AUSTRALIAN BANKERS' ASSOCIATION INC.

Submission

FINANCIAL SYSTEM INQUIRY

RESPONSE TO INTERIM REPORT

August 2014

Australian Bankers' Association Inc. ARBN 117 262 978
(Incorporated in New South Wales). Liability of members is limited.

This page is intentionally blank.

Contents

For ease of reference to the Financial System Inquiry's Interim Report, this submission has extracted the policy options to which the submission is responding. These extracts are included in shaded boxes.

Appendices

Appendix A: Australian Bankers' Association: International comparability of capital ratios of Australia's major banks

Appendix B: Position on Financial Literacy.

Glossary

ABA	Australian Bankers' Association
ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
ADI	Authorised Deposit-taking Institution
AML	Anti-money laundering
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
AUSTRAC	Australian Transaction Reports & Analysis Centre
BCBS	Basel Committee on Banking Supervision
CCR	Comprehensive credit reporting
CFR	Council of Financial Regulators
COSBOA	Council of Small Business of Australia
CRS	Compliance Reporting Standards
DFAT	Department of Foreign Affairs and Trade
D-SIFI	Domestic Systemically Important Financial Institutions
DVS	Document Verification Service
FATCA	Foreign Account Tax Compliance Act
FCS	Financial Claims Scheme
FDIC	Federal Deposit Insurance Corporation
FOFA	Future of Financial Advice
FSI	Financial System Inquiry
FSB	Financial Stability Board
FSR	Financial Services Reform
GFC	Global Financial Crisis
HQLA	High-quality liquid assets
IGA	Intergovernmental Agreement
IRB	Internal ratings-based
LMI	Lenders mortgage insurance
NCOA	National Commission of Audit
OECD	Organisation for Economic Co-operation and Development
OTC	Over-the-counter

PEXA	Property Exchange Australia
PIR	Post Implementation Review Process
RBA	Reserve Bank of Australia
RIS	Regulatory Impact Statement
RMBS	Residential mortgage-backed securities
SME	Small and medium enterprises
SRI	Statement of Regulatory Intent

Figures

Members

The ABA represents the following banks operating in Australia:

- AMP Bank Limited
- Arab Bank Australia Limited
- Australia and New Zealand Banking Group Limited
- Bank of America, National Association
- Bank of Queensland Limited
- Bank of Sydney Limited
- Bendigo and Adelaide Bank Limited
- BNP Paribas
- Citigroup Pty Ltd
- Commonwealth Bank of Australia
- Credit Suisse AG
- Defence Bank
- HSBC Bank Australia Limited
- ING Bank (Australia) Limited
- Macquarie Bank Limited
- MECU Limited
- Members Equity Bank Pty Limited
- National Australia Bank Limited
- Rabobank Australia Limited
- Rural Bank Limited
- Suncorp-Metway Limited
- United Overseas Bank Limited
- Westpac Banking Corporation

This page is intentionally blank.

1. Overview

The Financial System Inquiry (**Inquiry**) is a rare opportunity for a careful and considered reflection on the state of Australia's financial system, its role in serving the Australian economy and hence the Australian people and the policy settings need to ensure the system continues to serve Australia as well in the future as it has in the past.

For this reason, the banking industry has argued consistently that the Inquiry should focus on ensuring Australia has the best financial system to meet its future needs. This means having a banking system that meets the needs of household and business customers, investors, employees and the broader community. To achieve this objective, we need a banking system that is stable, resilient, safe, competitive, innovative, diverse, efficient, inclusive and profitable.

The banking industry itself has to play a significant role in achieving this. One outcome of the recent global financial crisis (**GFC**) has been the need for banks around the world to rebuild confidence in their banking systems. While Australia's experience of the crisis has been very different from that in many countries, and confidence in banks in Australia remains high, the Australian industry recognises that it needs to continue to work to maintain and improve the reputation of the sector. This means not only focussing on ensuring consumers and the community see banks as doing the right thing by them, but also ensuring policy makers and regulators see the banking system continuing to fulfil its critical economic role, reliably and responsibly.

Banks also have the prime responsibility for maintaining and enhancing confidence in the system, but cannot do it alone. There is a clear role for government to preserve the strength of our national economy and the banking system, to ensure policy and regulatory settings enable the sector to serve the economy and to deepen community appreciation of the strengths of our system and the importance of it being efficient, stable and fair."

To ensure the banking system can continue to serve the needs of Australian consumers and the economy, the banking industry's first round submission to the Inquiry recommended focussing on five key areas:

1. recognising the strengths of the current system and ensuring these are not undermined;
2. funding the economy – assessing the likely future credit needs of the economy and ensuring measures are put in place to strengthen and diversify sources of funding;
3. driving competition – ensuring competition is seen from the consumers' perspective, that discussion of competition is based on objective analyses and that impediments to competition are assessed and, where appropriate, removed;
4. improving regulation – ensuring the regulatory regime is such that it supports rather than inhibits the financial system serving the economy; and
5. supporting technology – ensuring the central role of technology in banking is understood properly and the regulatory regime supports the full realisation of technology's benefits, while protecting the system from any risks.

Many of the industry's proposals are reflected in the FSI Interim Report (**Interim Report**). In this submission, the industry would like to emphasise those matters that the industry believes the Inquiry should consider further. This includes policy options in the Interim Report that the industry supports, and those that it does not support, with reasons why.

In considering what final recommendations to make, the banking industry suggests the Inquiry take into account the following:

- Given the demonstrated strengths of the current system, regulatory and policy changes should only be made where there is clear evidence that the change is needed and that the benefits of the change outweigh the costs and consequences;

- While we need to be wary of complacency, considerable care is needed in introducing new policy or regulatory proposals in anticipation of potential future issues, when these policy or regulatory proposals have impacts on the system, consumers or the economy today;

- Careful consideration needs to be given to policy proposals developed offshore and any regulatory and policy changes need to be adapted appropriately to Australian circumstances when implementing internationally agreed rules, or should only be adopted in Australia if Australian circumstances warrant their adoption.

The following are the areas within the banking system that the industry believes warrant further attention from the Inquiry:

- Addressing the challenges presented by the current regulatory capital framework, particularly for regional and smaller banks;

- Ensuring there is a coordinated and comprehensive approach to improving the quality and diversity of funding for the economy;

- Recognising the considerable improvements already made to the stability and resilience of the system and prioritising any measures to improve stability towards those that minimise upfront impacts on the system and economy;

- Building on financial literacy, increasing the effectiveness of disclosure and improving the quality, accessibility and affordability of financial advice, to assist customers to get the best out of financial products and services; and

- Proposing a collaborative approach to managing technological change, involving regulators, industry and consumer representatives.

2. Competition

The banking industry notes the Inquiry findings in the Interim Report that the financial system is competitive, albeit concentrated. The industry believes that competition can be enhanced further if barriers to competition are assessed and, where appropriate, removed. In this regard, addressing regulatory capital requirements should be the focus.

2.1. Regulatory capital requirements

Policy options:

No change to current arrangements.

Assist ADIs that are not accredited to use IRB models in attaining IRB accreditation.

Increase minimum IRB risk-weights.

Introduce a tiered system of standardised risk-weights.

Lower standardised risk-weights for mortgages.

Allow smaller ADIs to adopt IRB modelling for mortgages only.

The banking industry welcomes the Interim Report's observations with regard to the challenges of the current regulatory capital framework. Attaining internal ratings-based (**IRB**) accreditation is proving a lengthy process for a number of Authorised Deposit-taking Institutions (**ADIs**) and the banking industry fully supports assisting ADIs in this process and that this be made possible expediently, but without compromising any integrity of the system.

The Interim Report provided a number of policy options that would see risk-weights adjusted. The banking industry is of the belief that capital is not set for competitive neutrality. If the risk management framework of an ADI qualifies, the ADI can benefit from actual loss experience. Otherwise, the ADI is subject to more conservative risk-weights. An issue is, therefore, one of "how much more conservative should the risk-weights be under the standardised approach".

The banking industry believes that an examination of the average risk-weighting gap between standardised and advanced approaches is warranted. Banks have a range of views on how and the degree to which this can be achieved and will address this further in individual bank submissions. For instance, some banks believe that materially reducing this gap would assist in helping restore competitive neutrality.

The banking industry also recommends the Australian Prudential Regulation Authority (**APRA**) work with banks wishing to achieve this status pragmatically and supports the regional banks' recommendation in their first round submission that the current approach of achieving IRB accreditation be reconsidered.[1]

There are two key areas in which APRA could support regional banks to achieve IRB accreditation quicker, and thereby, help to enhance the risk management capability within the broader system. The first is implementing a staged approach to accreditation, to enable standardised banks to achieve IRB accreditation

[1] Regional banks' FSI Submission, March 2014, http://fsi.gov.au/files/2014/04/Regional_Banks.pdf, pages 60-61

progressively across their respective portfolios and operations. For example, enabling accreditation for credit risk on a residential mortgage portfolio as an initial step – allowing regional banks to model risk and allocate capital accordingly on this portfolio – would go a long way towards levelling the playing field in what is recognised as a more homogeneous, lower risk asset category. This approach is also not uncommon in other jurisdictions. The second area of support would be for APRA to establish a dedicated team to work with the regional banks to ensure there is adequate resourcing of specialist teams within APRA to ensure timely progress with the accreditation process.

2.2. Funding costs

RMBS

Policy options:

No change to current arrangements.

Provide direct Government support to the RMBS market.

Allow RMBS to be treated as a high-quality liquid asset for the purpose of the liquidity coverage ratio.

The banking industry fully supports the treatment of residential mortgage-backed securities (**RMBS**) as high-quality liquid assets (**HQLA**). The key reasons for this are:

- RMBS has proven to be a high quality asset. Actual performance has been exemplary, having withstood a significant stress test with the GFC. The Australian product is unfairly tarnished with unrelated problems in other markets and products;
- The RBA already accepts RMBS through repo arrangements. Hence, such treatment would not propose any new exposure for the RBA, and the extent of proposed reporting on the product to the RBA will further enhance acceptance of the product;
- The extent of liquidity for most products, particularly through times of distress, will always be in question;
- There are limited assets qualifying as HQLA and this would appropriately expand choice and availability; and
- Such treatment would increase demand for the product and activity in securitisation.

2.3. Small business and personal lending

Comprehensive credit reporting

Policy options: No change to current arrangements. Expand CCR by making it mandatory, adding new fields and/or extending it to SME lending.

The banking industry expects comprehensive credit reporting (**CCR**) to be expanded to small and medium enterprise (**SME**) lending over time, by adding new fields and extending it, subject to privacy considerations and the potential impact on consumers.

The banking industry does not support mandatory CCR because of its significant cost, complexity and potential for unintended consequences, and believes voluntary reciprocity under the current CCR regime is the most appropriate approach, consistent with most other developed markets. Current legislation sufficiently encourages financial services providers to use CCR about an individual when an application for commercial credit is made.

Furthermore, in response to the Interim Report stating that none of the major banks have participated to date, the Inquiry should note that some banks are still in implementation mode, planning to participate under CCR in due course.

Spreads

The banking industry believes there is no evidence that spreads in SME lending and personal lending reflects reduced competition. On the contrary, the banking industry believes there is robust competition for both SME and personal lending. This is only expected to intensify as economic conditions improve and bank balance sheets continue to strengthen.

Spreads, interest rates and fees reflect the cost of funding, credit risk and market conditions. The cost of writing an SME loan or a personal loan is substantially higher than that for a residential mortgage because of the more complex credit assessment requirements and smaller scale of lending. Moreover, when compared to retail consumer residential lending, banks are required to hold additional capital, and incur associated extra capital costs, against small business loans and personal loans due to higher loss rates.

Further information was provided in the banking industry's first round submission.[2]

2.4. Lenders mortgage insurance

Policy options: No change to current arrangements. Decrease the risk-weights for insured loans.

[2] ABA FSI Submission, March 2014, http://www.bankers.asn.au/FSI/ABA-submissions, page 73

The banking industry believes consideration should be given to reducing the risk-weights for mortgage insured loans. Failure to do so may significantly damage the lenders mortgage insurance (**LMI**) market and the availability of mortgages for some customers, as summarised in the Interim Report.

There is substantial historical evidence supporting the value of LMI cover as a risk mitigant in lending and this is widely acknowledged by the market, not least through continued use. It is excessively conservative for LMI cover to have no bearing when measuring risk, given its proven contribution to risk mitigation.

3. Funding

In terms of the issues raised within the funding section of the Interim Report, the topics of greatest importance for the banking industry are housing finance, SME finance and bank funding.

The banking industry disagrees with the statement in the Interim Report that "economic growth will not be limited by access to funding".[3] The funding challenges and their potential to limit economic growth are as presented in the banking industry's first round submission.

As suggested in the Interim Report, lenders can change the interest charged on loans. However, increasing interest rates, *ceteris paribus*, will reduce demand and by definition limit growth.

The market does work well overall and funding will be obtained at a price but there is room for improvement. The call for improvement is to enhance capability and efficiency, improve the terms and conditions of funding, including price, and minimise the risks of future funding disruptions in order to optimise economic growth.

Accordingly, what is missing in the Interim Report is a holistic approach to the funding needs of the economy that fully supports economic growth. The banking industry believes this would be best achieved through the agreement of a national funding strategy that brings all the challenges of Australia's funding needs together in a considered, comprehensive and coordinated manner. This should include, but not be limited to, the funding needs of banks, given their critical role in funding the economy. Other types of funding that are not within the normal role of banks, such as risk equity, also need to be examined.

As an example of the discrete rather than the holistic approach taken, the Interim Report having appropriately acknowledged that the domestic bond market should be bigger, has failed to elevate all the issues around this. Instead it appears to focus on particular aspects of the corporate bond market, which on its own will not resolve the issue.

The need for a coordinated and comprehensive strategy on funding was set out in Section 3 of the banking industry's first round submission.[4]

3.1. Housing and the financial system

Developments in the housing market have been positive and this is supported by the RBA's first round submission to the Inquiry. Strong demand, largely a cultural factor stemming from the Australian desire to own their own home fuelled by positive economic factors, has been met through a strong period of product innovation and greater access to home loans. The prevalence of owner-occupied housing is also a positive factor. The population needs housing and a wealthy nation like Australia would naturally see the nation house itself.

Although the housing market varies across the country, research continues to show that the market works efficiently overall, yielding modest returns in comparison to alternative investments.[5]

---

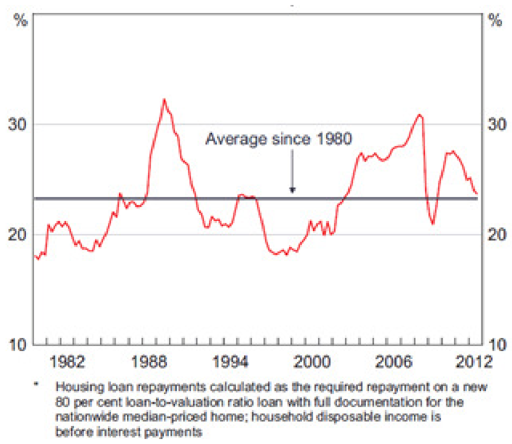
[3] FSI Interim Report, July 2014, http://fsi.gov.au/publications/interim-report/, page 2-77

[4] ABA FSI Submission, March 2014, http://www.bankers.asn.au/FSI/ABA-submissions, page 43

[5] RBA, July 2014, *Is Housing Overvalued*? http://www.rba.gov.au/publications/rdp/2014/pdf/rdp2014-06.pdf; RBA, February 2014, Submission to the Inquiry into Affordable Housing, http://www.rba.gov.au/publications/submissions/inquiry-affordable-housing/; RBA, May 2014, *Space and Stability: Some Reflections on the Housing-Finance System*, http://www.rba.gov.au/speeches/2014/sp-so-150514.html

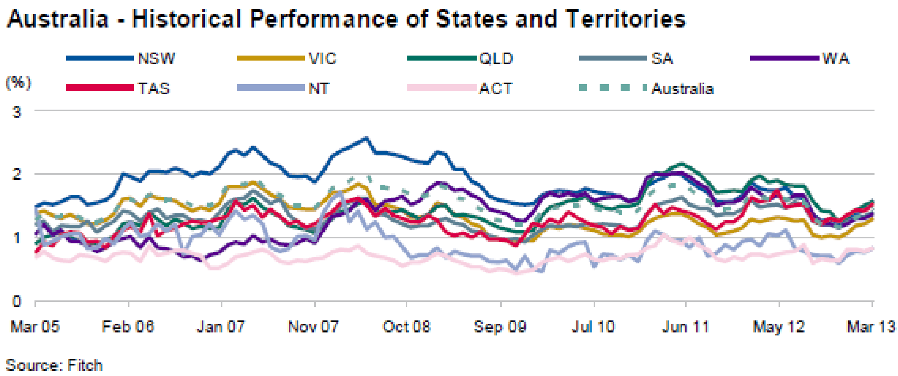
On the whole, the banking industry believes growth in housing finance has been sustainable. Household indebtedness has risen, but this has been based on sound economic fundamentals, such as the long period of strong economic, employment and income growth and on structural changes, such as reduced inflation and market liberalisation. Of particular note is that borrowers do not appear to have taken on excessive risk, as demonstrated by Figure 3.1. Delinquencies have also remained low, as demonstrated by Figure 3.2.

Figure 3.1: Repayments on New Housing Loans (% of household disposable income*)



Source: ABS; APM; CBA/HIA; RBA; REIA; RP Data-Rismark

Figure 3.2: Home loan 30+ day delinquency rates



The banking industry believes strongly that the housing market is sufficiently regulated and monitored, including through direct and indirect APRA and RBA oversight, and also by the banking industry itself through sophisticated risk management frameworks that allow them to monitor a suite of risks operating within agreed exposure limits.

The regulatory oversight in this market will be made even more explicit through draft Prudential Practice Guide APG 223 *Residential Mortgage Lending*, currently in consultation.

