BEAR) – Size of an Authorised Deposit-taking Institution – Draft Legislative Instrument**

Thank you for the opportunity to provide a submission on this proposed legislative instrument.

**Key points**

The threshold dividing “small” from “medium” ADIs should be at least doubled to \$20 billion.

This will:

- give policymakers the opportunity to apply more proportionality and graduation into regulatory frameworks
- more closely reflect the actual distribution of ADIs by size, and
- improve the fairness of the BEAR in relation to the market for executive talent and proportionality of the maximum fines.

**Our sector**

COBA represents mutual banks, credit unions and mutual building societies. Collectively our sector has more than \$110 billion in total assets and four million customers across 77 banking institutions ranging widely in size.

Customer-owned banking institutions are fundamentally different from their listed competitors in that the customers, not a separate group of shareholders, own the institution. This means that our customers are our number-one stakeholder. Our sector does not have the tension of trying to maximise returns to a separate group of shareholders at the expense of our customers.

The customer-owned banking sector generates value to its owners through better value products and services rather than dividends and share price growth. Given that executive remuneration seeks to align the interests of executives with owners, this means that our remuneration has significantly different incentives (and behavioural responses) to investor-

owned banks. Our sector also does not have the exorbitant remuneration structures of our competitors<sup>1</sup> and heavily share-laden packages<sup>2</sup> that create the individual incentives and personal enrichment to pursue behaviour that is contrary to the BEAR.

### **Three tiers**

We support the concept of three-tiers of ADIs within the BEAR and the Banking Act more generally. The tiering approach recognises the vastly different risks to the financial system posed by the major banks compared to other ADIs and allows for proportionate regulatory treatment of different categories of ADIs based on size.

However, COBA believes that the proposed \$10 billion total resident assets threshold between “small” and “medium” ADIs should be increased to more accurately reflect the structure of the Australian banking market and to provide a more practical and appropriate definition of a ‘small’ ADI.

COBA recommends that an appropriate “small ADI” threshold be set somewhere between \$20 billion and \$25 billion in total resident assets. This would comfortably cover the entire customer-owned banking sector.

As noted in the Explanatory Memorandum, Subsection 37G of the BEAR Act provides the Treasurer with the power to determine by legislative instrument the kinds of ADIs that are large, medium and small. This is the first time that there has been a legislative definition of a “large”, “medium or “small” ADI.

While this instrument’s primary purpose is for application of aspects of the BEAR, it may also be applied to improve the proportionality of future legislative regimes. For example, the *National Consumer Credit Protection Amendment (Mandatory Comprehensive Credit Reporting) Bill 2018* relies on this instrument to define the “large ADIs” that are mandated into the CCR regime. It is critical, therefore, that the thresholds appropriately reflect what is a “small ADI” in the Australian context.

### **Proportionate regulation**

Categorising ADIs into tiers in the Banking Act creates the opportunity for regulation to be better targeted, proportionate and risk-based. This is what the tiers are designed to achieve in the BEAR context for the commencement date, remuneration requirements and maximum fines.

A major concern of our members and a key factor influencing the competitive capacity of smaller challengers to the major banks is the regulatory compliance burden. The fixed costs of complying with regulation fall more heavily on smaller firms. The regulatory compliance burden provides yet another advantage to major banks because they can spread their costs over a vastly bigger revenue base.

The Productivity Commission’s February 2018 Draft Report on Competition in the Financial System found that the Australian banking sector is a strong oligopoly with four major banks holding substantial market power as a result of their size, strong brands and broad geographical reach. This is further supported by regulatory settings which contribute to the major banks’ structural advantages. “As a result, the major banks have the ability to pass on cost increases and set prices that maintain high levels of profitability — without losing market share,” the Draft Report finds.

These findings have been reinforced by the ACCC in its March 2018 *Residential mortgage price inquiry interim report* which drills into the detail of how the major banks’

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<sup>1</sup> See COBA’s August 2017 BEAR Submission to Treasury

<sup>2</sup> Customer-owned ADIs do not have ordinary shares and as such the equity-based remuneration that comprises a large part of investor-owned banks is not present in our remuneration packages

“accommodative oligopoly” is working against the long-term interests of Australian consumers.

The PC Draft Report calls for prioritisation of reforms that reduce regulatory barriers to entry and expansion in banking.

