



Australian Banking Association

12 April 2019

Mr Graeme Samuel AC
Chair
APRA Capability Review Panel
c/o The Treasury
Langton Crescent
PARKES ACT 2600
Delivered by Email:

Dear Mr Samuel

Submission to the APRA Capability Review

Thank you for the opportunity to contribute to the upcoming APRA capability review (**the Review**). The Australian Banking Association (**ABA**) supports the Government decision to undertake regular capability reviews of financial regulators as recommended in the Royal Commission Final Report¹, and congratulates the Government on its prompt implementation.

With the active participation of its members, the ABA provides analysis, advice and advocacy for the banking industry and contributes to the development of public policy on banking and other financial services. The ABA works with government, regulators and other stakeholders to improve public awareness and understanding of the industry's contribution to the economy and to ensure Australia's banking customers continue to benefit from a stable, competitive and accessible banking industry.

The ABA welcomes the opportunity to participate in this review of a key regulatory agency for our members. Our members engage closely with APRA daily through its supervision, policy development, data and reporting roles.

Overall, the ABA considers that APRA undertakes its role as a prudential regulator very well. APRA ensures that the reputation of the financial system is one that is unquestionably strong. A strong financial system is imperative for Australia's banks to access the necessary funding from international investors at a reasonable cost. All Australian banks (and consequentially their customers and shareholders) have benefited from the good reputation internationally achieved in part, through APRA's regulatory oversight.

That said, the ABA would welcome more engagement with APRA as part of its policy development. Changes to regulation can incur substantial costs and require significant time to implement, fit for purpose regulation is critical through the credit cycle. Early stakeholder engagement will enable APRA to better assess the impacts of its policy proposals and improve the effectiveness of the regulation.

Further, the ABA would question whether the current regulatory framework (of which APRA is a part) is equipped to deal with the rapid structural changes which are occurring in banking. Banking services are increasingly being provided by entities outside APRA's regulatory sphere. For example, the rise of the shadow banking sector, an outcome of non-uniform regulation in the financial system, puts the stability of the system and protection of customers at risk.

Regulatory agencies like APRA will require a more flexible legislative framework, a different organisational approach and skillset to adequately supervise the evolving financial services market.

¹ The Australian Government, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, <https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.docx>.



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Given this, the ABA looks forward to the Panels review of APRA's capability to meet these regulatory challenges of the future.

Yours faithfully

Karen O'Brien
Policy Director



1. Introduction

The ABA considered how APRA can continue to meet its regulatory objectives in the future. These are grouped into the following four categories:

1. Policy development and stakeholder engagement
2. Operational and overall strategic leadership
3. Supervision
4. Data collection, sharing and reporting

Each of these is discussed below.

2. Policy development and stakeholder engagement

The ABA welcomes engagement with the regulator during the policy development process. At present, the ABA and banks make submissions on consultation packages proposing specific changes to the current prudential regulatory regime. APRA also consults on guidance which assists banks greatly with the implementation of a prudential change. The ABA would like these policy consultation processes to continue. However, the ABA considers there are a number of ways the policy development process can be improved in the future. These include:

- Early stakeholder engagement
- Improved timeliness
- Require 12-month implementation periods as standard.
- Better analysis of regulatory impacts
- Move away from “one size fits all” approach to regulation
- Include competition impacts with non-ADIs in its consideration, and

These are considered in more detail below.

Early stakeholder engagement

At present, few if any ADI’s are consulted during the internal APRA policy development process. The first opportunity that ADI’s are often involved in the process is responding to the final consultation package which outlines the policy change being proposed. This is often seen as “too late” by ADI’s as the policy option has already been chosen without input from the stakeholders affected. Better and more effective policy could be developed if stakeholders were consulted informally about the impacts and implementation issues of policy options being considered. As part of its regulatory policy tool kit, ASIC often conducts soft-soundings/roundtables on potential concepts and ideas prior to drafting the final consultation paper. ASIC also often tests versions of a draft consultation paper with a subset of their regulated population to ensure the best policy outcomes.

The ABA considers that input from a wide range of stakeholders is needed for any realistic assessment of impacts. These should include wider impacts such as competition in the market (including non-ADIs), international competitiveness, and differences from the of size and/or business model of an entity. Early stakeholder engagement is even more important for highly technical subject areas where specialists within ADI’s could provide the necessary expertise to develop effective policy and realistic plans for implementation. This will ensure that the final policy is more appropriate through prevailing conditions in the economic credit cycle and will support growth in the economy.