Having said that, products such as securitisation and covered bonds offer a very practical means of managing Australia's exposure to housing finance, particularly when bonds are placed offshore. Unfortunately, this is increasingly limited under the proposed drafting of Prudential Standard APS 120 *Securitisation* and other regulatory settings, especially on credit risk transfer, which is the most critical risk when considering exposure.

Risk-weightings either reflect actual risk (under IRB) or are otherwise conservatively set. It is widely agreed that home loans are less risky than business loans and risk-weightings should and do reflect this relative risk. Nevertheless, lending decisions are not based on any credit rationing; a bank's appetite for home loans is set independently of their appetite for business loans and each reflects a different risk/price proposition. Credit limits based on risk appetite are set for each book overall, with various sub-limits in place reflecting geographic exposure, etc. In general, the Interim Report's arguments in this area should give greater consideration to risk.

We also note that the ABA submission to the Senate Economics References Committee inquiry into affordable housing provides some views from the banking industry about facilitating affordable and sustainable home ownership and supports the development of a national housing plan.

3.2. SME lending

Policy options:

No change to current arrangements.

Facilitate development of an SME finance database to reduce information asymmetries between lenders and borrowers.

The banking industry believes "information asymmetry" in relation to SME finance to consist of:

- Lenders having access to less information than borrowers; and
- Borrowers not being fully aware of the information lenders require.

Ultimately, both of these may mean that lenders are not provided with all the information they need to assess the risk of lending, which can lead to either a higher margin on the loan or, at the extreme, refusal to lend.

The Interim Report notes that debt finance may be more suitable to businesses later in the business life-cycle, with equity and venture capital more suited to start-up firms in nascent industries. Reducing information asymmetry may not, therefore, increase lending to all SME segments, such as start-ups.

The banking industry welcomes initiatives to reduce information asymmetries, including the development of an SME finance database. We note, however, there are particular challenges that would need to be overcome, especially with regard to privacy considerations. It cannot be up to the lender to make borrower sensitive information available publicly nor available to a wider audience. This will continue to be at the borrower's discretion.

The alternative option proposed by the Interim Report is to expand comprehensive credit reporting. As noted in Section 2.3, the industry does not support mandatory comprehensive credit reporting; rather the regime should remain voluntary, including any extension to SME lending. It is important to note, that increased access to credit history may affect the availability and pricing of funding for some SMEs (for example, those with a negative credit history may struggle to access finance).

The ABA considers that a reduction in information asymmetry should rely on educating SMEs about lenders requirements and the incentives to provide adequate information, such as the pricing implications of providing only partial disclosure.

The ABA has commenced a project to address SME education. The Small Business Loan Project aims to assist small business in understanding and applying for finance. The project will establish a central on-line point of information about accessing finance for a small business, with a focus on what banks look for when assessing loan applications from small business. The project is a partnership between the ABA, CPA Australia and other small business representatives and is expected to make it easier for small businesses to seek finance and improve the quality of applications.

The industry also notes the important role of better aggregated data in SME lending. Last year, the ABA released a joint paper with the Council of Small Business of Australia (**COSBOA**) that provided data on aspects of business lending that were previously not publicly available.

The industry is now building on this work through a Small Business Data Project that aims to improve the available information on small businesses' access to finance. This is being developed in response to a request from the Minister for Small Business. The project aims to identify existing data gaps and determine how best these can be filled. The data will then be used to provide a broader view on the performance of SMEs (including general sector outcomes) and their financing needs.

The Interim Report notes concerns on the use of loan covenants. Importantly, risk is not always adequately catered for through price adjustments. Lending to small business is provided in a range of forms, from simple retail like lending through to more complex individually managed lending. Loan covenants in some cases provide appropriate lender protection. Without these covenants, lenders may simply not be able to extend credit to some customers. Covenants are also an efficient means of managing this risk, without the need for extensive reporting, monitoring and review obligations on the business, which would increase the cost of financing and cause some business disruption. The banking industry already does, and will continue to, seek to ensure customers, including SMEs, understand the agreements they enter into and the implications of any loan covenant.

Prospects for a market for securitised SME loans developing are good in principle. However, current and proposed regulatory settings, including APS 120 *Securitisation*, limit its application, especially for capital relief, which means there is limited opportunity to transfer underlying credit risk and thereby increase lending appetite via securitisation. In any case, securitisation should not change risk appetite of a lender either. It should only free up credit limits to the extent of risk transfer. Having said that, there's been limited development in securitising SME loans in Australia to date, even prior to the GFC, and one of the greatest barriers to securitisation developing in any asset class since the GFC remains lack of investor appetite.

The banking industry believes that increasing the loan-size threshold (from $1m to $1.5m) by which banks distinguish retail from corporate lending is appropriate and will, at the margin, increase SME lending.

3.3. External administration

Policy options:

No change to current arrangements.

Implement the 2012 proposals to reduce the complexity and cost of external administration for SMEs.

The banking industry does not support adopting any new insolvency regime based on the US Chapter 11 approach, for the following reasons:

- Chapter 11 has repeatedly been shown to produce few rehabilitated companies in the long term. It has also been shown to be very expensive and to take an inordinate amount of time to administer (largely due to the US Bankruptcy Court having a substantial role to play at every step of the reorganisation process); and

- The Chapter 11 debtor in possession regime leaves a management in control that is unlikely to have the necessary skill set and/or time to achieve a business turnaround. Furthermore, the regime effectively gives control rights to unsecured creditors. This is at odds with the Australian legal system, which recognises the position of creditors with security.

In considering insolvency law reform generally, the banking industry would:

- Suggest further consideration of a "safe harbour" for directors from insolvent trading laws, where there are attempts by directors to facilitate genuine restructures (for example, by way of a modified business judgment rule). This could be reviewed, for example, by the Australian Law Reform Commission; and

- Support the introduction of some form of limited protection on the operation of *ipso facto* clauses.

Another area of law that could be considered for reform is section 420A of the Corporations Act. Currently, the section places undue focus on the process and discourages a quick sale even though there may be ample evidence that the proposed sale price exceeds market value.

The banking industry agrees with the Inquiry and believes there is little evidence that Australia's external administration regime is the cause of any business failure.

The corporate voluntary administration procedures now in place aim to have a constructive approach to corporate insolvency, for instance, by focusing on the possibility of saving a business, though not necessarily the company itself, and preserving employment prospects. The procedures were designed to be:

- capable of swift implementation;

- as uncomplicated and inexpensive as possible, with minimal court involvement; and

- flexible, providing alternative forms of dealing with the financial affairs of a company.

It is now the most commonly used form of insolvency administration in Australia and by all accounts has been very successful.

The Inquiry should also note that under the Code of Banking Practice, banks have committed to work with customers in difficulty, including small businesses, regarding any credit facility and try to assist, for example, through a repayment program. Banks typically seek to avoid formal insolvency mechanisms and prefer employing "workouts" as a means of rehabilitating a stressed business.

3.4. Bank funding

Basel III

Basel III means banks will need to hold significantly more capital and significantly more assets deemed HQLAs.

Capital is typically the most expensive form of funding. Therefore, holding more capital will ultimately mean a higher cost of funds and pricing/margins will need to rise in order to achieve similar returns. However, the ability of banks to finance long-term loans will remain the same.

As noted by B20[6], once fully implemented, Tier 1 capital will increase 2-6 percentage points; a further 2.5% capital will be required for the capital conservation buffer, 0-2.5% capital for the counter-cyclical buffer and 1-2.5% capital for Systemically Important Financial Institutions. The net impact will be for the minimum capital ratio to increase from 8% to 10.5%, noting that ADIs typically hold more than the minimum amount. In addition, ADIs will need to hold HQLAs for liquidity purposes which mean that, all things being equal, ADIs will have a commensurate amount less available for lending. While the net impact of this depends on the composition of HQLAs held, and therefore the return achieved from those assets, as opposed to lending, the net impact is expected to be for a further increase in the cost of funds.

Superannuation deposits

As detailed in the banking industry's first round submission, significant growth, in excess of system growth, is expected in superannuation funds over the next two decades. This could lead to wholesale deposits from superannuation funds accounting for an increasing share of funding for ADIs. However, assuming the treatment of wholesale superannuation deposits remains as it currently is under APRA and Basel III liquidity requirements, namely assumed to have a 100% runoff rate, there may be reduced demand for superannuation deposits and, in any case, banks will need to source additional funding for the same amount of lending, which will increase costs, rendering the ability of ADIs to write long-term loans more difficult.

The banking industry would like to reiterate that the regulatory runoff rates applied to superannuation deposits be reviewed as a matter of priority and periodically, consistent with the first round submission.[7]

3.5. Growth of the superannuation sector

It is clear that the assets under management of superannuation funds will continue to grow, as the minimum compulsory contribution increases and as assets are accumulated. This may lead to lower levels of consumer

---

[6] B20 Financial Growth Taskforce, June 2014, *Themes coming from the voice of the customer*, http://www.b20australia.info/Documents/%27Voice%20of%20the%20Customer%27.pdf

[7] ABA FSI Submission, March 2014, http://www.bankers.asn.au/FSI/ABA-submissions, page 62

retail deposits. While superannuation funds can be a source of bank funding, this wholesale funding has different characteristics to retail deposits. For example, as wholesale funding can be less 'sticky' compared to retail deposits, this can affect the ability of banks to fund term lending. Equally, an increase in the allocation of superannuation funds to fixed interest products, from their current low levels, would limit the impact of higher levels of superannuation funding.

3.6. Corporate bond market

The banking industry believes the development of annuity-style retirement income investment products will encourage the growth of fixed income markets.

The banking industry also believes enhanced transparency will improve liquidity, including its appeal to retail investors. However, this will not resolve the issue on its own. Other measures need to be taken, as detailed in the banking industry's first round submission.[8]

Alternative credit rating schemes or standards can be developed and may be particularly useful in aiding domestic efforts, including retail distribution. However, it will be challenging for these schemes or standards to be widely accepted, particularly offshore, which would limit significant improvement in investor appetite.

The greatest barriers to such developments are cost, time and lack of certainty regarding market demand and potential use. Clarity of intent and demonstrating a commitment to improving the market, through say the establishment of a national funding strategy, could aid in addressing these barriers.

Policy options:

No change to current arrangements.

Allow listed issuers (already subject to continuous disclosure requirements) to issue 'vanilla' bonds directly to retail investors without the need for a prospectus.

Review the size and scale of corporate 'vanilla' bond offerings that can be made without a prospectus where the offering is limited to 20 people in 12 months up to a value of $2 million, or for offers of up to $10 million with an offer information statement.

The banking industry believes 'no change' to policy is not an option when it comes to improvements that need to be made to the domestic debt capital market. The domestic debt capital market, in which the corporate bond market is an essential component, is widely recognised as being too small. To be optimally placed to support economic growth, this market must become deeper and more liquid. For example, allowing 'vanilla' bonds to be issued without the need for a prospectus would assist in promoting debt capital raisings. The disclosure requirements for 'vanilla' bonds should leverage the existing continuous disclosure regime for listed companies.

The banking industry believes that limiting the offering of bonds to 20 people works against the market becoming deeper and more liquid, as this restriction may at times pose an unnecessarily high limit on the size of the minimum investment required from an individual under a retail offering.[9]

[8] ABA FSI Submission, March 2014, http://www.bankers.asn.au/FSI/ABA-submissions, page 58

[9] $2m - $10m offering would mean a minimum of $100,000 - $500,000 per investor.

The banking industry supports the introduction of new prospectus requirements for retail corporate bonds commenced by the Treasury. However, while assisting, these policy adjustments would only be part of the solution.

The industry would recommend another alternative, one that addresses not only the needs of the corporate bond market, but takes a holistic approach, addressing all the funding needs of the nation, through the coordination and agreement of a national funding strategy, consistent with the banking industry's first round submission. This would make a substantial difference. A national funding strategy would, for example, address, in addition to the needs of the corporate bond market, the needs of the wider domestic debt capital market, including securitisation, covered bonds and sovereign debt, infrastructure funding, funds management including superannuation, venture capital and private equity and peer-to-peer lending. It would address these needs in the context of fully supporting economic activity and growth, improving access to funding and enhancing the efficient operation of markets, while retaining a sound and competitive financial system.

4. Superannuation

After banks, superannuation funds are the second largest component of the finance and insurance industry, in terms of assets, with current assets of $1.9 trillion, forecast to rise to $3.4 trillion by 2028. The security and stability of these funds is critical to not only provide the nation's retirement incomes but also to continue to serve as a major funding source for the growth and stability of the Australian economy.

As outlined in the banking industry's first round submission, superannuation funds, particularly given the expected growth in funds, can facilitate stable economic growth by enabling a diversification of funding sources, and where enabled to match the longer term growth needs of Australia, notably infrastructure projects, can create further growth opportunities.[10]

In light of the current and future funding imperatives to sustain the nation's economic growth and the integral role of superannuation, the banking industry supports the observation made by the Inquiry that superannuation policy settings need to be stable.[11] The banking industry concurs that a lack of stability not only imposes additional cost, but leads to an erosion of long term confidence and trust in the superannuation system. Integral to the efficiency and integrity of the superannuation system is stability. The banking industry strongly supports stability in the superannuation rules to ensure consumers have confidence in the system itself.

The banking industry has addressed the specific issues raised by the Inquiry on the impact of superannuation funds on bank funding composition and costs in Section 3.4 – Bank funding.

The banking industry notes that the Interim Report identifies a range of issues in relation to the efficiency of the superannuation system, including costs, fees and competition, member investment switching, active investment management and lifecycle investment. Underpinning measures to address these issues is the need to ensure that superannuation members make informed investment decisions and have confidence and trust in the superannuation system. The best interests duty for financial advice and the banning of conflicted payments, as adopted in the Future of Financial Advice (**FOFA**) reforms, facilitates the development of consumer trust and confidence in this important decision making process. Furthermore, the banking industry's financial literacy programs promote the importance of individuals managing superannuation and retirement savings as a pathway to achieving financial wellbeing.

These regulatory and industry measures are supported by innovations that have improved the administration and efficiencies of superannuation payments platforms, resulting in enhanced superannuation fund availability, access and security for consumers.

Integral to the efficiency and integrity of the superannuation system is stability. As indicated in Section 7.1 – Regulatory burden, a sample of seven members of the banking industry shows they have spent $1.73 billion on implementation costs for recent regulatory reforms. The banking industry strongly supports stability in the superannuation rules to ensure consumers have confidence in the system itself.

The Interim Report seeks further information as to whether vertical integration in the wealth management and superannuation sectors is reducing competitive pressures and contributing to higher superannuation fees.[12]

[10] ABA FSI Submission, March 2014, http://www.bankers.asn.au/FSI/ABA-submissions, page 61
[11] FSI Interim Report, July 2014, http://fsi.gov.au/publications/interim-report/, page 2-95
[12] *Ibid.*, page 2-115

As outlined in the banking industry's first round submission, there is agreement across the banking industry that markets are currently competitive and the Inquiry should consider proposals to drive more competition, on the merit of the case made for those proposals.[13]

Depending on the commercial strategies and market position, banks have a range of views on the degree of competition and what steps could be taken. These will be addressed through individual bank submissions.

The industry supports targeted reforms to improve governance, transparency and administration in the superannuation sector.

As noted in Section 8 – Retirement income, the banking industry believes that superannuation and retirement income policy needs to become more integrated.

[13] ABA FSI Submission, March 2014, http://www.bankers.asn.au/FSI/ABA-submissions, page 68

5. Stability

The GFC has heightened discussions on the potential stability threats posed by financial (and non-financial) institutions. These discussions have focused on reducing:

- The likelihood of a future financial crisis impacting on the broader economy; and
- The actual impact on the broader economy, including reducing the potential burden on sovereign accounts, that is 'the tax payer', should a financial crisis occur.

As a result, a wide range of new regulatory and legislative measures have been adopted, with additional policy responses continuing to be developed, both domestically and internationally. Reponses have included restructuring regulatory agencies, increasing the quantity, quality and composition of capital held by financial institutions and increasing the degree of regulatory scrutiny. At their core, these responses aim to minimise the chance and severity of a crisis or to 'prevent and protect'.

The optimal policy framework to 'prevent and protect' varies across jurisdictions and time. Key drivers for determining the policy framework include the types of institutions in a jurisdiction and the operations they conduct. It also includes nuances between jurisdictions, such as the level of recourse on home loans and the level of depositor protection. Getting the framework right could help safeguard Australia's economy to produce stable economic returns. Getting the framework wrong could lead to our national competitiveness being reduced, business growth opportunities being missed and our standard of living being eroded. Getting the policy framework right requires the detailed consideration of the entire sector (and economy) and how any change (or package of changes) could impact the sector and the broader economy. It also requires Australian policy makers to consider all measures, and their interrelationships in the Australian context. As a country reliant on overseas investment to grow our economy, Australia must meet internationally agreed standards. This is not the same, however, as adopting any measure merely because others have. Any additional measures should only be adopted where there is evidence that they are appropriate in the Australian setting, and the benefits to Australia outweigh the costs.

It is of course not possible to prevent completely a financial crisis from ever occurring again. Nor is it possible to protect completely the broader economy from the fallout of every possible kind of financial crisis. Financial crises have been occurring for centuries.[14] It is prudent to work to reduce the likelihood and impact of financial crises, but it must be recognised that the sources and causes of disruption change, as do the impacts. As such, any policy framework must be flexible and adaptable.

Furthermore, a strong, healthy, functioning financial system is a well-integrated part of the economy that enables economic growth and prosperity. Any moves to change or limit this relationship will have an impact on the broader economy. As such, policy makers must also be cognisant of this relationship and the trade-offs between stability, growth and innovation when developing the final policy framework for Australia.

[14] A good summary of crises over the past eight centuries is provided by Reinhart, C.M. in his book, *This time is different: Eight Centuries of Financial Folly*.

While there are many aspects to a stable financial system, for the purposes of considering the issues and policy options raised in the Interim Report (relating to banks), stability can be examined on three levels:

1. the economy;
2. the financial system; and
3. banking institutions.

5.1. Strong, flexible and resilient economy

A strong economy is the first condition that needs to be met to ensure a stable financial system.