Appropriately set thresholds differentiating ADIs by size will give policymakers the opportunity to apply more proportionality and graduation into regulatory frameworks.

Under the proposed tiers in the draft instrument, two customer owned banking institutions would currently be categorised as “medium ADIs”. Another two customer owned banking institutions are closing in the \$10 billion threshold and would therefore likely soon be categorised as “medium ADIs”.

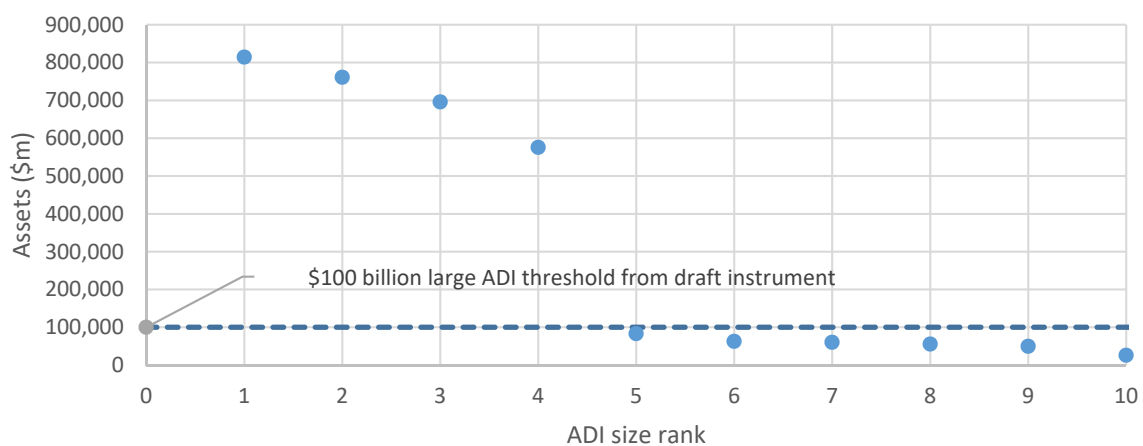
Based on current estimated total resident assets of \$3.7 trillion, each of these four entities would individually represent around 0.25% of total resident assets. A quarter of one per cent of total resident asset is an extremely low threshold to be categorised as a medium sized ADI.

Half of one per cent of total resident assets is \$18.5 billion, suggesting that the threshold dividing “small” from “medium” ADIs should be at least double the current threshold, i.e. \$20 billion rather than \$10 billion.

### Size thresholds based on the structure of the Australian market

An important factor to consider in determining the thresholds is the respective distributions of entities by size. From the graph below, we can see that the \$100 billion large ADI threshold is appropriate as there is clear separation between these two groups (i.e. the major banks and the rest). Given the next closest “medium” entity has \$90 billion in assets, it makes sense for a threshold to be at a lower level than the median (i.e. \$100 billion rather than \$500 billion).

**Graph 1: ADI total resident assets vs. ADI size rank (all ADIs) – with thresholds as proposed by the legislative instrument<sup>3</sup>**