APRA is currently working on how it can improve stakeholder engagement and whether different ways of engaging with stakeholders could be more effective. The ABA is working with APRA by jointly holding workshops on consultation packages with members and we want this to continue. However, we would welcome the Panel’s consideration of how APRA can improve its current policy capability by engaging more often and early with stakeholders.



Improved timeliness

APRA sets its policy agenda by publishing its policy priorities each year. This publication also outlines when consultations and final standards are likely to be issued. The ABA considers this to be regulatory best practice and would like to see this continue. Further, some banks would like to see this practice adopted by other regulators as it greatly assists with forward planning. However, the proposed timetable often slips, and timelines are pushed out. Sometimes this is at the expense of the implementation period when the implementation date is fixed by international requirements.

ADI's are often not informed of a delay or updated on the progress of a policy issues in train by APRA. It is often left to the stakeholder to find out why, where and when a policy will be finalised. This creates significant risks for ADI's as implementation periods become inadequate and resource availability internally diminishes. For example, promised guidance or answers to frequently asked questions needed to progress implementation may not be delivered ahead of the required implementation date. This creates significant regulatory risk for ADI's and is not best practice

The ABA would like the Panel to consider what factors contribute to policy delays and how APRA can improve its policy capability to better meet timelines and provide ongoing updates to stakeholders.

Implementation period needs to be at least 12 months

Delays to finalising the prudential standard and guidance by APRA often reduces the time available to implement the regulatory change by the required date. Often implementation requires new system changes, large resource allocations and updating of internal practices and/or policies. This requires a minimum 12-month time frame to ensure the business can be compliant and can deliver effective change. However, in many cases, APRA's implementation time frames are less than 12 months to meet international timetables, given the delays in the policy formation process (often due to workloads) the shortened timeframes for implementation is not only a costly and unreasonable burden but also adds systemic risk into the system. Further, implementation time frames in excess of 12 months for complex regulatory change was recommended by the Financial Services Inquiry in 2014² and the Government adopted that recommendation, but the ABA's view is that Government and regulatory agencies typically do not consistently adhere to this policy.

The ABA would like the Panel to consider requiring APRA to provide a minimum of a 12-month implementation timeframe for regulatory change to ensure businesses can meet regulatory requirements, the international timetable is important but rigid adherence is no longer the right answer, a balance must be achieved.

"One size fits all" approach to regulation

The ABA considers that current prudential regulation does not take into consideration the proportional cost of regulation given the potential risk posed by an entity, given its size and complexity. Prudential regulation adopts generally a one size fits all approach when addressing risks which can be unsuitable, costly and unlikely to deliver benefits proportional to the cost.

Smaller banks are less complex and present less risk to systemic financial stability but are required to shoulder the same costs to meet the same prudential requirements. These fixed costs form a much higher relative to the ADI's income and increasing barriers to expansion or entry for new ADI's. Further, the prudential requirements imposed on smaller ADI's are unlikely to reduce risks to the financial sector in a meaningful way.

The ABA would like the Panel to consider how APRA can adapt and stratify its regulatory approach, so the financial system remains unquestionably strong while ensuring that regulation is proportional to the risk presented by the entity.

Greater analysis of regulatory impacts as part of policy development.

The ABA considers that more comprehensive and transparent analysis of regulatory impacts could improve policy outcomes and assist APRA in meeting its objectives. At present, APRA does indicate its

² See recommendation 31, Financial Service Inquiry – Final Report, <http://fsi.gov.au/publications/final-report/appendix-1/>



views on the likely impacts, however, its analysis and evidence is not published as part of its decision making.

The ABA would like more transparency of any analysis of impacts including what factors have been considered, how these have been assessed against the likely impacts and the evidence its views are based on. In particular, how the impacts may differ across business model and business size of the regulated entity. The ABA would welcome the Panel's views on how analysis of impacts can lead to more effective policy as well as how APRA could better approach its assessment of impacts.

Impacts of regulation on competition with non-ADIs

APRA's competition objective is an important secondary objective of APRA. APRA considers competition during the policy development process and notes its views on the likely impact on competition amongst ADIs as part of its consultation package. However, many retail banking products (such as home loans, business lending and personal lending) are not exclusively supplied by ADIs but are also supplied by non-ADIs (also known as shadow banks).

The supply of financial services by non-ADIs is rapidly growing and represents an increasing competitive force in the market. According to RBA data, lending by ADIs rose 4.5% (\$113bn) over the year to February 2019. This was outpaced by the pace of growth in lending by Non-ADIs. Non-ADI lending rose by 10.9% (\$15.8bn) over the year to February 2019. Whilst non-ADIs represented 5.7% of total loans and advances in February 2018, non-ADIs accounted for 12% of total loan growth over the year³.