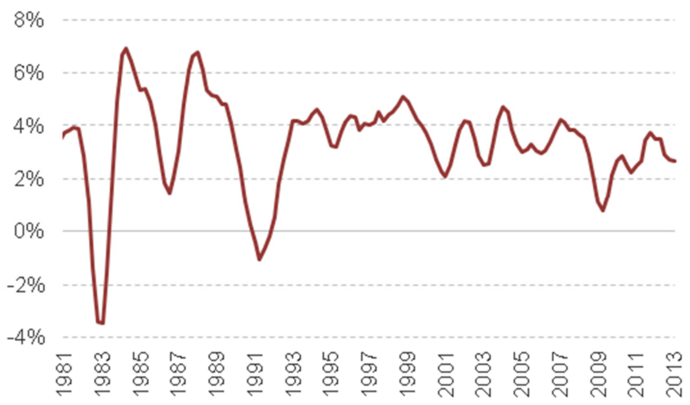
Australia's economy withstood the GFC relatively well. In fact, the Australian economy has performed well through a number of economic disruptions, including the Asian crisis, dot-com crash and the GFC. This success is due to a variety of factors that have helped prevent these disruptions materially impacting Australia – factors that should be considered when formulating possible policy options to help prevent any impact from future financial crises.

Despite this economic success and Australia's strong structural settings, there is no room for complacency. It is prudent to consider if additional preventative layers are required.

Strong economic growth for over two decades

Australia's economy has shown strong resilience to international economic turmoil. It is now more than 23 years since Australia experienced a recession (see Figure 5.1).[15] This strong and sustainable growth has provided Australia's economy with a buffer to help withstand the turmoil stemming from overseas and the capacity to absorb a slowdown in a particular sector of the Australian economy.

Figure 5.1: Australia – economic growth (%annual)



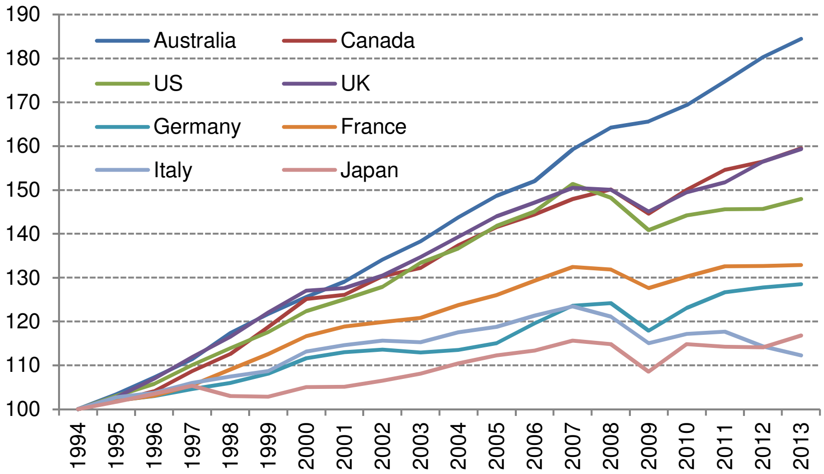
Source: ABS

[15] The last time Australia experienced a recession, i.e. two consecutive quarters of negative growth, was in Q1 and Q2 1991.

This is in contrast to the experience in many overseas economies. The recent economic troubles and destruction of wealth in Europe and the United States are well documented. Considering economic growth over a longer period allows for a fuller appreciation of the success of Australia's economy.

Since 1994, the beginning of the available data series, the Australian economy has grown by almost 85% (see Figure 5.2). This contrasts to the United Kingdom and the United States, which have grown by approximately 60% and 48%, respectively. The contrast is even greater when compared to Germany, Japan and Italy, which have only grown by approximately 28%, 17% and 12%, respectively. Australia's strong growth has helped fuel our increased living standard and Australia's Prime Minister, the Hon. Tony Abbott MP, has gone so far as to state that "stronger economic growth is the key to addressing almost every global problem".[16]

Figure 5.2: Economic growth (Index: 1994 = 100)



Source: OECD

Effective automatic stabilisers

Supporting Australia's strong economic growth is an important set of automatic stabilisers that have helped prevent harm to the Australian economy from exogenous economic shocks. These go beyond the progressive tax system and transfer system and include a number of aspects that are not present in some overseas economies. These automatic stabilisers include:

- *The floating exchange rate*: The lack of an independent currency was a restriction for European Union countries trying to respond to the GFC;
- *High prevalence of variable interest rate borrowings*: Monetary policy adjustments more rapidly flow into the economy where variable rate borrowings are more prevalent. The high proportion of fixed rate loans reduced the ability of some foreign central banks, such as the US Federal Reserve, to respond effectively to changing economic conditions; and

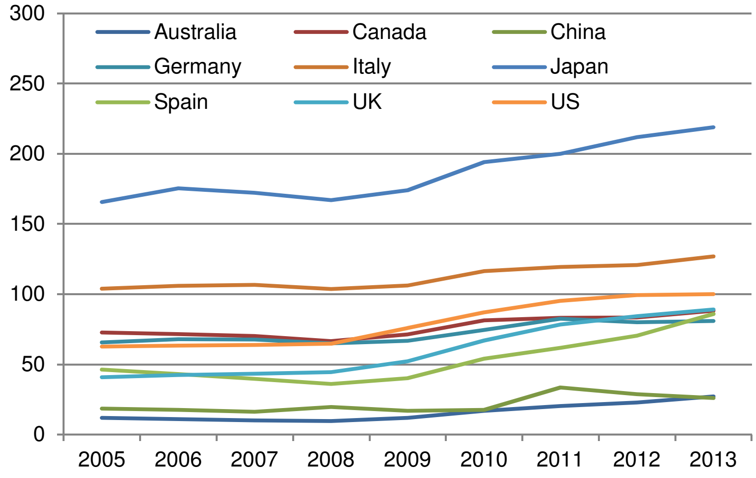
[16] Abbott, A.J., 2014, *Address to the World Economic Forum*, 23 January, Davos, Switzerland.

- *Hedging of offshore funding*: With banks heavily hedging their offshore funding, external shocks (which result in a devaluation of the currency) generally lead to an inflow of liquidity.

Strong fiscal position

Another standout structural element of the Australian economy is the relatively low level of government debt. As at December 2013, Australia's gross national debt level was approximately 27% of GDP (see Figure 5.3). At the same time many countries, including the United States, United Kingdom, Canada, Japan and Germany, had levels of debt over 80% of GDP. These high levels of government debt hampered the ability of those governments to respond effectively to the GFC. In contrast, Australia's low level of government debt has provided it with a range of options and the flexibility to respond to external shocks and to increase government debt without compromising the nation's stability. This highlights the economic importance of governments maintaining fiscal discipline.

Figure 5.3: Gross Government Debt to GDP (%)

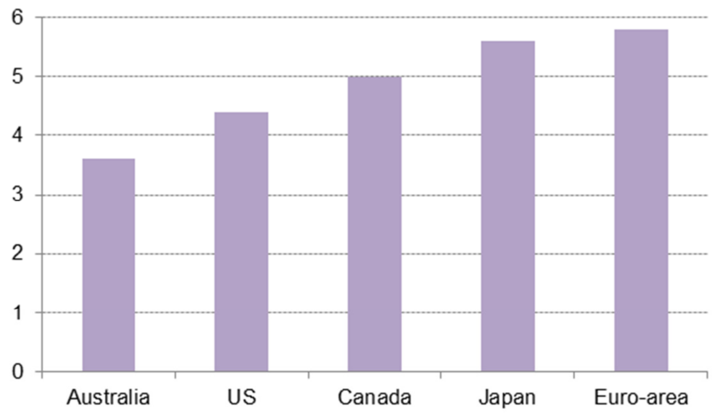


Source: Trading Economics

Appropriately sized financial system

Australia's financial system has been a significant contributor to the Australian economy. The financial sector, for example, paid $47 billion in taxes over the past five years and employs 1.2% of the labour force, or approximately 140,000 people. However, the financial system has not grown to the size seen in some other jurisdictions. In 2013, Australia's financial system was 3.6 times the size of the Australian economy as measured by GDP (see Figure 5.4). By comparison, in the Euro-area the financial system is 5.8 times GDP. Canada, which given its banking system and population provides a good comparison with Australia, has a financial system which is 5.0 times its economy.

Figure 5.4: Financial system assets as a multiple of GDP, 2013



Sources: RBA, Bank of Japan research

Deep superannuation pool

The superannuation industry currently holds assets of $1.9 trillion, with this forecast to rise to $3.4 trillion by 2028. This creates a significant pool of capital that is able to support investment and stability in Australia. Superannuation also provides a pool of savings for individual Australians that can act as a buffer against financial stress.

The starting point then in considering stability in the financial system is to ensure Australia continues to enjoy the benefits of a strong, flexible and resilient economy.

5.2. Sound financial system

Financial systems are inherently complex. They involve many interrelated elements, such as banking, insurance and retirement savings. When considering the financial system, it is important to consider all the individual elements, how they interact and how imposing changes to one element may impact on others. The formation of a policy framework to shape Australia's future financial system should take a whole of sector and whole of economy approach. An example of this is the industry's recommendation for a national funding strategy, discussed in Section 3 - Funding.

A common factor of the financial sector is regulation. Often regulation is developed to target a specific type of institution, activity or product. In many cases, this is appropriate, however, a broader consideration of the sector is important to limit unintended consequences, such as pushing activities into the shadow banking sector.[17] One of the areas the Interim Report focuses on is the capacity of regulators to respond to financial crises – an additional layer of protection for the Australian economy. Finding the right balance of power, flexibility and accountability is important for sustaining the stability of and confidence in, the financial system.

Effective regulation requires regulators that are capable and willing to act, both proactively and reactively. Australia's regulators have proven to be very capable in identifying potential risks and willing to act to mitigate those risks. The banking industry supports moves to strengthen further the ability of the regulators to respond

[17] The industry's thinking in relation to the development of regulation is further explored in Section 7 – Regulatory architecture.

to financial crises, where the new initiatives are appropriate for the Australian context. Ensuring the Australian context is considered properly is vitally important, to avoid inefficient and ineffective (and potentially very burdensome) policies being implemented.

The Interim Report raises a number of options to increase regulators' capacities. Having internationally well regarded regulators adds to the reputation of the financial system, including its institutions. As such, having strong regulators is in the best interest of the nation, the financial sector and financial institutions. The banking industry is broadly supportive of most of the proposals put forward in the Interim Report to improve regulators' capacities. However, the industry does have some concerns with the potential complexities and side effects of some of the proposals.

Resolution powers

Policy options:

No change to current arrangements.

Strengthen regulators' resolution powers for financial institutions.

The banking industry acknowledges the importance of regulators having sufficient powers to achieve their regulatory aims. As noted in the Interim Report,[18] the previous Government consulted on a proposal to strengthen the crisis management powers of APRA[19]. Industry generally supports the aims of the paper *Strengthening APRA's Crisis Management Powers* (**Consultation Paper**) and provided detailed comments on the proposals in December 2012.

The Consultation Paper raised a number of proposals of merit. For example, it discussed powers to protect the domestic financial system against shocks caused by the failure of Australian branches of foreign ADIs. The banking industry supports the proposal of granting APRA greater powers to (at a minimum):

- appoint statutory managers and prevent assets being transferred offshore; and
- wind-up branches if necessary.

However, the banking industry did have (and continues to have) concerns with what it believes to be significant practical and legal issues with some of the proposals (as highlighted in the ABA's detailed response to Treasury in December 2012). Some of the concerns held by industry include:

- The ability to appoint a statutory manager to a solvent non-operating holding company or subsidiary may have very material adverse consequences for solvent entities and hence the financial system. Such a power is unnecessary given other powers available to APRA and may not be effective in assisting the ADI. If such a power were to exist, there should be robust conditions imposed on its application. In fact, appointing a statutory manager to an ADI may lead to, or accelerate, the financial distress that APRA is trying to avoid;

[18] FSI Interim Report, July 2014, http://fsi.gov.au/publications/interim-report/, page 3-13.
[19] The Treasury, September 2012, *Strengthening APRA's Crisis Management Powers*, http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2012/APRA

- The proposals on suspending continuous disclosure have merit. However, there are practical implementation problems that must be addressed, such as the potential civil liability of Boards; and

- Many of the proposals were broadly worded. Without sufficient detail, it is difficult to see how some of these proposals will promote financial stability. It should be recognised that certainty contributes to financial stability and that further detail regarding when and how these powers could be exercised is required, particularly on when APRA's decisions would be reviewable.

If the proposals in the Consultation Paper were to be considered again, the banking industry feels it would be appropriate for a further round of consultation, given outstanding concerns and the various developments that have taken place since December 2012.

Financial Claims Scheme

Policy options:
No change to current arrangements.
Simplify the FCS pre-positioning for implementation is complicated and has been expensive. In particular, the single customer view required per individual, per ADI has practical difficulties.
Introduce an ex-ante fee. Broaden the allowable use of these funds to assist in resolution.

Depositors in Australia are well protected, with many layers of depositor protection, including the Financial Claims Scheme (**FCS**).[20] Due to these multiple layers, Australian depositors are better protected than those in some other jurisdictions. This strong depositor protection also contributes to the stability of Australia's financial system.

Simplification of the FCS

Implementation of the FCS has been, and continues to be, complex. To date, the banking industry has spent over $100 million to implement the FCS, with ongoing costs estimated to be approximately $5.4 million per annum. Much of the complexity has stemmed from aspects of the scheme that add relatively little value to depositors, such as the calculation of fees, charges and interest withholding tax. While these aspects add to a more robust and thorough deposit guarantee scheme, the complexity and cost they impose is considerable, while the value to depositors is minimal. Finding solutions to these complexities continues to consume considerable resources for regulators and industry. The regulatory burden arising from the implementation of the FCS is discussed further in Section 7.1 – Regulatory burden.

To ensure full and functional implementation, the industry continues to engage closely with APRA and remains committed to the implementation of the FCS. To reduce the burden on regulators and industry, the FCS could be simplified to remove some of its complexities, while maintaining the aims and intent of the scheme. Any simplifications would most likely require legislative changes and, for there to be any benefits from them, the changes will need to be expedited.

[20] These layers were detailed in the industry's initial response to the FSI.

The banking industry recommends that Treasury and APRA work with the banking industry, leveraging off the substantial work already completed, to identify aspects of the FCS that can be simplified without compromising the aims of the scheme and that the legislative and regulatory changes required are implemented as soon as possible.

'Funding' the FCS

The Interim Report notes that currently the FCS is post-funded; that is, the costs from the payout of any claims would be recovered from the assets of the failed institution and, if insufficient, a levy could be imposed on the rest of the banking sector. It is also noted in the Interim Report that funding the FCS through an *ex ante* fee would impose costs on the industry that would most likely be borne by depositors, the ultimate beneficiaries of the scheme. It has been argued that this would be in line with the principle of 'user pays', however, depositors today will actually be paying for a benefit received by future depositors due to some unknown, and unlikely, future event.

In the first round submission to the Inquiry, the banking industry argued strongly against implementing an *ex ante* fee for the FCS. The details of the industry's arguments are presented in that submission.[21] In summary, the banking industry believes strongly that before any *ex ante* levy is considered, it would need to be clearly demonstrated that:

- it is based on a sound underlying policy rationale (for the Australian context);
- it is clearly necessary and increases depositor protection; and
- the benefits clearly outweigh the costs.

It remains the view of the banking industry that an *ex ante* fee for the FCS does not satisfy these criteria and should not be implemented.

Mechanism to adjust the prudential perimeter

Policy options: No change to current arrangements. Establish a mechanism, such as designation by the relevant Minister on advice from the RBA or CFR, to adjust the prudential perimeter to apply heightened regulatory and supervisory intensity to institutions or activities that pose systemic risks.

History has shown that threats to financial stability do not always come from institutions and markets within the regulatory framework. The Interim Report discusses this in the context of risks coming from "outside the prudential perimeter".[22]

For the confidence (and stability) of the system, it is important that regulators have the power to react in a timely and appropriate manner to systemic risks, including those from outside the 'prudential perimeter'. The banking industry supports in principle the option highlighted in the Interim Report that a mechanism be

21 ABA FSI Submission, March 2014, http://www.bankers.asn.au/FSI/ABA-submissions, page 98-100.
22 FSI Interim Report, July 2014, http://fsi.gov.au/publications/interim-report/, page 3-28.

developed by which the relevant Minister, on advice from the RBA or Council of Financial Regulators (**CFR**), could designate an institution or activity within the 'prudential perimeter' of APRA. However, in developing such a policy, it is important that there is certainty on the types of institutions and products that could potentially be targeted, the processes that would apply and how it will balance the challenge of timing such a response. For example, it may be inefficient to include institutions or activities in the 'prudential perimeter' prematurely, whereas waiting until a problem has crystallised could result in adding additional burdens at a time when it could be harmful.

In developing a framework for identifying such institutions and activities, it may be appropriate to consider the work that has been, and continues to be, done by the Financial Stability Board (**FSB)**. The FSB has carried out considerable work on identifying systemically important banks, insurers and, more recently, non-bank non-insurer institutions.

Additional macroprudential powers

Policy options: No change to the current arrangements. Introduce specific macroprudential policy tools.

The current set of macroprudential powers available to regulators has proven to be effective – as evidenced by regulators being able to assist the financial industry, and broader economy, to withstand successfully the challenges of the GFC. The banking industry does not see a need for additional macroprudential powers in Australia as:

- The current set of powers has proved to be adequate and effective;
- There is a lack of clear evidence that additional powers would enhance regulators' ability; and
- There are potentially significant difficulties with operationalising some of the macroprudential powers being considered and/or implemented overseas.

5.3. Strong and resilient financial institutions

The GFC highlighted, amongst other challenges, difficulties that can be faced in winding up or restoring financial institutions. These challenges were most acute for highly complex and interconnected institutions. As a result, the international regulatory community has considered, and in some cases implemented, a variety of options to allow for a more informed and more efficient recovery and/or resolution of troubled financial institutions in the future.