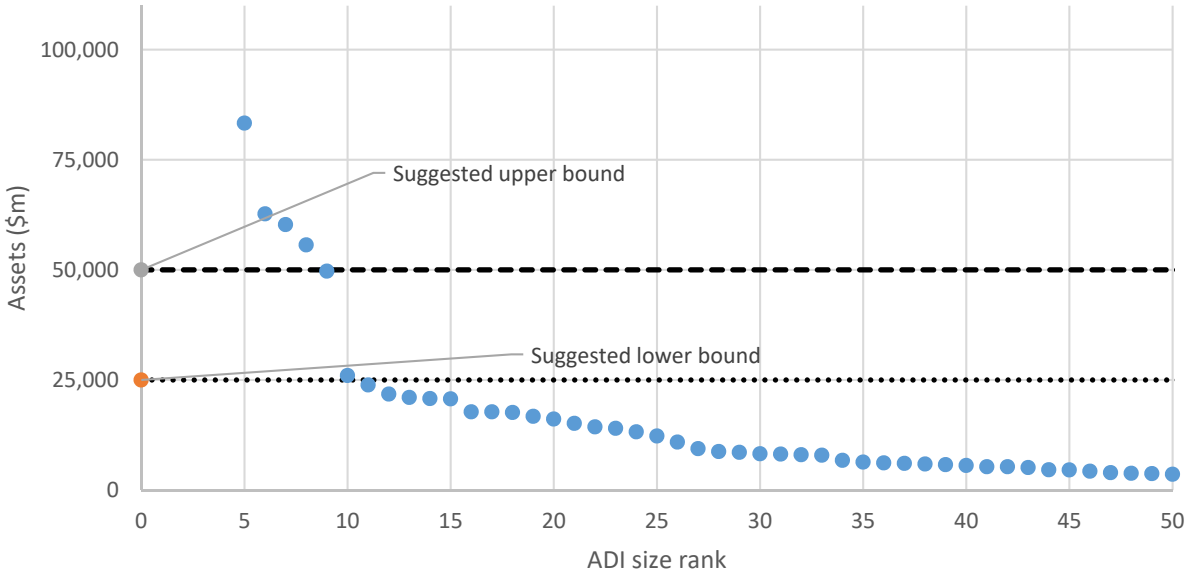


However, looking at the Graph 2 which takes a closer look at these non-major ADIs, there is clear gap within which it would be appropriate to insert the threshold dividing “small” and “medium” ADIs. This gap sits between \$25 billion and \$50 billion in assets. This contrasts with the proposed threshold of \$10 billion in the legislative instrument.

<sup>3</sup> ADI asset size is from APRA's Monthly Banking Statistics

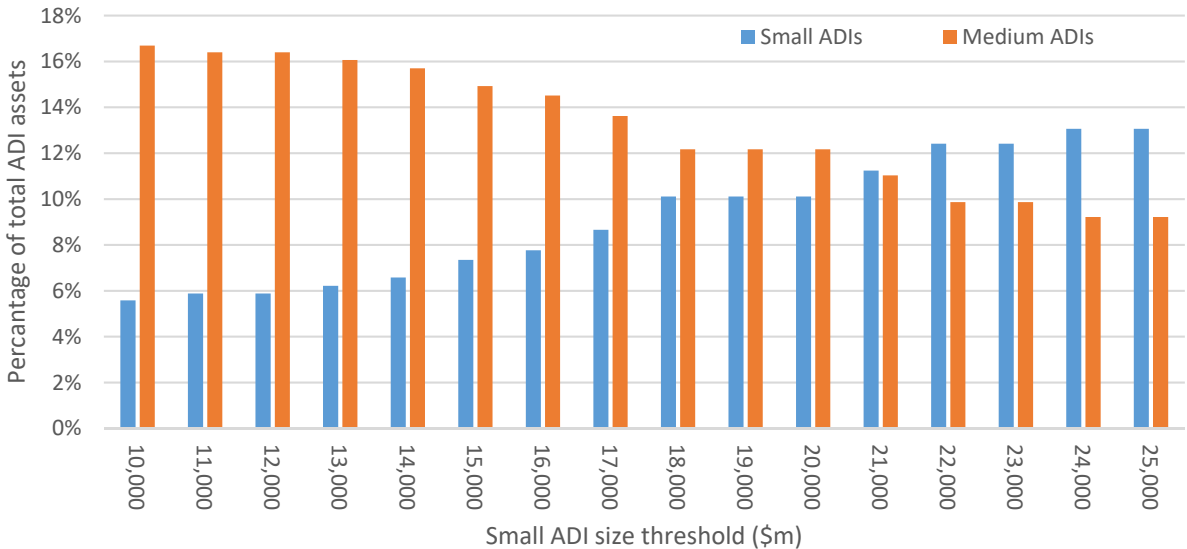
COBA suggests that taking the approach used by the “large” ADI threshold would yield a “small” ADI threshold of approximately \$25 billion.

**Graph 2: ADI total resident assets vs. ADI size rank, less than \$100 billion**



Another important consideration is the proportion of assets covered by ADIs in each respective grouping. As the threshold increases, more assets will be covered within the small ADI category. COBA’s estimates in the graph below show that with a \$20 billion threshold that there would still be a larger proportion of assets covered in the medium ADI category than the small ADI category (12 per cent vs 10 per cent). This supports \$20 billion as an appropriate level to set the threshold.

**Percentage of ADI assets covered by group vs small ADI thresholds**



### Disproportionate fine size for small ADIs and the smaller medium ADIs

Given that the fine levels are now set in legislation, the current proposed threshold of \$10 billion for a small ADI would generate a disproportionate impact on ADIs transitioning up to the “medium” category.