The current regulatory framework does not seem to have been able to keep up with these developments. This is resulting in a mix of non-regulated and regulated entities providing similar services to customers. Given this, traditional banks are heavily regulated as authorised deposit taking institutions (ADIs) whereas non-banks providing the same services are not subject to the same prudential requirements. Focusing regulation on a traditional bank structures for regulation rather than the entities activity going forward imposes greater costs on ADI's than their non-ADI competitors. This is likely to hold-up the entry and expansion of ADIs, the adoption of more efficient ways of banking, lead to firms structuring their business operations to avoid regulatory costs and reduce consumer protections in some markets.

Given this, the competition impacts of regulatory changes need to be assessed in comparison to all suppliers in the product market, including non-ADIs. This is regulatory best practice and will provide a more realistic view of the regulatory impacts on competition in the market. In addition, APRA's analysis of competition needs to be more comprehensive and transparent in line with best practice. Other international regulatory agencies such as the Financial Conduct Authority (FCA) and the UK Prudential Regulatory Authority (PRA) both publish more rigorous analysis on competition for stakeholders.

The ABA would like the Panel to consider how APRA should assess the impact of its regulation on the competition between non-ADIs and ADIs; and develop the capability to provide more rigorous competition assessment of its regulation to better inform its future decision making.

3. Operational capability and overall strategic leadership

Strong leadership and financial stability

As noted earlier, the ABA considers that APRA meets its financial stability objectives as reflected by the number of reviews and its international reputation⁴. APRA is well-respected for its focus on prudential strength and its contribution to managing Australia through the GFC. A contributor to this success is the twin-peaks regulatory framework which should be continued as recommended recently by the Royal

³ Reserve Bank of Australia February 2019, Lending and Credit Aggregates – D2, <https://www.rba.gov.au/statistics/frequency/fin-agg/2019/fin-agg-0219.html>

⁴ Productivity Commission, *Competition in the Australian Financial System – Inquiry Report*, <https://www.pc.gov.au/inquiries/completed/financial-system/report/financial-system.docx>



Commission recommendation 6.1, as well as maintaining regulation consistent with international standards⁵.

The ABA considers that the leadership of APRA is strong. APRA has demonstrated its leadership and independence by making somewhat controversial macro prudential interventions to address emerging risks in the mortgage market. APRA have also undertaken prudential reviews of organisational culture in the entities they supervise. This reputation and leadership are a gain for industry as it demonstrates that the regulator is actively managing all types of risks as part of an unquestionably strong financial system.

Given this, the ABA considers that the leadership framework of APRA remains appropriate for now and in the future. Having a non-executive Board that provides strategic oversight and direction of the organisation rather than focusing on operational matters is an effective framework for the future.⁶

Ensuring accountability

While the ABA supports capability review of regulators, it does question the efficiency of having such a high number of Government review processes for APRA to ensure accountability. Such a high number of reviews can take away key resources from allowing APRA to focus on its core objectives and contributes to regulatory uncertainty. Examples of overlapping Government reviews include:

- The Australian National Audit Office (ANAO) audits and appearances before Senate and House of Representatives Parliamentary Committees each year,
- reporting annually against the Australian Government's Regulator Performance Framework
- tabling of its Annual Report in Parliament. This includes performance reporting such as the Annual Performance Statement, as well as the Performing Entity Ratio and Money Protection Ratio which are indicative of APRA's supervisory performance.
- Surveying stakeholders annually about their supervisory experience of APRA.
- international reviews by the International Monetary Fund (IMF) and the Financial Stability Board (FSB).

The ABA understands that in future, APRA will now also be accountable to further regulatory oversight and ongoing review as recommended by the Royal Commission⁷. It may be now a useful time for the Panel to consider whether streamlining and removing duplicative Government review processes could yield a better use of APRA's resources while maintaining the discipline of accountability. The Australian Government's Regulator Performance Framework is at least one review that should be examined for usefulness.

Future expertise needed to meet growing requirements

The Royal Commission highlighted to the financial sector the importance of risk management. Going forward, APRA has stated it will be focusing its policy making and supervision more on operational risk⁸. Examples of risks include information security, culture, governance, and remuneration. These subject areas are of a highly technical nature and sit outside that skillset usually found in prudential supervisory and policy teams. APRA will need to develop, maintain and/or access when needed the required expertise for effective regulation of these areas. For example:

- Policy making will require specialised technical assistance when developing prudential regulation such as Prudential Standard CPS 234 Information Security and its associated guidance⁹. This is needed to ensure that standards can be operationalised and can achieve its objective of mitigating operational risk.