In Australia, much has already been done to improve further the strength and resilience of Australia's financial institutions. This includes:

- banks actively strengthening, diversifying and terming out their balance sheets;
- the level and quality of banks' capital increasing in line with Basel III requirements;
- the FCS being introduced; and

- a framework for domestic systemically important banks (including extra capital charge) being implemented.

The Interim Report raises a number of options to strengthen further Australia's financial institutions. Some of these policies, such as stress testing, are supported by the banking industry. Other policy options, such as ring-fencing, would seem less appropriate for the Australian market. Increasing loss absorbency and further implementing recovery and resolution plans may be policy responses for further investigation. However, careful consideration must be given to these options and how they might be combined, due to their potentially significant impact.

Australian banks' capital levels

When assessing if additional measures are required to protect against future financial crises, it is important to consider the current preventative and protective layers already in place, such as those described above. It is also important that the current status of financial institutions is accurately assessed. It is the view of the banking industry that the Interim Report's assessment of Australian banks' capital level is incorrect.

To provide a more accurate assessment of current capital levels, the ABA engaged PwC Australia to measure current levels of capital held by Australia's largest banks in relation to the Basel Committee on Banking Supervision (**BCBS**) Basel Framework and in relation to capital held by banks in other jurisdictions.

That assessment concludes that the Australian banks are well capitalised relative to both the global standards and by comparison with banks regulated in many other jurisdictions and that, on average, the Australian banks are at or above the 75^{th} percentile of bank capital relative to the most appropriate comparator set of global banks.

A copy of the PwC assessment is provided at Appendix A.

Calibration of Australia's prudential framework

Policy options:

No change to the current arrangements.

Maintain the current calibration of Australia's prudential framework.

Calibrate Australia's prudential framework, in aggregate, to be more conservative than the global median. This does not mean that all individual aspects of the framework need to be more conservative.

Adopt an approach to calculating prudential ratios with a minimum of national discretion and calibrate system safety through the setting of headline requirements.

As noted above, the banking industry does not agree with the Interim Report's conclusion that banks' capital levels are around the international median level. Even putting aside the question of the appropriate method for calculating comparable capital ratios, it is commonly held, including by APRA and the Interim Report, that the Basel III requirements implemented in Australia are more conservative than the internationally agreed standards and ahead of the agreed timetable.

Australia is a net importer of capital and there are advantages to being, and being perceived to be, more conservative and safe. However, the costs of that conservative approach need to be considered. It is not appropriate that a more conservative approach be maintained merely because that is how prudential regulation has previously been implemented or because that is the regulator's preference. The degree of conservatism should be adjusted to reflect the risks posed by, and particular circumstances of, the Australian financial sector. The setting of the prudential framework should also take into account the need for economic growth and the nation's risk appetite.[23]

Internationally harmonised capital ratios

Policy options:

No change to current arrangements.

Develop public reporting of regulator-endorsed internationally harmonised capital ratios with the specific objective of improving transparency.

Adopt an approach to calculating prudential ratios with a minimum of national discretion and calibrate system safety through the setting of headline requirements.

To aid transparency and comparability of capital ratios across jurisdictions, the banking industry supports the development of internationally harmonised capital ratios. Currently, APRA and Australian banks are engaged in a project to develop a harmonised capital ratios template that could be used by Australian banks. The template should assist in improving the comparability and transparency of the capital ratios of Australian banks to the Basel standard. APRA should redefine the measurement of capital to reflect the globally consistent Basel definitions and separately identifying the localisation adjustments they make, making all banks responsible for reporting on this basis, to deliver a framework for international comparisons that will enhance trust, particularly for the funding markets that are global.

While this would be a welcome development, the template will not allow direct comparability of the ratios used in other jurisdictions, as the template will not pick up the varying nuances in the way the Basel standards have been implemented internationally. To allow for direct comparability across jurisdictions, an internationally agreed template would need to be developed and implemented.

The banking industry recommends that APRA, through the BCBS, and the Australian Government, through its chair of the Group of 20 (**G20**), push for an internationally agreed harmonised capital ratio template.

The Interim Report also raises the option of implementing a 'layered' prudential capital regime. This is where a 'base' prudential capital ratio, or set of ratios, incorporating a minimum degree of national discretion, is supplemented by a 'headline' requirement. The 'headline' requirement could be adjusted to achieve the desired level of system stability. Such an approach would be in line with the Basel capital framework, which is based on three Pillars:

- Pillar 1: a minimum capital requirement based on risk-weighted assets;
- Pillar 2: regulatory adjustments to the capital minimum; and

[23] The national risk appetite is discussed below in Section 5.7 – Additional stability issues for consideration.

- Pillar 3: which aims to enable market discipline through a range of disclosure requirements.

Currently, APRA's Pillar 1 capital calculations include a number of regulatory adjustments that make it difficult to compare the Pillar 1 capital disclosures of Australian banks to those of offshore banks. Adopting the 'base' plus 'headline' approach could increase the comparability of Australian banks' capital ratios. While this approach has merit, it would require greater change to the current prudential requirements to implement than the development of a harmonised capital ratio template. If such an approach were to be considered further, an analysis of broader impacts and how the 'headline' requirements are calculated should be conducted.

Stress testing

Policy options:

No change to current arrangements.

Australian regulators make greater use of stress testing, with appropriate resourcing.

The banking industry supports stress testing and agrees that it can add to the knowledge and capability of regulators, as well as the knowledge and risk capabilities of financial institutions. While stress testing involves considerable resources from both industry and regulators, further stress tests may provide assistance in identifying and better understanding risks and vulnerabilities to the financial system. To implement this, the banking industry supports regulators having additional resources to allow them to utilise better the data acquired from the current set of stress tests.

Policy options:

No change to current arrangements.

Imposing losses on creditors.

Increase the ability to impose losses on creditors of a financial institution in the event of its failure.

The Interim Report discusses the option of increasing the loss absorbency of banks' debt to protect taxpayers and to impose losses on the private sector should a failure occur. Requiring banks' (senior unsecured) debt to be bail-inable has been raised as one of the possible ways to increase the loss absorbency of banks' debt.

Arguments in favour of bail-inable debt that have been put forward include the relatively large loss absorbing buffer it could provide, while the costs remain contingent on the debt being bailed-in (or the market increasing its view that the debt will be bailed-in). However, there are also potentially significant consequences of such a policy option. For example, requiring debt to be bail-inable for some banks is likely to result in credit rating reassessments for all Australian banks, potentially materially affecting the ability of all the banks to fund themselves. Additionally, the recent actions by rating agencies demonstrate that imposing bail-in requirements would most likely have a negative impact on banks' ratings (and costs of funding).[24]

[24] Recently, Standard & Poor's downgraded its outlook on Canadian banks following the government's release of a consultation paper on bail-in. Additionally, on 10 June, 2014, Standard & Poor's placed seven Austrian banks on CreditWatch negative, following the Austrian Government's proposed legislation to bail-in holders of Hype Group Alpe Adria's subordinated debt.

It has been argued that a global approach to bail-in would mean that, in a relative sense, banks would not be disadvantaged, on the basis that if all banks are equally downgraded, their ratings relative to each other do not change. This overlooks a number of factors:

- Different approaches are being taken to bail-in in different jurisdictions, with some countries adopting contract based approaches and other statutory approaches;
- There will inevitably be a transition period when bank funding will be disrupted, with the length of this transition period dependent on how early a country is seen to be developing bail-in measures – this highlights the need for Australia to proceed cautiously with any consideration of bail-in and is another reason for a comprehensive approach to be taken to developing a national funding strategy, to mitigate the risks; and
- Investors have other investment options than just banks – downgrading the attractiveness of banks compared to other investments will have ongoing implications for the costs of bank funding and hence the rates at which banks can lend for economic activity.

International thinking on loss absorbency options is still being developed. Work continues to be done by the BCBS and the FSB on these policy options. Additionally, the G20 will consider this, and other issues, when it meets in November this year, as part of its focus on building global economic resilience. With the arguments for and against loss absorbency still developing and uncertainty remaining on their potential flow-on effects, the industry recommends that the Government develop any Australian specific response to these issues after the conclusion of G20.

Recovery and resolution

Policy options:

No change to current arrangements.

Invest more in pre-planning and pre-positioning for financial failure.

The BCBS, FSB and a number of international regulatory authorities have completed a significant amount of work regarding recovery and resolution planning. Most of this work has been directed towards Global Systemically Important Financial Institutions. However, a number of jurisdictions have implemented requirements for Domestic Systemically Important Financial Institutions (**D-SIFIs**) to complete recovery and resolution plans.

A number of Australia's banks have already participated in an APRA run 'pilot project' considering recovery and resolution plans. The participating banks have completed comprehensive recovery plans and it is the banking industry's understanding that APRA is currently working on resolution plans. Industry sees considerable usefulness in the development of recovery and resolution plans and supports these plans being further developed and integrated into APRA's regulatory approach.

A related policy option that requires considerable consideration due to its potentially significant impact is pre-planning and pre-positioning. The extent to which these policies are intrusive depends on how they are implemented. For example, if ring-fencing (discussed below) was included in pre-positioning requirements, this would have a material impact on the cost and operation of banks. As such, the banking industry requires more information on the type of pre-planning and pre-positioning being considered before it can consider such a policy.

Ring-fencing

Policy options: No change to current arrangements. Ring-fence critical bank functions, such as retail activities.

One of the drivers internationally towards ring-fencing was the view that 'riskier' activities, such as proprietary trading, should be functionally separated from 'core' banking divisions. In theory, having 'core' banking divisions separate would allow for 'non-core' elements of a bank to be sold off or wound down while the 'core' could be preserved. This approach would seem less appropriate in the Australian context, given the lower level of complexity of Australian banking operations.[25]

As noted in the Interim Report, Australian banks, partly due to the risk appetite of their Boards and senior management, are not as heavily involved in the types of activities targeted by ring-fencing. As such, the potential gains for 'core' banking divisions, and the Australian system more broadly, are noticeably lower than in some foreign jurisdictions. Further, as pointed out by the Interim Report, the costs of ring-fencing can be quite significant. If implemented, ring-fencing could require the legal separation of banks' businesses, and the reconstruction of business activities, as well as risk and reporting systems. Such changes would institutionalise inefficiencies.

It might be suggested that, while Australia's banks have limited involvement in the higher risk activities that are driving the ring-fencing of banks in other jurisdictions, this could change over time and therefore putting ring-fencing in place now would be a prudent measure against banks becoming riskier in future. This ignores, however, the role of APRA in supervising banks closely and adjusting bank prudential requirements if APRA perceives that a bank's risk profile has changed. This is a more effective way to manage risk levels than blunt instruments such as ring-fencing.

To the extent that ring-fencing can assist with the resolution of a failing bank, Australia has adopted the approach of developing 'living wills', plans developed by banks that would be executed by APRA should a bank get into severe difficulty (see Section 4 - Superannuation). This negates any resolution benefits from ring-fencing.

Given the low prevalence of 'riskier' activities and the potentially significant direct and indirect costs, implementing ring-fencing in Australia would be both inefficient and inappropriate. A strong case must be made before any such proposal was considered.

[25] It is important to note, as pointed out by the Interim Report, that there are significant variations in the 'ring-fencing' policies implemented overseas.

Capital requirements

Policy options:
No change to current arrangements.
Further increase capital requirements on financial institutions considered to be systemically important domestically.

The RBA and APRA have both expressed views on the appropriateness of the additional capital requirement for those institutions determined to be D-SIFIs. Given not all ABA members have been determined to be D-SIFIs, an industry response on this issue is more appropriately left to individual bank submissions.

As a general statement on capital, however, in light of the PwC analysis noted above, compelling evidence would need to be produced to suggest that Australian banks do not hold enough capital, either relatively or absolutely, before further measures are considered.

Further, it is important to consider the point at which adding additional layers of capital affects the capacity of the banking system to fund economic growth, as increased capital costs will of necessity be borne by customers.

Corporate governance

Policy options:
No change to current arrangements.
Review prudential requirements on boards to ensure they do not draw boards into operational matters.
Regulators to continue to clarify their expectations on the role of boards.

Boards remain an effective component in the governance of organisations. Traditionally, the oversight role of Boards has been distinct from the management role of senior executives. However, recent moves by APRA have blurred that distinction and evolved the role of Boards more towards that of management. The banking industry and other groups have expressed serious concerns with involving Boards in operational matters. As such, the banking industry would welcome a review of the prudential requirements of Boards across the finance industry to bring them into line with the actual and accepted role of Boards. It would be appropriate, as part of that review, that regulators continue to clarify their expectations on the role of Boards.

5.4. Additional stability issues for consideration

Two issues that the banking industry considers were not sufficiently addressed in the Interim Report but are important to the debate on Australia's financial system are:

- the level of understanding of government support for financial products, services and institutions; and

- the articulation of the Government's view of the acceptable amount of risk in the financial services industry.[26]

These issues are explored below.

Understanding government support

It is important that information on the type and level of government support for financial products, services and institutions is readily accessible to help facilitate good policy development and to allow better informed consumer decisions. Information that would be useful includes details on:

- which financial products, services and institutions receive government support;
- the extent of that support;
- under which circumstances that support is rendered; and
- implications of that support.

The government guarantee on deposits is one example where, anecdotal evidence suggests, public knowledge remains limited. This is despite the FCS being in place since 2008. Without being aware of when their deposits are guaranteed, including the amount guaranteed and at which institutions, consumers are not able to access properly the risk-return trade-off of different investment options.

Another example is government support for a failing institution. There is a perception by some in the community that if a bank in Australia appears to be failing, the Government will step in to shore up the institution and that the Board and senior management will carry on unaffected. This has been cited as one of the drivers for moral hazard – that being the tendency of Boards and senior management to accept greater risks because they feel they will be 'saved' by the Government should the institution face trouble. However, reality would be quite different. It is most likely that in such a case both the Board and senior management would be replaced. If they were found to be negligent in their duties, especially the Board, civil and criminal charges could be laid. This would obviously have an instant negative impact on those individuals (and the organisation). Additionally, it would have a material negative impact on their future employment prospects. It is extremely unlikely that a Board member or senior executive would accept such a large risk merely for the possibility that the institution for which they work could potentially achieve slightly higher returns by taking on additional risk.[27]

These are just two examples where an improved dissemination of information regarding government support of financial products, services and institutions would help facilitate better outcomes, through both more informed consumer decisions and policy development.

[26] The Interim Report briefly mentions the need for the Government to articulate its tolerance for risk in the financial system while discussing Statements of Expectations, on page 3-114 of the Interim Report.

[27] All this of course assumes that the regulator and the market do not notice such actions. It is unlikely that APRA would accept such risk taking. It could also be argued that if the market perceived a financial institution to be taking on excess risk that it would demand a higher risk premium, which in turn would erode the potentially higher returns sought in the first place.

The banking industry recommends the Inquiry support the development of a detailed and accessible information registry on government support in the financial sector. Such a registry could be developed and maintained by Treasury or another suitable government agency.

Defining Australia's economic goals and risk appetite

Driving economic growth is a key goal of the G20. The value of economic growth has also been highlighted by Australia's Prime Minister.[28] It is important that Australia's long stretch of economic growth is not jeopardised by a reaction to foreign problems. It is important that any response is consistent with Australia's broader goals and objectives.

These goals and objectives must be clearly articulated to allow the policy response to align with them. This includes defining Australia's economic goals and its risk appetite, and articulating how much stability is desirable and how much growth and innovation the nation is willing to give up to achieve that stability.

Much of the current debate has been centred on trying to achieve a greater level of stability. While stability is an important goal, by itself, it will not achieve Australia's national goals. An alternative approach, and perhaps a more appropriate approach, is to determine the rate of economic growth (innovation and productivity) the nation wishes to achieve. Once this has been determined, the degree of stability and risk required to generate these economic outcomes can be determined.

Defining the acceptable risk tolerance for the financial industry is an important element in articulating our national goals and in determining how financial risk is allocated and systemic risk is managed (*per* Term of Reference 2.2 for the Inquiry). It could be argued that Australia has a relatively low tolerance for risk in its financial system. For example, the public is not willing to accept the failure of banks and the system's stability is held as paramount. This is in stark contrast to some of our major trading partners, most notably the United States, where 506 Federal Deposit Insurance Corporation (**FDIC**) insured institutions failed between January 2007 and July 2012. In 2010 alone, 157 FDIC insured institutions failed, with 884, or approximately 10%, of the surviving institutions being considered 'vulnerable'.[29]

Risk tolerance is more granular than how many bank failures a society is willing to accept and how much growth and innovation it is willing to forgo in the pursuit of increased stability. Risk tolerance also relates to how much risk individuals are personally able to take on. The United Kingdom, for example, has actively supported and encouraged individuals having direct credit exposure to small businesses.[30] In contrast, peer-to-peer lending in Australia has been subdued and restricted. For example, on Australia's most prominent Australian platform, SocietyOne, participation is limited to 'sophisticated investors' – a small subset of the community.[31]

---

[28] The Prime Minister's views have been presented at a number of fora including his speech, *Address to the World Economic Forum*, delivered in Davos, Switzerland on 23 January, 2014.

[29] Sourced from FDIC and RBA.

[30] For example, over £325 million has been lent to small businesses via Funding Circle (a peer-to-peer lender). Funding Circle has been actively supported by the UK Government, including the commitment (in February 2014) to invest £40 million through Funding Circle, in addition to the £20 million invested from 2012.
Sources: Funding Circle and the UK Department for Business, Innovation and Skills.
It is interesting to note the proposal by the South Australian Government to guarantee $50 million in bank loans to small and medium businesses, announced on 11 August, 2014, which may signal a change in how Australian governments are willing to respond to the challenge of supporting small and medium business growth.

[31] 'Sophisticated investors' is defined by ASIC. Criteria include: being a qualified accountant; having a gross income of $250,000 or more per annum in each of the previous two years or, having net assets of at least $2.5 million. Full details are available on the ASIC website.

To be able to consider robustly the future of Australia's financial system, our economic goals and acceptable risk tolerance must be assessed, evaluated and clearly articulated.[32] If this is not done, policy makers and regulators will not be able to develop an effective policy framework and Australia will have missed an opportunity to shape its future financial system in a way that best fits its expectations and objectives.