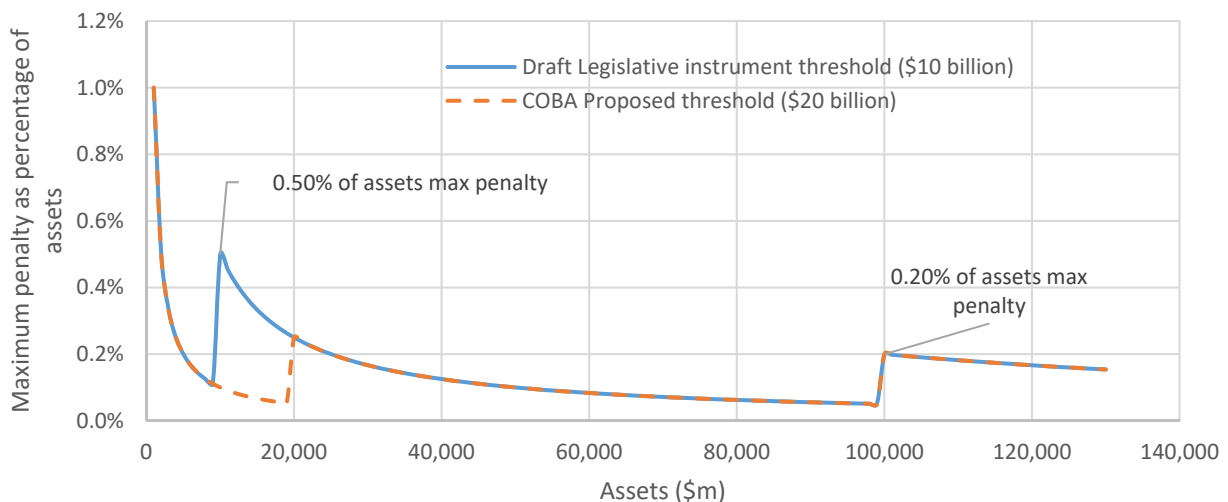
As these ADIs tick over this threshold they will be subject to a maximum fine that is up to 0.5 per cent of their total assets, compared to a newly large ADI which faces a fine of up to 0.2 per cent. This is clearly unfair.

The report of the Senate Committee inquiry into the BEAR bill reinforces this point:

The committee notes that penalties for ADIs based on size do appear to be disproportionate. Given that many of the issues the BEAR seeks to address are the result of the actions of the larger ADIs, the government may wish to consider whether a more proportionate penalty regime should be introduced relative to ADI size.

COBA believes that increasing the threshold to bring relative fines for these ADIs into line would require a \$25 billion “small” ADI threshold. This would bring the penalty for a newly “medium” ADI in line with that of a newly large ADI in relative terms at around 0.2 per cent of total assets.<sup>4</sup>

**Graph 3: Size of maximum fine relative to ADI total resident assets**



### Impact on the ability to attract talent within the sector

A further important consideration in setting the threshold dividing “small” from “medium” ADIs is the impact on executive talent markets within the customer-owned banking sector.

Customer-owned institutions in the \$10 billion to \$20 billion category compete in the same market for executive talent with those with less than \$10 billion in assets. This arbitrary \$10 billion threshold for “small” vs “medium” ADIs will mean these institutions have different deferred remuneration requirements. This is likely to reduce the competitiveness of these “medium” customer-owned ADIs to recruit this talent.

COBA believes that the “small” ADI threshold must be increased to ensure that these peer institutions are subject to the same deferred remuneration requirements.

<sup>4</sup> Page 29, Senate Economics Legislation Committee Report into the Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Bill 2017, November 2017

**Summary**

Appropriately set thresholds dividing “small”, “medium” and “large” ADIs will deliver a more effective and proportionate BEAR and will also give policymakers capacity to apply more proportionality and graduation into the broader regulatory framework.

Increasing the threshold for defining a “small” ADI from \$10 billion to \$20 billion is justified on a range of metrics, including the actual distribution of ADIs by size, but also better meets a simple common-sense test of what is a “medium” ADI.

Please do not hesitate to contact me on 02 8035 8441 or Luke Lawler on 02 8035 8448 to discuss an aspect of this submission.

Yours sincerely,



**MICHAEL LAWRENCE**  
**Chief Executive Officer**