⁵ The Australian Government, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, <https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.docx>

⁶ Treasury, ASIC Capability Review – Final Report, <https://treasury.gov.au/sites/default/files/2019-03/ASIC-Capability-Review-Final-Report.pdf>

⁷ The Australian Government, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, <https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.docx>

⁸ APRA, Wayne Byers opening statement to Senate Economics Legislation Committee 21 February 2019, <https://www.apra.gov.au/media-centre/speeches/opening-statement-21-february-2019>

⁹ Prudential Standard CPS 234 Information Security, <https://www.legislation.gov.au/Details/F2018L01745>



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- Bank supervision teams will require a level of expertise so it can detect emerging operational risks as part of its regular supervisory activities. Ad-hoc thematic supervisory reviews focusing on specific risks, such as culture and remuneration, will need to access specialist skills to enable it to deliver adequate governance, analysis and recommendations.

The ABA would welcome the Panel's consideration of APRA's skills requirements going forward given its need for greater technology skills and operational risk expertise.

Regulatory framework – Fit for purpose for the digital age?

The current regulatory framework is focussed on the regulation of entities, rather than activities, hampering the ability of APRA to maintain oversight of a rapidly changing field. As new platforms and business models emerge, traditional ways of providing credit are transforming at an accelerating rate. Shadow banks, buy-now pay-later schemes, crowd sourcing platforms and the shift by global giants such as Apple into the credit market are just the beginning of what may be seismic shifts in the sector. Continued reliance on an entity based legislative framework is unlikely to equip APRA with the tools it needs to meet these challenges.

The ABA asks the Panel to consider whether the current legislative architecture is fit for purpose to equip APRA with the regulatory tools it needs in a time of change and disruption.

Overlap with conduct regulator (ASIC)

APRA's focus on operational risk going forward raises issues of scope overlap with the conduct regulator, ASIC. The two operational and governance issues arising from this are:

- APRA and ASIC working together to ensure more effective and consistent regulation; and
- Maintaining the twin peaks regulatory framework which separates conduct and prudential regulation.

APRA is considering many conduct risks often in tandem with ASIC. For example, both ASIC and APRA are currently reviewing lending requirements through ASIC's RG209 Credit licensing: Responsible lending conduct and APRA's draft Prudential Standard APS 220 Credit Risk Management consultations this year. The ABA considers that final regulatory requirements are more effective if they are developed in close collaboration with ASIC. This will ensure that there are no inconsistencies between the prudential and conduct regulation addressing similar risks.

Further, it would be more efficient if APRA and ASIC data and information requests on similar risks were consistent and coordinated to avoid the repeated costly duplication currently experienced by all ADIs. This coordinated approach would also benefit the regulators as the interplay between both prudential and conduct requirement impacts can be assessed better if consultation is undertaken jointly. A more coordinated approach between ASIC and APRA is also consistent with Royal Commission recommendations 6.9 and 6.10¹⁰. We would welcome the Panel's views about how APRA can develop this cooperation capability further.

The twin peaks model separating conduct and prudential regulatory responsibilities requires clear delineation to ensure that regulatory responsibility is clear. The UK experience of the GFC showed how any blurring of the lines can have a serious outcome for financial stability in the times of a crisis¹¹. Given the risk of overlap and duplication, there needs to be a clear delineation between the responsibilities and oversight of the various regulatory regimes. We welcome the Royal Commission's acknowledgement of the BEAR having a conduct and prudential outlook, and therefore requiring the oversight of the conduct regulator as well as APRA. We have seen examples of co-regulation in the UK (e.g. Senior Managers and Certification Regime regulated by PRA and FCA).

How APRA and ASIC maintain this separation while coordinating regulation on similar risk is likely to be a future challenge which the Panel may wish to consider as part of its review.

¹⁰ The Australian Government, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, <https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.docx>

¹¹ Schoemaker, D and N Véron (2017): "A 'twin peaks' vision for Europe", Bruegel Policy Contribution, no 30., <http://bruegel.org/wp-content/uploads/2017/11/PC-30-2017-1.pdf>



4. Supervision and regulatory approvals

The supervision model of APRA is considered excellent by members. The ABA considers that

- the current supervisory model of teams dedicated to specific banks is the right model; and
- supervisory teams are highly experienced and qualified.

An example of this excellent work is benchmarking the regulatory performance of ADI's against peers using a traffic light grading system. Banks find this extremely useful input to assess their risk management and would seek to ensure this APRA work and feedback continues.