[32] This 'acceptable risk tolerance' should influence not only government policy but also the way and extent to which regulators intervene in financial markets.

6. Consumer outcomes

The banking industry strongly supports the Inquiry's recognition of the central role the financial system plays as an enabler of economic growth. Meeting the needs and maintaining the trust of Australians, is central to fulfilling that role.

As noted by the Inquiry, it is through a combination of mechanisms, notably competition, innovation and effective regulatory regimes that the system can continue to deliver these outcomes for Australians.[33]

Critical to the effective operation of the financial system is the need to strike a balance between the allocation of risk to consumers and the providers of financial products and services. An imbalance can create inefficiencies, barriers to innovation in product and service delivery and a cost impost on industry and consumers.

In the banking industry's first round submission, the industry argued that regulation, when done well, can provide real benefits to individuals, regulated entities and society. The banking industry's first round submission also outlined a framework for getting regulation right.[34]

Specifically, the banking industry recognises that improvements can be made to enhance the effectiveness of disclosure, regulate products and improve industry standards, promote the quality, accessibility and affordability of financial advice, build on financial literacy efforts, and raise the professionalism of the financial advice industry. However, any changes should not impose unnecessary barriers to innovation in product and service delivery, must be technology neutral, to accommodate evolving technology and new media, and should not add unnecessary expense for Australians or inhibit the provision of information and advice to customers. The banking industry believes that consumer outcomes and industry efficiencies can be gained through targeted changes to the existing regulatory framework, including self-regulatory and co-regulatory measures.

6.1. Disclosure obligations

The banking industry supports the Inquiry's view that disclosure is important, and recognises that effective disclosure will enable consumers to make informed decisions and consistently purchase financial products and services that meet their needs. It is essential for consumers to understand their banking and financial services, rights, responsibilities and obligations.

While consumers expect simple disclosures, the Financial Services Reform (**FSR**) regime has resulted in complex and detailed regulated disclosures. Prior attempts to adjust the disclosure requirements, shorten documents or provide key information have often resulted in the need to provide separate additional disclosures, as the industry has sought to ensure that the material is comprehensive. Furthermore, many of the disclosure requirements are based on face-to-face delivery models and paper-based disclosures, and have not kept pace with the development of online banking and financial services, new technologies and media, or the expectations of consumers.

The industry has made considerable and continued efforts to improve disclosures and enhance transparency and consumer engagement and acknowledges that further efforts can be made to improve the effectiveness

[33] FSI Interim Report, July 2014, http://fsi.gov.au/publications/interim-report/, page 3-49
[34] ABA FSI Submission, March 2014, http://www.bankers.asn.au/FSI/ABA-submissions, page 93

of disclosure practices. Modernising the disclosure requirements will ensure Australians can receive meaningful information and gain useful communications at times, and in ways, which will assist them to better manage their finances and help them make informed choices about their financial products and services. Technology and new media also offers the opportunity to present and provide information in better ways, which will drive greater customer engagement and can convey information in ways that are more effective than written disclosure.

Consumers have varied interests, and these interests will change depending on their needs and circumstances at the time. It is important for the disclosure requirements to support different consumer interests and needs, and recognise different business models to respond to those interests and needs. Some consumers want to interact with their bank via their local branch during the day. Some consumers want to conduct their banking at a time that is convenient to them via electronic, online or digital channels. Some consumers want to have their banking transactions automated and some want to have their banking and financial services aggregated. Some consumers want to access basic information or advice before they make a decision about a particular product, service or provider, while others want to speak to a financial adviser and have a financial plan prepared for them. Therefore, the regulatory framework for financial services should accommodate all these consumer preferences and support business models and structures designed to fulfil these consumer interests and needs.

Layered disclosure, risk profile disclosure and online comparators

Policy options:

No change to current arrangements.

Improve the current disclosure requirements using mechanisms to enhance consumer understanding, including layered disclosure, risk profile disclosure and online comparators.

The banking industry supports the Interim Report's suggestion that disclosure should only be seen as part of a more flexible framework to inform consumers in their financial decision making.[35] In improving disclosure, the industry believes it is important for government, industry and consumer representatives to be able to work collaboratively to ensure the development of the most effective and efficient disclosure regime.

The Interim Report has asked for feedback on policy options to improve the current disclosure requirements and enhance consumer understanding, including layered disclosure, risk profile disclosure and online comparators.

A layered approach to disclosure accommodates varied consumer interests and needs as well as different levels of understanding. The banking industry believes that a layered approach is currently used, albeit in discrete product situations. This approach could be appropriately applied to other targeted areas.

In retail banking, a layered approach can provide consistent and simple disclosure for basic, retail banking products (Tier 2 products) where consumers are seeking minimal, but sufficient, information and advice. The use of key facts or short form alternative disclosures for simple products is an effective tool for basic, retail banking products and credit products (for example, terms and conditions, interest rate schedules or policy summaries).

35 FSI Interim Report, July 2014, page 3-58. http://fsi.gov.au/publications/interim-report/

In a wealth management context, customers may receive multiple regulated disclosures, (such as pre-contractual, point of sale, and post-contractual disclosures), including a Financial Services Guide (**FSG**), Product Disclosure Statement (**PDS**) and Statement of Advice (**SOA**). Banks and banking groups may also issue information and general advice via marketing materials and reports. The use of short form PDSs provides customers with key product information in simple and easy to read formats.

The existing approach to disclosure gives rise to complaints about the length of disclosure documents. However, it is difficult for banks and banking groups to meet consumer expectations while complying with their legal obligations. The disclosure requirements currently attempt to balance the needs of all consumers, including those seeking more detailed and/or comparative information, rather than focusing on the core information, such as product features, benefits, risks, and fees and charges.

The banking industry believes a layered approach would allow disclosures to be tailored to a retail audience, but utilise incorporation by reference and other referencing for more sophisticated audiences. Specifically, modernising the disclosure requirements will ensure that information can be presented and provided in better ways, and in ways which cater to different customer needs.

Furthermore, as identified in the Interim Report, a layered approach lends itself to integration with technology-based solutions.

Digital technologies, including online and mobile banking channels, and the use of new media (such as, video and interactive avatar), present opportunities for providing regulated disclosures and other communications and further access to other information and advice to customers.

A number of banks are already using technology to provide customer alerts and messages (for example, about security risks, financial hardship assistance options or money management tips). Some banks are also enhancing their products and customer experiences by offering free or low cost services to help customers better manage their accounts, financial products and financial information (for example, budgeting or account aggregation services).

Therefore, the banking industry recommends reviewing the existing disclosure requirements with a view to identifying key information, adopting more pragmatic approaches to incorporation by reference (including clarifying the legal standard of disclosures incorporated), promoting more interactive disclosures that utilise new forms of technology and media, and implementing a layered disclosure approach and better information presentation. Greater use of key facts and short form disclosures, using plain English, graphics and new media, is endorsed by the banking industry.

A review should include consumer testing and research to ensure disclosure is meeting its purpose in terms of content, presentation and format, and in particular, whether improvements can be made to FSGs and PDSs which enhance consumer engagement with these regulated documents. Certain insights from behavioural economics may also be a useful contributor to research into ways to improve regulated disclosures.

However, the banking industry does not support mandating performance ratings or risk indicators. These disclosure approaches are problematic and may have unintended consequences for consumers, in terms of improving the accessibility and understanding of financial products.

The banking industry supports the use of simplified risk profile disclosure in certain situations and acknowledges the recent introduction and use of the MySuper product dashboard in improving a consumer's ability to understand risk. A product dashboard has some merit in this instance, where it is applied to a basic and mandatory product that can be simply and effectively compared across a range of service providers. However, the banking industry is wary of the use of dashboards for products more broadly, where there is the potential for inaccurate and misleading risk assessments and comparisons and the reduction in product innovation and competition. The banking industry strongly recommends the use of key facts or short form disclosures instead of product dashboards, where these documents can be easily translated into similar technology-based approaches.

Similarly, the banking industry is wary of the use of online comparators provided by third party providers. These tools will only support an improvement in a consumer's ability to understand and assess risk where they are based on accurate and relevant data. The use of online comparators needs to be subject to appropriate user disclosures and warnings in order to mitigate any likelihood of detriment to consumers. It is important that online comparators are able to display all relevant material that distinguishes between products and providers to ensure consumers are making an appropriately informed choice.

To assist consumers better understand and compare their products, a number of banks have been redeveloping disclosures on their websites to provide comparison tables about key product information. These comparison tables assist consumers select a product right for them.

The banking industry supports a review of the prospectus requirements. Similarly, modernising the disclosure obligations for prospectuses should enable the use of electronic, online and digital delivery channels. The industry supports the introduction of new prospectus requirements for retail corporate bonds commenced by the Treasury.

Importantly, the banking industry recommends that any changes to disclosure obligations require an appropriate transition period to ensure sufficient time and resources can be allocated to change compliance systems. Any new disclosure requirements should also be aligned with existing security practices and not intervene in banks' and banking groups' security and risk management systems or consumers' protection. For example, simple consumer messages about when and how banks will communicate with their customers should not be undermined, such as those issued to reduce the chances of customers being victims of online scams.

Technology and electronic delivery

Policy options:

No change to current arrangements.

Remove disclosure requirements that have proven ineffective and facilitate new ways of providing information to consumers, including using technology and electronic delivery.

The banking industry supports the Interim Report's observation that the current disclosure regime produces complex and lengthy documents that often do not enhance consumer understanding of financial products and services, and impose significant costs on industry participants.[36]

[36] FSI Interim Report, July 2014, http://fsi.gov.au/publications/interim-report/, page 3-56

The current regime generally takes the view that disclosures need to be provided in writing (paper-based) or are typically provided via face-to-face advice models, despite efforts that have been made to accommodate electronic disclosures. Yet many consumers want to interact with their bank in easy, simple and low cost ways across different banking channels, and increasingly via online banking. As a result, consumers are increasingly seeking and expecting alternative forms of communications and disclosures, including through digital channels and the use of new media. The banking industry considers that it is important for disclosure requirements to be format and technology neutral, and allow consumers to interact with the bank through their preferred channel, or across multiple channels.

Policy developments regarding online disclosure should allow further opportunities for banks and banking groups to develop innovative ways of distributing financial information and general advice. Through innovation there has been an increase in the use of non-traditional media for communicating with customers. It is imperative that the disclosure regime recognises the limitations associated with these forms of social media, notably the restriction in the length through character and word restrictions.

It should also be recognised that financial information and general advice is provided via banks' websites, money management workshops and education seminars, client presentations, marketing documents, brochures and materials, newsletters and market reports and online calculators. This information is generally available to consumers without the need to be a customer of the bank. It therefore would be unreasonable to place additional compliance obligations on such information, putting upward pressure on the cost of banking for all customers.

It is important that there is clarity as to the provision of factual information, general advice and personal advice that reflects consumer demands and interests and the evolution of business models intended to satisfy these demands and interests. The disclosure requirements should not prevent or prescribe 'financial literacy' type information, but encourage innovative information and advisory solutions, especially online information services and automated advice.

Therefore, the banking industry recommends the removal of disclosure requirements that have proven ineffective and the facilitation of new ways of presenting and providing information to consumers, including using technology, forms of new digital and interactive media and electronic delivery. The industry supports the modernising disclosure project commenced by the Treasury. For additional information on the banking industry's position on technology, see Section 9.1 – Technology neutrality.

Financial Literacy

The banking industry strongly supports financial literacy strategies as a vital life skill for all Australians and financial literacy is important in assisting consumers to make informed financial decisions. Improving consumer understanding and outcomes requires both supply and demand side issues to be addressed. Modernising the disclosure requirements will assist in addressing the supply side, while financial literacy is critical to assist in addressing the demand side.

The banking industry invests significantly in financial literacy programs and initiatives, and supports a substantial program of collaboration with community organisations, educators and government agencies.

The ABA's own financial literacy program, *Broadening Financial Understanding*, has been running for over a decade. As a demonstration of the banking industry's ongoing commitment and support of the Government's recently published *National Financial Literacy Strategy 2014-17*[37], the ABA published its revised *Position on Financial Literacy* (the Position). The Position identifies a range of actions for the industry to work on with Government and other stakeholders. Specifically, the Position includes an action about simplifying and modernising disclosure obligations on banks and other financial institutions to provide meaningful information to customers and clients of banks and banking groups, noting that actions on disclosure and financial literacy are complementary. The Position can be found at Appendix B.

The ABA believes that increased consumer participation, consumer engagement and individual consumer confidence is not just a benefit for consumers, but a benefit for the economy. Preparing consumers to make informed decisions and choices is not just good for consumer empowerment, but necessary for consumer wellbeing.

Product design requirements

Policy options:
No change to current arrangements.
Subject product issuers to a range of product design requirements, such as targeted regulation of product features and distribution requirements to promote provision of suitable products to consumers.

As outlined above, the banking industry believes it is important to ensure that the disclosure regime does not impose unnecessary costs and barriers to innovation in product and service delivery as well as in the provision of information and advice to banks' and banking groups' customers. Similar concerns arise with proposals for targeted regulation of product features and distribution requirements and, therefore, the industry does not support such proposals.

The banking industry believes that government, including regulators, should generally not be involved in setting price controls or designing banking and financial products and services. The Interim Report acknowledges that such an approach may stifle innovation and limit competition.[38]

Product design regulation will not address product suitability issues, especially as there are already rules under the FSR, National Consumer Credit Protection (**NCCP**) and FOFA frameworks addressing such issues. Banks and banking groups already have sophisticated compliance systems and appropriate consumer protection frameworks in place. Furthermore, product design is a commercial decision, and regulatory intervention to standardise or overly prescriptive regulation to impose certain product features can create other problems for competitive product offerings and, ultimately, can increase product costs or decrease product offerings for consumers.

The banking industry does not support the position proposed by the Interim Report to shift responsibility for the assessment of the suitability of products to the product issuer. The industry is wary of introducing disclosures that are likely to mislead consumers and that intervene in the role of financial advisers and other intermediaries. For example, risk indicator disclosures applied across all financial products is unlikely to provide a meaningful assessment of the suitability of a product, which will depend on the needs and circumstances of an individual consumer. This approach would suggest the creation of a new 'class' of

[37] http://www.financialliteracy.gov.au/
[38] FSI Interim Report, July 2014, http://fsi.gov.au/publications/interim-report/, page 3-60

products that are subject to additional specific disclosure obligations. Such an approach not only has the potential to create uncertainty, particularly in relation to financial advice and the role of financial advisers, but also creates additional costs for consumers and be contrary to the expectations and needs of consumers.

Additional ASIC powers

Policy options:

No change to current arrangements.

Provide ASIC with additional powers such as (a) product intervention powers to prescribe marketing terminology for complex or more risky products and (b) a power to temporarily ban products where there is significant likelihood of detriment to consumers.

The banking industry endorses an addition to the Australian Securities and Investments Commission's (**ASIC)** powers to temporarily ban products where there is a significant likelihood of detriment to consumers. However, the industry does not support additional ASIC powers for product intervention to prescribe terminology for complex or more risky products or to restrict product features. Such interventions will limit product innovation and inhibit the ability to outline accurately the features of more complex products.

As an alternative, the banking industry supports a review of current market practices and the establishment of commonly understood language, notably for structured products, in consultation with industry and stakeholders. Changes to improve use of language should also involve consumer testing and research to ensure that language adopted by the industry is readily understood and based on principles to assist in improving consumer understanding.

The banking industry also supports ASIC adopting more formalised market-wide surveillance programs. For example, ASIC conducts reviews into certain market and industry practices. The results of these reviews should be the subject of consultation with industry and stakeholders to identify any systemic issues. Where the reviews do not uncover systemic issues, these matters should continue to be addressed via targeted consultation and/or direct action between the regulator and the financial institution or regulated entity.

Default products

Policy options:

No change to current arrangements.

Consider a move towards more default products with simple features and fee structures.

The banking industry does not support a move towards default products. MySuper applies in unique circumstances, where superannuation is mandatory and receives concessional taxation treatment. A broader application to other banking and financial products raises significant issues in terms of consumer choice, product and innovation. Furthermore, default products may not be the most suitable for a consumer, which causes legal confusion with existing obligations under the FSR and NCCP frameworks.

6.2. Financial advice

The banking industry supports the Interim Report's observations that affordable, quality financial advice can bring significant benefits for consumers.[39] Improving standards of financial adviser competence and professionalism, requiring financial advisers to act in the best interests of their clients, and banning conflicted payments goes to improving the quality of advice, quality of customer service, standards in compliance and governance and business efficiencies. The industry is concerned about the quality of advice and ensuring the availability of different forms of financial product advice to meet different consumer interests and needs at different times of their lives.

Financial advice should be accessible and affordable and provided by financial advisers who are part of a trusted profession. Financial services law and professional standards should seek to improve the quality of advice and the professionalism of the financial advice industry. Adviser education and competence is part of a professional framework.

Qualifications - Education and competence

Policy options:

No change to current arrangements.

Raise minimum education and competency standards for personal advice (including particular standards for more complex products or structures, such as SMSFs) and introduce a national examination for financial advisers providing personal advice.

The banking industry strongly supports a review of adviser competencies as part of the Government's announced review of professional standards. The industry has been engaging with ASIC for some time about our concerns with the existing training standards framework, and therefore, it is pleasing this work is being progressed with Treasury and ASIC.

The banking industry supports the policy option to strengthen education and training requirements, raise the minimum education and competency standards for personal advice on Tier 1 products to retail clients and the introduction of a national examination for financial advisers providing personal advice on Tier 1 products to retail clients. Adviser education and competency is part of promoting the financial advice industry as a trusted profession.

The banking industry supports a higher standard of education, qualifications, training and competency for financial advisers providing personal advice on Tier 1 products to retail clients and an integrated framework for all financial services professionals. A national exam, where the core competencies are established by an independent body, is a possible mechanism for establishing a minimum entry qualification standard, raising the existing qualifications for financial advisers, and establishing 'qualifications portability' for the industry. Increasing the minimum education and competency standards for financial advisers providing personal advice on Tier 1 products to retail clients is of benefit to industry and consumers. However, a national exam is only part of the way forward and if pursued in isolation will not deliver the overall objective of moving the industry from today to a new and improved model in the future.

[39] FSI Interim Report, July 2014, http://fsi.gov.au/publications/interim-report/, page 3-63

The banking industry believes that new education, qualifications, training and competency standards should be determined in a holistic manner, rather than considering distinct elements in isolation, and should seek to deliver against a set of policy principles. The design and implementation of a new and improved framework, therefore, provides an opportunity to streamline education and competency requirements across the industry, and in particular, make sure that the regimes administered by the ASIC and the Tax Practitioners Board, as relating to financial advisers who also provide a tax (financial) advice service, are coordinated.

The banking industry strongly endorses the development of a single model that incorporates all of the relevant initial and ongoing education and competency requirements. Specialisations, including advice on certain products, such as self-managed superannuation funds, should be addressed in this context. Importantly, a new framework should seek to improve the accessibility and affordability of financial advice for consumers.

The banking industry supports and agrees that the main elements of new education, qualifications, training, and competency standards should establish a minimum entry qualification standard (learning), practising certificate (evidence of learning), supervision requirement, and continued professional development for financial advisers providing personal advice on Tier 1 products to retail clients. It should also establish appropriate standards of conduct and behaviour for all financial services professionals. The new education, qualifications, training, and competency standards should integrate the existing training and competency requirements for financial advisers providing general advice and financial product advice on Tier 2 products.

Furthermore, the banking industry is of the view that other elements of professionalisation which go beyond education to practice, including establishment of best practices, membership of professional bodies, the role of self-regulation and codes, leadership and mentoring within the industry and other aspects which influence conduct and behaviour are essential.

The banking industry's proposed approach to education and competency standards for financial advisers represents a fundamental change to the existing model and training system, and is an important and necessary change for the industry. As such, it will take time to design, implement and transition the industry. The banking industry is of the view that it is likely to take around five years from agreement for any new model to be implemented and for financial services providers, professional bodies, education institutions and training providers and others to be equipped to deliver the core components within the new model.

Importantly, this co-regulatory approach would build on existing legal obligations and raise the education and competency standards for all financial advisers providing personal advice on Tier 1 products to retail clients and streamline the education and competency standards for all financial services professionals.

Public register

Policy options:

No change to current arrangements.

Introduce an enhanced public register of financial advisers (including employee advisers) which includes a record of each adviser's credentials and current status in the industry, managed either by Government or industry.

The banking industry supports the policy option for the introduction of an enhanced public register of financial advisers (including employee advisers) which includes a record of individual financial adviser's credentials and current status in the industry, managed either by Government or industry.

However, the implementation of a financial adviser register must be a part of a broader move to raise the professionalism of the financial advice industry. A financial adviser register should improve transparency and empower consumers to validate that their financial adviser is licensed, authorised and appropriately qualified and experienced to provide their advisory services.

The main objective of a financial adviser register should be to empower consumers, and the design of the register should reflect this objective, so that the register is user-friendly with quick, simple and easy to use search functionality and data.

The secondary objectives should include the ability for industry to check the credentials and status of a financial adviser (including for recruitment and reference checking purposes) and for the regulator to identify, track and monitor the financial adviser population in Australia. Therefore, the register should include information about individual financial advisers.

The register should allow a consumer to check the credentials and status of a financial adviser authorised to provide personal advice on Tier 1 products to retail clients, including basic and professional data, being current licensee details, adviser licensee/authorised representative employment history (employment history), qualifications and specialisations (including authorisations), and years of experience as a financial adviser, as well as enforcement data, namely banning orders, disqualifications and enforceable undertakings. The register should also be developed so that as efforts are made to raise the professional standards of financial advisers, other relevant data can be added to the register, such as professional memberships, and data to assist improving recruitment and reference checking practices and deal with 'bad apples'.

The register should not be designed to provide a tool for consumers to find, choose or select a financial adviser. The initial design should focus on key, factual information about a financial adviser to assist a consumer validate their financial adviser. There are other online tools, typically offered by industry associations, which provide assistance to consumers wanting to find, choose or select an adviser.

The ABA is currently working with the Government and stakeholders on a proposal to implement a financial adviser register.

ASIC powers to ban individuals

Policy options:

No change to current arrangements.

Enhance ASIC's power to include banning individuals from managing a financial services business.

The banking industry endorses the Interim Report policy option to enhance ASIC's power to include banning individuals from managing a financial services business. The extension of the current enforcement requirements and actions that apply to financial advisers to those managing a financial service business provide an additional mechanism to enhance consumer confidence and trust in the financial advice industry, and the financial services industry more broadly.

Scaled advice

The banking industry supports the Interim Report's observation that comprehensive financial advice can be costly, and there is consumer demand for lower-cost scaled advice.[40] The industry is concerned about the affordability and accessibility of financial advice. The *Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014*, currently before the Parliament, contains a number of important technical amendments, corrections and clarifications, including changes to clarify that a financial adviser can provide 'scaled advice' while meeting their obligation to provide advice that is in the best interests of their client.

Banks and other financial institutions have an important role to play in the delivery of low cost, high quality scaled advice to consumers. Online advice solutions provide significant opportunities to tailor advice to the particular needs of consumers, reduce costs for consumers, and expand the reach of financial advice, especially to regional and rural areas where advice services are typically less available.

The banking industry believes that additional regulatory guidance is needed on the delivery of scaled advice, especially via online functionality. For example, emerging technologies will result in consumers accessing financial information and financial advice in different ways and expecting services to be provided in easier, simpler and faster ways. Regulatory guidance around the concept of 'reasonable investigation' in a scaled advice situation and via electronic, online and digital channels would be useful. Online calculators and other tools should also be considered in this context.

Accessibility

Policy options:

No change to current arrangements.

Rename general advice as 'sales' or 'product information' and mandate that the term 'advice' can only be used in relation to personal advice.

The banking industry acknowledges that general advice is not widely understood to be financial advice by consumers. Therefore, the industry believes there is merit in giving further consideration to different and more appropriate terminology and labels which more closely reflects the true nature of information that is legally termed 'general advice'. Specifically, the industry supports clarification of the financial product advice framework and an examination of terminology and labels as part of the Government's announced review of professional standards.

Importantly, alternative terminology should be more closely assessed before any changes are made to the law. It would be undesirable to make changes that impacted adversely on current compliance systems and caused unintended consequences for access to general advice, such as increased compliance costs. More importantly, consumers should have access to different types of services and forms of financial product advice and understand what service or advice they are getting. Therefore, as part of the review, consumer testing and research should be conducted into understanding consumer perspectives, expectations and engagement so any alternative terminology is appropriate and meaningful for consumers and the industry.

Based on customer surveys and consumer research recently commissioned by the ABA:

---

40 FSI Interim Report, July 2014, http://fsi.gov.au/publications/interim-report/, page 3-63

- Consumers expect to continue to have access to their banking and financial services in easy, simple, free and low cost ways across different channels.

- Consumers want to have access to free, simple and general advice; they do not always want a full financial plan, they do not always want to pay a financial adviser for personal advice, they do not always want a product recommended to them, they just want basic information or general advice about some options.

- Consumers understand the difference between information and advice from a bank teller or bank specialist and personal advice from a financial adviser. However, consumers generally do not understand the real cost of advice and largely underestimate and/or rarely indicate a willingness to pay the full cost.

The banking industry believes that the existing principles-based law underpinning the FSR regime should be maintained, however, further consideration should be given to whether the existing one-size-fits all approach to licensing and the distinctions of financial product advice serve the interests of the industry and consumers.

The definition of financial product advice in section 766B of the Corporations Act sets out two types of advice, being personal advice and general advice.

Banks and banking groups have implemented sophisticated compliance systems reflecting these legal distinctions and have adopted different business models to provide products and services to their customers, including financial product advice. Some banks have developed businesses across a wide range of financial products and services. Some banks have targeted product offerings and specialised services. Some banks offer their products and services online only. Some banks operate a community bank or mutual bank model. No matter what the business model, banks and banking groups must comply with their legal obligations, adhere to industry codes and standards, and act in a way their customers want and expect.

Additionally, the FOFA reforms and the introduction of the best interests duty and the ban on conflicted payments have been substantial and have, and will, fundamentally change the industry. Banks and banking groups have made significant investments to change certain financial advice distribution and remuneration practices and introduce new compliance systems to comply with the new FOFA provisions, including changes to the way their employee financial advisers and other financial advisers, including authorised representatives, interact with their clients, record their advice, provide these records to their clients, and are paid for the provision of their services.

The prevailing business operating model adopted across the industry, not just by banks and banking groups, is a value proposition for consumers and allows financial institutions to better manage business, operational and compliance risk. Bank customers and retail clients specifically seek these full service models to ensure their banking, insurance and investment needs are met by the group. Additionally, this business model drives down product and service costs, including financial product advice, for the benefit of consumers.

The important factor with any business model is that the licensee(s) within the group maintain compliance systems and processes that support the group meeting their legal and regulatory obligations and requirements and provide products and services to respond to consumer interests and needs. For example, bank staff must meet the modified best interests duty (for basic banking products and general insurance products) and the best interests duty (for all other financial products, including consumer credit insurance), just like any other financial adviser.

Personal advice

'Personal advice' is defined to include "financial product advice that is given or directed to a person (including by electronic means) in circumstances where the advice provider has considered one or more of the person's objectives, financial situation and needs (otherwise than for the purposes of compliance with the Anti-Money Laundering and Counter-Terrorism Financing Act 2006 or associated regulations and rules) or a reasonable person might expect the advice provider to have considered one or more of those matters."[41]

Personal advice can be provided on Tier 2 products and Tier 1 products.

Tier 2 products

'Tier 2 products' include basic banking products[42], general insurance products, and consumer credit insurance. Some banks provide personal advice on these simple, well understood products, whereas some banks provide general advice or factual information only.

The banking industry believes that the treatment of basic, retail banking products in the law should reflect the fact that:

- These products are simple and well understood;
- The advice situations associated with the offer of these products is simple and straightforward;
- The banks and other financial institutions providing these products already have sophisticated compliance systems and appropriate consumer protection frameworks;
- The expectations of consumers when interacting with their bank and seeking information and advice on these products is they can do so with ease and in ways convenient to them; and
- There has not been any evidence of a market failure in the offer of banking products and services by bank staff.

Bank tellers and bank specialists must be trained and competent to provide personal advice on Tier 2 products as well as meet the customer service standards, legal and compliance requirements of their business. The law recognises that Tier 2 products are simple and well understood, and therefore, reduced conduct and disclosure obligations apply. The regulated disclosure requirements are less than those applied to more complex financial products, such as investment products. The regulated conduct and training standards are less than those applied to financial advisers.

For example, if personal advice is provided on these products, a SOA does not need to be prepared. The modified best interests duty applies (with the exception of consumer credit insurance) and the training requirements are different. This approach is sensible and acknowledges that consumers do not expect these

41 Section 766B of the Corporations Act.

42 Section 961F of the Corporations Act sets out that a 'basic banking product' includes basic deposit products, non-cash payment facilities, first home saver accounts, travellers cheques, and any other product defined by regulations. The FOFA amendments clarify that 'functionally equivalent products' are included, such as a travel money card being similar to a travellers cheque.

disclosures in these simple advice situations. Similarly, it acknowledges that consumers do not want the compliance costs associated with more burdensome conduct obligations to result in higher products costs.

The banking industry believes that consumers should be able to continue to conduct their banking and financial services in the ways they want and expect and to have access to different forms of financial product advice to suit their needs. Consumer expectations when interacting with their bank and seeking information and advice on these products is that they can do so with ease and in ways convenient to them.

Tier 1 products

'Tier 1 products' are all other financial products, for example, managed investments, shares and superannuation. Some banks and banking groups offer Tier 1 products, whereas other banks do not. Those banks that offer Tier 1 products either provide personal advice following a full fact-find and preparation of a full financial plan, or more limited personal advice (being 'scaled advice'), or general advice. Many consumers are seeking advice tailored to their particular immediate needs or about certain classes of products.

Bank financial advisers must be trained and competent to provide personal advice on Tier 1 products (and typically Tier 2 products as well). The regulated training standards for financial advisers include general and specialised knowledge components, relevant to the types of financial products upon which they provide advice. The regulated disclosure requirements include, broadly, a FSG (information about the financial services business), a PDS (information about the financial product), and preparation of a SOA (record of the advice provided and recommendations made to the retail client by the adviser).

General advice

All other financial product advice[43] is known as 'general advice'. General advice does not take into account a consumer's personal circumstances or needs and must be accompanied by a general advice warning, either verbally or written, depending on how the advice is provided.

Banks provide general advice across their banking channels and across different service models, not just by bank staff through face-to-face channels (including one-to-one conversations, scripted client assistance, etc). Financial information and general advice might be provided via banks' websites, money management workshops and educational seminars, client presentations, marketing documents, brochures and materials, newsletters and market reports or online calculators.

Consumers can access general advice for free via various banking channels, including technology and online media, and not even speak to any bank staff. Consumers do not even need to be a customer of the bank.

Advice terminology and labels

Both general advice and personal advice are important for consumers. The industry agrees that it is important for consumers to be able to access readily the financial information and financial product advice they want, and to also better understand what they are getting; whether that is factual information, general advice or personal advice. The industry also acknowledges that general advice is not widely understood to be financial advice by consumers.

---

[43] Section 766B(1) of the Corporations Act sets out that financial product advice is a recommendation or a statement of opinion, or a report of either of those things, that is intended to influence a person or persons in making a decision in relation to a particular financial product or class of financial products, or an interest in a particular financial product or class of financial products; or could reasonably be regarded as being intended to have such an influence.

The banking industry believes that most consumers will identify financial advice as the service provided by a financial adviser providing personal advice on Tier 1 products. General advice is not the same as personal advice and it goes beyond merely factual information. For this reason, the industry agrees that clearer distinctions from a consumer perspective may be warranted, particularly in the area of general advice, and to ensure that terminology more closely reflects the information and advice provided. It is important that there is transparency around financial advice and that consumers better understand what they are getting.

However, changing the legal term and renaming general advice to ‘sales’ or ‘product information’ may be problematic for a number of reasons. For example, such a change could suggest that general advice is only about the sale of a financial product. As noted, general advice is not always related to a financial product and is not always provided by an individual. Additionally, general advice can be provided about financial products or not, such as financial strategies. General advice can be provided via a bank’s website, and whether a sale is the consequence of a consumer accessing this advice indirectly is unknown. General advice is also helpful in raising levels of financial literacy. Therefore, to rename ‘general advice’ by reference to sales in these instances may not be clear and could be misrepresenting the advice provided to a consumer. Furthermore, changing the legal term without making sure it is appropriate and meaningful for consumers and the industry could merely result in additional compliance costs. It is important to ensure that any alternative terminology improves consumer awareness, understanding and engagement.

Therefore, the banking industry proposes an approach to clarifying the type of service and associated standards and to establishing a uniform approach and terminology across the industry. Appropriate standards for roles within the industry should include the associated conduct, disclosure, education, qualifications, training and competency, supervision and monitoring, continuing professional development, and ethics and best practices.

In this context, the banking industry also supports consideration of certain concepts, legal terms and obligations, including:

- ‘Financial planner’ and ‘financial adviser’ and more clearly linking the term ‘financial adviser’ with the provision of personal advice;
- ‘Independent’ as defined in section 923A of the Corporations Act; and
- Certain disclosures and warnings, including a FSG and general advice warning in terms of content and prominence, respectively.

Taken together, this approach would more clearly separate personal advice from other forms of information and advice (factual information and general advice) and clarify the type of service or advice provided to consumers. The underpinning education and competence standards relevant to the provision of personal advice on Tier 1 products would ensure that consumers have confidence that the financial adviser is licensed, authorised and qualified to hold themselves out as being a financial adviser and to provide personal advice to them.

The banking industry also believes that the ‘retail/wholesale distinction’ test in the law should be reviewed to ensure that it remains relevant. This legal test is fundamental to the way in which the FSR regime applies and underpins the consumer protections afforded in the law to retail clients.

6.3. Access credit

The banking industry believes further consideration should be given to the provision of micro-finance for disadvantaged and marginalised consumers. Banks and other mainstream lenders are subject to responsible lending obligations under the NCCP framework. In many instances, although not all, consumers who seek small amount credit and access loans from payday or fringe lenders do so because they are unable to meet the lending standards of a bank or other mainstream lender and in particular, through demonstrating a capacity to repay and service a loan.

The banking industry does not support mandating small amount lending from banks, while noting a number of banks voluntarily support micro-finance products, micro-enterprise loans and matched savings programs to assist disadvantaged and marginalised consumers. The role of government, community organisations and banks and other financial institutions in addressing financial exclusion should be examined. The findings of the Government's Community Development Financial Institution pilot and research conducted by banks about their programs would be useful in this context.

6.4. Consumer loss and compensation

Policy options:

No change to current arrangements.

Amend the existing, regulatory framework for managed investment schemes.

The banking industry does not support the implementation of a last resort compensation scheme for financial services. The industry supports the proposals to amend the existing regulatory framework for managed investment schemes. Specifically, it supports the recommendations proposed by the Corporations and Markets Advisory Committee to:

- Change the 'trustee like' obligations of responsible entities;
- Review the structural requirements of managed investment schemes;
- Prohibit the common enterprise schemes;
- Amend the definition of what can be called a liquid asset;
- Clarify what is meant by 'scheme property' and how the client money provisions are applied to monies held by responsible entities; and
- Improve the external administration framework for failed managed investment schemes.

6.5. Product rationalisation

Policy options:

No change to current arrangements.

Government to renew consideration of 2009 proposals on product rationalisation of legacy products.

The banking industry endorses the policy option to renew consideration of the 2009 proposals on product rationalisation of legacy products. There is currently no mechanism to manage effectively products that have, or will, become legacy products. A framework is required that would include managed funds, life insurance products and retail banking products, such as the First Home Saver Account.

6.6. Other – self regulation

The banking industry believes that self-regulation is an integral component of the consumer protection framework.