Supervisory model needs better resourcing

The ABA would like APRA's supervisory capability and model to continue. However, many banks consider that the supervisory teams are currently under resourced and generally "spread too thin". This under resourcing could contribute to the delays experienced by ADI's requiring regulatory decisions for their business. The ABA would welcome the Panel's consideration of how APRA can appropriately resource its supervision function so that it can continue its high-quality work in the future.

Transparency can be improved

The ABA considers that there is an opportunity to further improve the transparency of APRA's supervisory function. Thematic review findings provide an interpretation of the regulation and therefore can have a policymaking or guidance function. The ABA considers that the findings of thematic review these should be published and consulted on in a similar fashion to regulatory policy changes and guidance. The ABA would welcome the Panels consideration on how thematic reviews can better involve stakeholders, be better communicated and where changes to current practice are required, assess the potential impacts as part of their decision making.

Delayed regulatory approvals

Banks often experience extensive delays receiving responses to regulatory inquiries and regulatory approvals. Delayed responses (often measured in months and in the case of an IRB application it can take years) can have a significant impact on businesses to take advantage of opportunities to earn a return or make cost savings.

The ABA considers that regulatory approvals from APRA are unnecessarily time consuming, can require more information than needed to meet international requirements and regulatory requirements are not consistent.

A prime example is the APRA approval of capital issuance transactions. Regulatory approval can take many months even when previously approved identical terms are used. APRA interpretations of requirements appear to change constantly and without notice which further contributes to delays. An immediate improvement would be the ability for ADIs to discuss the transactions with APRA prior to full documentation being provided, to ensure their application will provide adequate information for a quicker decision. Further, as the application is being considered ADIs should have the ability to discuss emerging issues or clarify comments through direct discussions with the APRA team.

The ABA would like the panel to consider how APRA can improve the speed and transparency in all aspects of its decision making on capital issuance transaction approvals.

Delayed approvals impose significant costs on ADIs. Markets can change rapidly, and ADI's need to be able to respond quickly to take advantage of optimally priced funding opportunities on these markets. The uncertainty around the possible regulatory approval timeframe and its typical length mean that ADIs often miss competitively priced funding opportunities. The lengthy approval process increases ADI costs and these form part of the cost base of products offered to business and consumers.

The ABA would like the Panel to consider how APRA can improve its capability to meet business needs better by making faster regulatory approvals.



5. Data collection, sharing and reporting

The ABA considers the data collection and reporting by APRA is useful and should be continued. APRA's recent investment in a new data collection system is welcome and continued investment in technology needs to continue. Internationally, the trend for regulatory data collection is moving towards real time automated collection which will require more investment in skills and technology within the organisations.

APRAs will need the future capability to maximise the use of this data and other available data to manage prudential risks. This will require greater use of data science skills across the organisation. For example, data can be used to model policy outcomes and detect regulatory breaches in a more systematic way. These skills are also needed when considering new approaches to credit risk. Many innovative lending providers are using technology to use non-traditional sources of data to assess individual lending applications. APRA needs the capability to assess the likely prudential risks of these new methods quickly to ensure better and more efficient products can be delivered to customers.

APRA currently collects a vast number of regulatory data returns from banks. For non-major banks and smaller banks, the number of Government and agency data reporting requirements is overwhelming. At present, not all data collected is publicly available which means banks face multiple requests from multiple different regulatory agencies for similar data. It would be more efficient for the financial industry if APRA could make more collected aggregate anonymised data publicly available for analysis or improve sharing its data within Government to ensure multiple requests are minimised.

The ABA supports increased data collection from non-ADI's (shadow banks). While non-ADI lending may not present material risk now, it is important that data on their lending is collected so any emerging risks can be identified. The Reserve Bank of Australia (RBA) identified the potential for non-ADI risks and that data on non-ADI lending is limited¹². At present, APRA monitors the exposures of ADI's to non-ADIs through its wholesale lending reporting. However, the limited data collected and APRA's monitoring means that lending to the non-ADI sector may not be optimal. APRA has been given the powers to collect data from non-ADIs and is working with the Council of Financial Regulators on a future data collection. The ABA would urge APRA to begin data collection as soon as possible.

The ABA would like the Panel to consider how APRA can improve its data capability and meet the growing data requirements of the future, in particular for non-ADIs. Further, it would be useful for the Panel to consider how APRA can better use and share its current data collections to minimise regulatory costs for ADI's.

¹² Reserve Bank of Australia April 2019, Financial Stability Review.

https://www.rba.gov.au/publications/fsr/2019/apr/?utm_source=rbanews&utm_medium=email&utm_campaign=fsr-2019-apr