The industry's Code of Banking Practice[44] sets the standards for fairness, transparency, behaviour and accountability that customers can expect from their banks and gives customers additional rights, on top of those in the law. It also provides straightforward ways for customers to complain if they feel their bank has not met its Code obligations supported by an independent body, the Code Compliance Monitoring Committee.

The Code is contractually binding on subscribing banks and sets out the minimum standards banks have agreed to follow when dealing with personal and small business customers.

[44] http://www.bankers.asn.au/Industry-Standards/ABAs-Code-of-Banking-Practice

This page is intentionally blank.

7. Regulatory architecture

The current regulatory architecture has served Australia well and allowed regulators to support the economy in withstanding the GFC. However, opportunities exist to improve the regulatory architecture to reduce regulatory burdens and to improve regulatory coordination. As detailed below, the banking industry recommends, *inter alia*, that:

- Regulators' mandates are adjusted to include explicit consideration of economic growth;
- The Inquiry investigates the process of regulation development;
- If budgetary independence is granted to regulators, clear guidance and accountability measures are put into place; and
- A root and branch review of data collection processes is needed.

7.1. Regulatory burden

The Interim Report asked if there is evidence to support conclusions that the regulatory burden in Australia is relatively high. In *The Global Competitiveness Report 2013-14*, published by the World Economic Forum, Australia ranks 128th out of 148 countries for "Burden of government regulation".

The report finds "The quality of Australia's public institutions is excellent except when it comes to the burden of government regulation, where the country ranks a poor 128th. Indeed, the business community cites labour regulations and bureaucratic red tape as being, respectively, the first and second most problematic factor for doing business in their country."[45]

An Australian Bureau of Statistics (**ABS**) survey titled *Selected Characteristics of Australian Businesses, 2011-12*, supported this conclusion.[46] The most frequently reported barrier by the finance and insurance industry to general business activities and performance was "government regulation and compliance". Of the respondents, 27% identified this as a barrier, which was more frequent than any other barrier cited by any other industry.

The banking industry has analysed the cost of implementing a select range of new regulation. A survey was conducted within the banking industry to arrive at estimates of the implementation costs (project expenditure or popex) and first year operational costs (opex) associated with eight pieces of regulation. It covered the cost of compliance, rather than the cost of the impact on the flow of funds to customers. Seven Australian banks participated,[47] which included all four major banks and the three main regional banks.

It should be noted that this project was not completed to focus on the need for regulation, but rather to look at the cost of implementing that regulation and identify opportunities where it may be carried out more efficiently. Poor regulation processes lead to excessive costs when implementing regulatory change. This invariably adds to the cost of living for all in Australia, even if there are well-recognised benefits from the final regulation.

[45] World Economic Forum, 2013, *The Global Competitiveness Report, 2013-2014,* http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2013-14.pdf, page 31

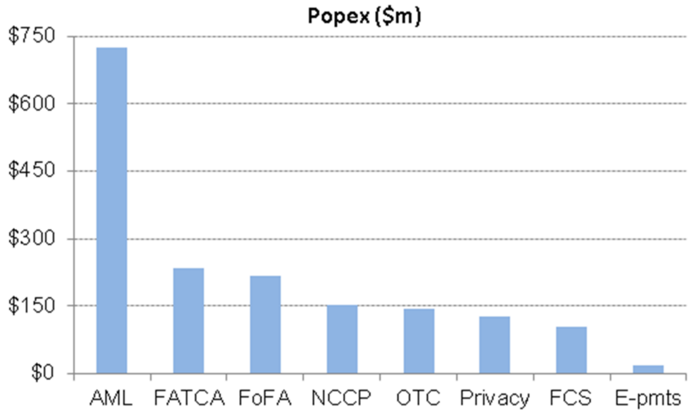
[46] ABS, September 2013, *Selected Characteristics of Australian Businesses, 2011-12*, http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/8167.02011-12?OpenDocument

[47] Australia and New Zealand Banking Group Limited, Bank of Queensland, Bendigo and Adelaide, Commonwealth Bank of Australia, National Australia Bank, Suncorp and Westpac.

The regulation covered in the survey related to eight recent projects: Foreign Account Tax Compliance Act (**FATCA**), FOFA reforms, anti-money laundering (**AML**) from 2005-06, privacy (including credit reporting), e-payments, the FCS, OTC derivatives reform and the NCCP framework.

The survey showed that the seven banks have allocated $1.73 billion for implementation (popex) of the eight selected projects since these projects commenced, with AML contributing the most significant cost at $725 million. The second highest overall expenditure was on FATCA at $234 million. The high price tags of these two projects reflect the need for substantial information technology (**IT**) system changes as well as the development of new skills and operations to implement the new regulation.

Figure 7.1: Implementation Costs (popex) ($m)[48]



Source: Selected ABA banks

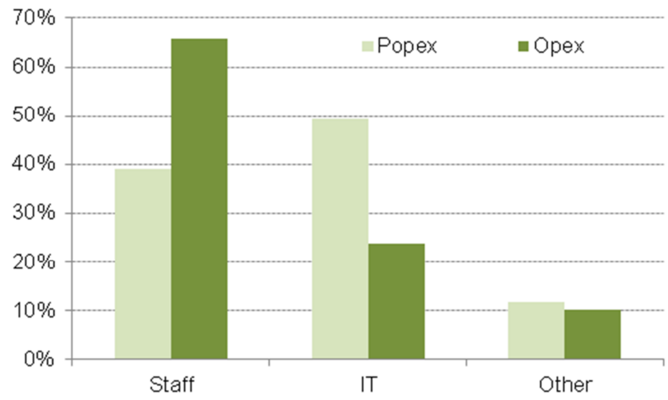
This pattern was similar for large and small banks, with each of these projects absorbing significant resources and expenditure. The lesser impact of FATCA on the smaller banks can be explained by their greater domestic focus. This was the only variation in the sequence of size of spend between the large and small banks.

Information technology costs accounted for the highest proportion of popex expenditure for the banks, being $849 million or 49.2% of the total expenditure recorded by this survey. Staff costs were $672 million or 38.9% and other costs made up the remaining $204 million or 11.8% of total implementation costs for the eight selected projects. While these values only pertain to the selected regulatory examples, they do illustrate the high costs of system changes. As would be anticipated, staffing constitutes the major cost once a project has been implemented. Aggregating the data shows that 66% of the opex spend is on staffing, 24% on IT and 10% on “other”.

A comparison of implementation and operational costs shows that regulatory change is a larger expense than ongoing compliance, which in itself is expensive. The first year of operation of a regulatory project, on average, costs less than a tenth of the implementation cost (although implementation may well run for more than a year, as it has in AML). This would be the case for any change: both removing current regulatory provisions or adding new ones.

48 Costs conservatively estimated.

Figure 7.2: Distribution of Implementation Costs (popex) and First Year Operations Costs (opex) ($m)[49]



Sources: ABS; APM; CBA/HIA; RBA; REIA; RP Data-Rismark

Factors that increase implementation costs

The primary factors which increase implementation costs were identified as poor timing of commencement, lack of coordination, inadequate consultation and overly prescriptive legislation.

Examples of timing problems include lack of clarity on the required date of compliance; change of compliance date; unrealistic timelines for compliance; and, too narrow a window between a regulator's decision on an application for regulatory relief and the compliance date of new regulation.

Lack of coordination is a complex problem. Regulatory changes need to be consistent with the existing stock of regulation, too many changes within a year can over-burden industry, yet failure to bunch like-changes can expand costs unnecessarily.

Inadequate consultation can also add to implementation costs and less effective regulatory solutions. This could include failure to extract sufficient information from industry, or to give that information sufficient weight. Effective consultation takes time and giving banks short timeframes in which to respond to proposed new rules will typically jeopardise the quality of their response. Conducting consultation during resource constrained periods (late November-January and the end of financial year, when resources are shifted into critical system and compliance functions) can add to implementation costs.

Finally, overly prescriptive legalisation, often as a result of lack of consultation, adds to cost and complicates delivery as it makes no allowance for variations in process and systems capabilities between banks.

As noted in the Interim Report, smaller banks face a higher relative burden where implementation involves fixed costs. Large banks also face a higher absolute regulatory burden given the diversity and size of their businesses.

There are a number of examples that illustrate these issues which may be of benefit to the Inquiry.

[49] Costs conservatively estimated.

Implementing the Foreign Account Tax Compliance Act

The implementation of FATCA is an illustration of moving deadlines and a lack of coordination. Timelines for implementation were first established by US regulation sitting under FATCA, and then adjusted with Internal Revenue Service (**IRS**) notices as various jurisdictions advised they could not meet the timelines. International commitments by the US meant that an extension for one jurisdiction was an extension for all jurisdictions, adding to the mobility and uncertainty of the timelines.

One of the challenges with the implementation in Australia was that the Australian Taxation Office (**ATO**) delayed giving guidance on how FATCA would operate in Australia until the enactment of domestic legislation implementing the signed Intergovernmental Agreement (**IGA**) between the United States and Australia. A decision was required of the banks well before this date on whether they register directly with the US IRS to avoid withholding tax, or wait until an IGA would be signed and enacted in which case the data would be provided to the ATO. Banks were required to implement systems without knowing how the law would be applied. Industry sought regulatory relief, but this was not provided in sufficient time for it to be of any use. The delay meant that industry had to manage the risk of the relief not being granted, and thus aim to meet the established deadlines.

The forthcoming Compliance Reporting Standards (**CRS**), under development by the Organisation for Economic Co-operation and Development (**OECD)** at the request of G20 and G8, add significant additional costs on top of FATCA compliance costs. The CRS will establish similar (but not identical) requirements to FATCA, but these obligations will apply multilaterally, not just in relation to the United States. Implementing the CRS will involve opening up the same IT systems to make very similar changes to those required under FATCA. There is limited capacity to leverage existing FATCA systems.

Implementing the Financial Claims Scheme

The implementation of the regulation to give effect to the FCS is an example of a multitude of issues that the industry has been grappling with in regards to regulatory reform. It illustrates the need for better coordination between government and regulators, longer lead times for implementation of requirements once the legislation and regulatory guidance has been made final, and a greater understanding on the side of the regulators of the commercial impacts of change.

The process of implementing required legislation, including Prudential Standard APS 910, commenced in January 2010. The industry responded to the consultation period, and after a number of discussion papers and responses, draft APS 910 was released and came into effect on 1 January 2012. Transition arrangements were established with compliance for the Single Customer View aspects of APS 910 due by 1 January, 2014 and all other requirements (such as payments, reporting and communication) by 1 July, 2014. APS 910 included the option for ADIs to apply (in writing) for extended transition relief to APRA.

During the industry transition period, a number of issues were highlighted, including uncertainty around coverage of accounts in foreign branches, and the impact on credit cards, prepaid cards, overdrawn accounts, trust accounts and multi-currency accounts. In November 2012, APRA published a consultation package which was followed by an APRA-run workshop on 6 December, 2012. A summary note on the workshop was produced on 21 December after which banks were given an unrealistic deadline of 18 working days to respond over the December holiday period; a time of year when subject matter experts were unavailable.

ADIs continued to work on FCS implementation well into the industry transition period, however, many outstanding questions remained unanswered. These included the impact on cleared and uncleared funds, end-of-day balance calculations, coverage and other technical clarifications, all of which were outstanding leading up to the release of a revised APS 910 on 30 June, 2013. The uncertainty around final requirements significantly impacted projects across many banks and led to many assumptions being adopted across the industry.

In October 2013, APRA issued a letter to all ADIs confirming that the expectation was to generate a Single Customer View of deposits within 48 hours after end-of-day. This was after feedback from industry that this would not be achievable in all circumstances, given the operation of payment systems. While this issue has now been resolved through the issuance of industry guidance, it did highlight the need for a greater commercial understanding of banking systems and adequate consultation prior to the release of final requirements.

Industry appreciates the recent efforts by the regulators to enable solutions to be finalised to ensure compliance with APS 910, however, the FCS experience highlighted a number of issues. Going forward, there needs to be longer lead times between the release of final requirements, a greater understanding of the commercial impacts of change prior to the issuance of final standards and greater coordination between the government and regulators when implementing change.

Achieving better regulation

The banking industry outlined solutions in its first round submission to the Inquiry.[50] Many, but not all of these solutions have been canvassed in the Interim Report. To reiterate, we urge the Inquiry to review the following options:

- Factoring the impact of regulation on economic growth into all decisions by regulators;
- Improving preparation of Regulatory Impact Statements (**RIS**);
- Making greater use of Statements of Intent (**SOI**) and Statements of Expectations (**SOE**) to better identify and substantiate the problem, demonstrate that existing regulation is insufficient, and to determine if regulation is the most effective means of addressing the problem.
- Granting a stronger mandate to the CFR to coordinate efforts between regulators as well as maintain a focus on economic growth;
- Including Government and Parliament in the consideration process for major regulatory changes such as Basel III;
- Conducting Post Implementation Review (**PIR**) processes for all regulation with a major impact; and
- Placing the national interest at the forefront of all regulatory decisions.

RISs need to more comprehensively examine the benefits and costs of regulatory reform. The banking industry in its first round submission submitted that “Despite repeated criticism of poor compliance with RIS

50 ABA FSI Submission, March 2014, http://www.bankers.asn.au/FSI/ABA-submissions, page 103

requirements, and commitments by governments to improve that performance, major pieces of legislation continue to be passed without a RIS being completed."[51]

Frequently, where costs of reform are cited in a RIS, they are inadequate. For instance, the costs cited in relation to ASIC's OTC derivatives reporting regime are a fraction of those actually incurred by impacted reporting entities.[52] One RIS cites industry submissions on the likely costs of the proposed regulation (in the tens of millions of dollars), but the regulator nevertheless concluded that the regulatory intervention proposed will save industry money.[53] In some RISs there is no quantification of the costs of reform. Instead, statements such as "it is difficult to estimate the costs of compliance…" are included.[54] The banking industry supports all measures to improve the regulatory process, including better assessment of impacts of regulation.

Data collection

The Inquiry has asked if data collection could be improved. As part of the Government's deregulation agenda, work has commenced between regulators and industry on identifying opportunities to improve the data collection process. While efforts by the regulators are greatly appreciated by the industry, it has become apparent that there is an opportunity for a more comprehensive approach to the topic. The banking industry recommends a root and branch review of the reporting frameworks, with the CFR overseeing the effort. The work should be scoped by the regulators, as primary users of the data.

Issues identified to date include:

- Legacy reporting of data which does not serve a clear prudential purpose. Experience from previous reviews has shown a reluctance of government agencies to discontinue data series as they are (or could be) of "some value", despite costs to industry.

- Duplicated reporting of data. This also includes data series which are slightly different, but for no material reason. While some regulators are of the belief that retrieving the data a second time is a sunk cost, effort is required.

- A lack of coordination of data requests and alignment across regulators and agencies. Addressing this would minimise the frequency of data requests and the occurrence of multiple requests in different formats.

- A lack of alignment of data requests with contemporary business models, including modern accounting and trading systems, which results in industry having to create new compliance systems and processes merely to satisfy data requests.

- Data requests without a clear statement of purpose. This makes it difficult for ADIs to correctly identify and source the information sought. Time can be wasted seeking clarification.

51 ABA FSI Submission, March 2014, http://www.bankers.asn.au/FSI/ABA-submissions, page 103

52 ASIC, July 2013, Regulation Impact Statement, *G20 OTC derivatives transaction reporting regime*, http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ris-G20-OTC-derivatives-transaction-reporting-regime.pdf/$file/ris-A-OTC-derivatives-transaction-reporting-regime.pdf

53 ASIC, December 2012, Regulation Impact Statement, *Future of Financial Advice: Best interests duty and related obligations*, https://ris.govspace.gov.au/files/2012/12/best-interests-duty.pdf

54 Australian Government, Regulation Impact Statement, *National Consumer Credit Protection Bill 2009*, Explanatory Memorandum, Part 3, paragraphs 10.106 to 10.122, http://www.comlaw.gov.au/Details/C2009B00148/Explanatory%20Memorandum/Text

- Tight reporting timeframes. The reporting timeframes are unduly short when considering the granularity of the information often required. A review of the reporting timeframes to determine which can be extended would be desirable.

- A growing number of hard copy requests. Some regulators have started requesting material for review to be provided in hard copy, along with electronic versions. This is both costly and raises security issues.

- Too many *ad hoc* information requests. More background information on the request and the benefit of the information provision would assist the banks in compiling fit-for-purpose information.

Two examples of opportunities to improve data collection processes are included here for illustrative purposes.

Parent entity accounts

Amendments were made to the *Corporations Act 2001* to allow companies to cease preparing audited financial statements for parent companies of a consolidated group of companies, effective for financial years ending on or after 30 June, 2010. Both APRA and ASIC then issued a class order requiring ADIs to continue to include parent entity financial statements. The requirement is onerous and costly and in many cases the industry believes it provides no marginal utility.

Scenario analysis testing

ADIs are asked to recast their forecasts into years which differ from their financial year for scenario analysis testing. This generates significant additional work and costs. As the objective is to assess the relevant ADI's risk management practice, applying the ADI's reporting period is more relevant from a prudential perspective. The industry recommends that scenario testing be aligned to the ADI's reporting period.

7.2. Budgetary independence

Policy option:

No change to current arrangements.

Move ASIC and APRA to a more autonomous budget and funding process.

Replace the efficiency dividend with tailored budget accountability mechanisms, such as regular audits and reviews to assess the regulators' potential for savings.

The independence of the regulators is an essential element of Australia's regulatory framework; an element aimed to ensure regulation and enforcement are not impacted by the political agenda. However, in some cases regulators are able to expand their responsibilities without government engagement, which can lead to increased budget pressures for the regulator and/or increased costs to business, consumers and the economy. Ultimately, regulators must remain accountable to elected governments.

Removing constraints on resources, combined with budgetary independence, could significantly increase the regulatory burden, including the cost of regulation, to industry. As such, while the banking industry believes regulators should have independence in enacting their regulatory powers, regulators should not have independence in setting the total amount of funds they spend in implementing this approach. Budget constraints are an important mechanism for the Government in managing the overall size and impact of the public sector.

Additionally, moving to an autonomous levy-based funding arrangement for APRA and ASIC could greatly diminish any incentive for the Government to manage the resources of the regulators and could lead to a 'gold plated' system, where unnecessarily high standards and onerous processes are adopted without increased cost to Government. It could also incentivise regulators to expand their areas of operation, knowing that doing so will not lead to budgetary or resource constraints as the costs of servicing the expanded remit can be passed on to industry (and consumers).

The banking industry is also concerned that the move to budgetary independence and an industry funding model could lead to inequity with larger organisations potentially bearing the bulk of cost. For example, under the proposed model for the Australian Transaction Reports & Analysis Centre (**AUSTRAC**) Industry Contribution levy, only 15% of AUSTRAC's Reporting Entity population will pay the levy. The proposed $1,000 minimum threshold means reporting entities that pose a higher risk of being used for money laundering and terrorism financing, such as money service businesses, may be exempt from contributing to the cost of monitoring for illegal activity and the burden substantially shifted to banks.

Transparency and accountability

The banking industry acknowledges that Australian regulators are held accountable through a range of mechanisms, including Parliament, courts and tribunals and reviews by international bodies, such as the International Monetary Fund Financial Sector Assessment Program. However, as the Inquiry recognises, there is room to strengthen the accountability mechanisms for regulators, particularly in light of proposals to increase budgetary independence.

The banking industry recommends that if an industry funding model is adopted it should be developed in close consultation with industry and should adhere to the principles such as those identified in the Interim Report.[55]

Additionally, the industry supports the proposal that APRA be required to publish a comprehensive budget proposal, levy proposal and business plan each year, ahead of the Government's annual budget process. Currently, the consultation period on APRA's proposed levy does not allow sufficient time for industry to comment.

Coherent policy framework for cost recovery

As banking is one of the most regulated industries in Australia, it is important that the regulatory regime works well together rather than impedes the ability of banks to support Australian economic growth. The National Commission of Audit (**NCOA**) found that in relation to financial management and regulation, "There are too many government bodies in Australia. This leads to duplication and overlap, unnecessary complexity, a lack of accountability, the potential for uncoordinated advice and avoidable costs."[56]

---

55 FSI Interim Report, July 2014, http://fsi.gov.au/publications/interim-report/, page 3-10 to 3-11

56 National Commission of Audit, February 2014, *Towards Responsible Government,* Phase One, http://www.ncoa.gov.au/report/index.html

The banking industry believes there needs to be a shared understanding of the financial sector's regulatory landscape between regulators and relevant government departments and agencies. At the moment, levies appear to be set by each regulator without reference to each other despite regulating the same entities. Introducing budgetary independence to the various regulators will increase the autonomy of each regulator in the setting of levies and could lead to a significant increase in regulatory overlap and cost to industry.

7.3. Accountability

Policy options:

No change to current arrangements.

Conduct periodic, legislated independent reviews of the performance and capability of regulators.

Clarify the metrics for assessing regulatory performance.

Enhance the role of Statements of Expectations and Statements of Intent.

Improve the oversight processes of regulators.

As stated above, the independence of the regulators is an essential element of Australia's regulatory framework. However, this independence means that regulators are frequently not constrained in the frequency, volume, content and complexity of regulatory changes they make. Recognising this dynamic, Governments have put in place a comprehensive and complex set of accountability mechanisms that apply to regulators, key elements of which are:

- Acts of Parliament setting out the powers and responsibilities of the regulators. These also set out requirements for annual reports to be tabled in Parliament;
- The *Legislative Instruments Act 2003* which imposes: consultation requirements; drafting standards; tabling requirements which include a check conducted by the Senate Standing Committee on Regulations and Ordinances, and listing on the Federal Register of Legislative Instruments;
- A requirement of all regulators to appear before Senate Estimates Committees, and an additional requirement of the RBA and ASIC to address Parliament twice a year;
- RISs;
- Cost Recovery Guidelines; and
- The Government's SOE.

These requirements generate substantial volumes of information. However, the information is complex, technical and fragmented. It is difficult to get an overall picture of the volume and detail of regulatory activity of one particular regulator, let alone the volume of activity in relation to a particular industry. It is also difficult to identify the budget or industry impact of a particular tranche of regulatory activity. Therefore, while existing public accountability mechanisms may in sum provide comprehensive information, they do not enable observers to readily understand regulatory burden. Consequently, they do not appear to provide any real disincentive to developing and imposing new regulations.

The Interim Report proposes a number of additional mechanisms to improve accountability, most of which are logical and valuable, particularly:

- Conduct periodic, legislated independent reviews of the performance and capability of regulators;
- Clarify the metrics for assessing regulatory performance;
- Enhance the role of SOEs and SOIs; and
- Improve the oversight processes of regulators.

What these proposals omit, however, is a means of providing a view of regulatory impact on an industry sector, which is essential to the understanding of regulatory burden.

The banking industry seeks a mechanism that would answer this need. Information that would be useful in forming such an industry view includes a complete list of new regulations (including the estimate of impact from the RISs), the number of consultation exercises, applications for relief, educational initiatives and enforcement activities. If the annual audit reports proposed by the Productivity Commission are progressed (including the suggestion of an independent reviewer of Regulatory Impact Assessment compliance), they could provide a vehicle for this information.

Also, the accountability framework delivers little information on whether a regulation has delivered value for money. The regular reviews proposed above may address this problem. PIRs would provide another mechanism. The banking industry encourages the requirement of PIRs in relation to all regulation with an impact on economic growth.

Other options that could improve accountability include:

- The OECD's suggestion of a "regulatory budget", whereby an upper limit on the costs of regulatory activities to the economy is established, and this sum is apportioned across the regulatory agencies.[57] The Inquiry's recommendation regarding metrics on regulatory performance would be useful in supporting this strategy; and
- Leveraging the SOEs by publishing regulator reports against the statements.

Given the volume of accountability mechanisms in place, the banking industry cautions against adding additional requirements without reviewing the existing requirements. An integrated approach should improve cohesion and reduce regulator costs.

[57] Malyshev N, 2010, *A Primer on Regulatory Budgets,* OECD Journal on Budgeting, Volume 2010/3, http://www.oecd.org/gov/budgeting/48170563.pdf

7.4. Council of Financial Regulators

Policy options:

No change to current arrangements.

Consider increasing the role, transparency and external accountability mechanisms of the CFR:

- Formalise the role of the CFR within statute.

- Increase the CFR membership to include the ACCC, AUSTRAC and the ATO.

- Increase the reporting by the CFR.

A fragmented regulatory approach is an almost inevitable result of the number of regulators and sources of regulation making authority, and the volume of existing regulation relevant to the financial sector. The Productivity Commission identified piecemeal consideration of prudential or other significant regulations as a problem for the financial sector.[58] This fragmentation is compounded by the impact of international standards and legislation in other jurisdictions impacting on Australia.

The current framework can result in overlaps, gaps and inconsistencies in regulation, all of which have the potential to impact on government and industry costs, and the effectiveness of the regulation. Specific issues that have emerged through submissions to the Inquiry include:

- Registered financial corporations are regulated by APRA and ASIC depending on their asset size;
- Stored value devices or "purchased payment facilities" (**PPFs**) are currently regulated by APRA, the RBA and ASIC, depending on their similarity to deposit accounts;
- Duplication in the reporting requirements of APRA, ASIC, the ATO, ABS, RBA and a number of other State and Federal agencies; and
- Double capture of entities, for example Registrable Superannuation Entity licensees (licensed by APRA) and Responsible Entity (licensed by ASIC).

To improve regulator cooperation and coordination, the Interim Report explores the idea of extending the role of the CFR. The industry submits that whatever the mechanism, the task of coordination should have the goals of supporting both economic growth and financial stability.

One of the strengths of the CFR is that it provides for "frank discussion and collaboration between its members".[59] It is the view of the banking industry that this strength could be compromised if the membership of the CFR was expanded, for example to include the Australian Competition and Consumer Commission (**ACCC**), AUSTRAC and ATO.

While the current CFR is well suited to the adoption of an objective of supporting economic growth and setting broad strategy to guide regulators, it may not be well suited for the coordination of regulation. Coordination of

[58] Productivity Commission, 2010, *Annual Review of Regulatory Burdens on Business,* http://www.pc.gov.au/projects/study/regulatory-burdens/business-consumer-services/report, page 26

[59] FSI Interim Report, July 2014, http://fsi.gov.au/publications/interim-report/, p3-118.

the volume of regulation applying to the financial sector would be a highly detailed and technical task, which if made the responsibility of the CFR, could detract from its capacity to take a strategic view.

Treasury provides some coordination in that five of the relevant regulators (RBA, APRA, ASIC, ACCC, ATO) fall within the Treasury portfolio, but two (AUSTRAC and the Office of the Australian Information Commissioner) are in the Attorney-General's portfolio. The industry has some concerns that Treasury is not well placed to take the cross-sector, cross regulator view, given limited resources. A 2011 *Strategic Review of the Treasury* quoted business stakeholders as reporting being involved in 30-40 Treasury or Treasury portfolio consultations at the one time, which suggests that even then, coordination was not as strong as it could have been.[60] The industry is concerned that substantial reductions in Treasury resources may limit further Treasury's capacity to play this coordinating role.

Additionally, there needs to be a shared understanding of the financial sector's regulatory landscape, between regulators and relevant departments, to reduce overlaps, improve effectiveness, reduce regulatory burden and improve sequencing of regulation and regulatory change. Considering this, the establishment of a Director-General of Regulation, as explored by the Inquiry (and suggested by Uhrig[61]), may provide a more suitable coordination body.

Other mechanisms that should be considered by the Inquiry include:

- The development of a cohesive, highly transparent and publically accountable approach to any cost recovery from the industry. This should clarify the tax status of levies and the tax deductibility of expenses incurred in compliance;
- Industry representation on a supervisory board and improved reporting to Government and the industry against key performance indicators;
- Industry focussed joint regulator approaches to make compliance (particularly in reporting data) cheaper. There may be room to build on the Standard Business Reporting initiative; and
- Improved coordination of multiple international regulatory requirements. The G20 is considering means to improve harmonisation of regulation between jurisdictions and how substituted compliance could be better utilised. The industry welcomes mechanisms such as the B20 which provides an opportunity to join the regulatory conversation.

[60] The Treasury, December 2011, *Strategic Review of The Treasury*, http://www.treasury.gov.au/About-Treasury/OurDepartment/Strategic-Review-of-the-Treasury, page 41

[61] Uhrig J, 2003, *Review of Corporate Governance of Statutory Authorities & Office Holders*

7.5. Responsibilities and powers

Policy options:

No change to current arrangements.

Strengthen competition considerations through mechanisms other than amending regulators' mandates.

Requiring the RBA to report every three years on the efficiency and competitiveness of the Australian financial system.

Requiring APRA's annual report to include a section on competition.

Appointing an additional APRA member of establishing another mechanism for considering the impacts of regulatory intervention on competition.

While it is important for regulators to consider competition when they carry out their responsibilities, it is also important that regulators have a responsibility to support economic growth. It is the view of the banking industry that the only effective way of ensuring regulators explicitly consider economic growth is to amend their mandates. The mechanisms proposed by the Interim Report, to ensure consideration of competition, would not be effective in achieving this, particularly given the independence of the regulators.

Of the relevant regulators, three do not have a requirement to support economic growth or efficiency (ASIC, the Payments Systems Board, Office of the Australian Information Commissioner – Privacy), and for those that do, the requirement is represented in different ways with differing weights. The RIS requirements require regulators to assess the impact of the proposed regulation on business and competition, and to consider market mechanisms for resolving the considered problem. They do not, however, compel proponents of regulation to consider the impact on the broader economy.

The lack of economic objectives in the decision making process occurs despite the acknowledged benefits to all Australians of market focussed reforms and the economic benefits of competition. The Campbell, Wallis, and Hilmer Reports built a consensus that the best approach to regulation is market-based, whereby government intervention is limited to addressing market failures. The Campbell and Hilmer Reports triggered national efforts to reduce regulation and enable the market (and competition) to become a stronger driver of economic activity. Exposure of more of the economy to competition through the removal of restrictive regulation resulted in efficiencies, driving down costs, increasing innovation, and improving responsiveness to customer needs. In 2005, the Productivity Commission, with qualifications, estimated the benefits to the Australian economy of the National Competition Reforms to be $20 billion.[62]

Arguably, the focus on market-based solutions and competition has reduced with increased regulation becoming the favoured response of Governments. This focus needs to be addressed. The Interim Report raises a number of options, supported by the banking industry that may form part of a response to this concern, including the policy options of requiring:

- RBA to report every three years on the efficiency and competitiveness of the Australian financial system; and

[62] Productivity Commission, 2005, *Review of National Competition Reforms,* http://www.pc.gov.au/projects/inquiry/national-competition-policy/docs/report

- APRA's annual report to include a section on how it is meeting the competition component of its mandate.

These options could be strengthened by ensuring these statements clearly articulate the RBA's and APRA's definition of competition and that the statements also include an evaluation of the impacts of regulatory intervention on economic growth, over the relevant period. It is not clear to the industry if appointing an additional APRA member to consider the impacts of regulatory intervention on competition would greatly assist in meeting the competition, or economic growth, objectives.

ASIC's mandate

Policy options:

No change to current arrangements.

Refine the scope and breadth of ASIC's mandate.

As noted in the Interim Report, ASIC's mandate has expanded considerably since its inception, with ASIC currently having quite a broad and ill-defined mandate. While splitting some of ASIC's functions to new (or existing) agencies may allow ASIC to become a "more tightly focused regulator"[63], material inefficiencies and issues can develop from having multiple agencies (as discussed above).

Given its current broad scope, the banking industry would support a review of ASIC's mandate and would welcome the opportunity to provide its views and insights.

[63] FSI Interim Report, July 2014, http://fsi.gov.au/publications/interim-report/, page 3-124

8. Retirement income

8.1. Retirement options

Policy options:
No change to current arrangements.
Maintain the status quo with improved provision of financial advice and removal of impediments to product development.
Provide policy incentives to encourage retirees to purchase retirement income products that help manage longevity and other risks.
Introduce a default option for how individuals take their retirement benefits.
Mandate the use of particular retirement income products (in full or in part, or for later stages of retirement).

See next section.

8.2. Product development

Policy options:
No change to current arrangements.
Take a more flexible, principles-based approach to determining the eligibility of retirement income products for tax concessions and their treatment by the Age Pension means-tests.

The banking industry agrees with the level of importance that the Inquiry has placed on Australians' retirement incomes and the Inquiry's observation that Australia's three pillar retirement income system of age pension, superannuation guarantee and voluntary savings has considerable strength.

As noted in Section 3 – Funding, the banking industry believes there is merit in the development of annuity style retirement income investment products, not just in terms of supporting retirement income options, but also in aiding the growth of the fixed income markets.

The banking industry supports the policy options for maintenance of the *status quo* with improved provision of financial advice, as endorsed by the FOFA reforms. The industry also supports measures that enable innovation and enhance competition, notably the removal of impediments and disincentives to product development, such as taxation.

The policy options to improve access to affordable and high quality financial advice and financial literacy programs to support wealth accumulation and help retirees manage risks over the remainder of their lives are addressed in Section 6 - Consumer outcomes.

The banking industry does not support measures, such as mandating default options, directing how individuals take their retirement benefits or the use of mandatory retirement income products, as these will not only reduce competition, but also inhibit the ability of individuals to match their savings and risks with product availability and income management strategy.

The policy options raised in the Interim Report in relation to incentives to encourage retirees to purchase retirement income products and the ability to take a more flexible, principles-based approach to determining the eligibility of retirement income products for tax concessions and their treatment by the age pension means test, are ones that require additional consultation. The banking industry would welcome the opportunity to provide further input on these matters, including through the Tax White Paper.

The banking industry supports reiterating the need for the superannuation and retirement income systems to deliver the objectives of maximising retirement incomes for members, reducing the fiscal impact on the Federal Budget and ensuring Australians are able to manage their savings now and into the future. Superannuation and retirement incomes policy needs to become more integrated to optimise outcomes for consumers, the Government, community and the industry.

9. Technology

As covered in detail in the industry's first round submission, technology will continue to transform banking and bring many benefits to consumers. Technology also raises the potential for regulatory gaps to develop, especially in terms of system integrity and consumer protection. The challenge for regulators will be that the pace of change in technology will be faster than the normal processes for regulatory responses.

The banking industry, therefore, proposes that the Inquiry recommend that a collaborative approach to managing technological change be developed involving regulators, industry and consumer representatives.

In terms of specific proposals, the priority policy areas for the banking industry within the topic of technology are digital identity, technology neutrality and cyber security. The policy area where industry has some disagreement is with mandatory breach notifications.

9.1. Technology neutrality

Policy options:

No change to current arrangements.

Amend regulation that specifies using certain technologies with the aim of becoming technology neutral. Amendments should enable electronic service delivery to become the default: however, they should include opt-out provisions to manage access needs for segments of the community.

Adopt a principle of technology neutrality, for future regulation recognising the need for technology-specific regulation on an exceptions basis. Where technology-specific regulation is required, seek to be technology neutral within that class of technologies.

The banking industry supports a technology-neutral approach for current and future regulation. The revision of regulation should be done in conjunction with steps to modernise and improve disclosure, covered in Section 6 - Consumer outcomes within this submission. To achieve the optimal outcome for this project, the industry suggests that a detailed initial scoping document should be developed in conjunction with Government.

The banking industry recommends priority be given to the following:

- All references to disclosure statements being provided on paper to be removed.
- All references to payments being required by cheque to be removed.

The industry agrees an opt-out provision should be included to manage access needs for individuals for whom online access is not available.

9.2. Facilitating innovation

Policy options:

No change to current arrangements.

Establish a central mechanism or body for monitoring, and advising, Government on technology and innovation. Consider, for example, a public-private sector collaborative body or changing the mandate of an existing body to include technology and innovation.

Establish a whole-of-Government technology strategy to enable innovation.

The banking industry supports mechanisms to facilitate innovation in the banking industry, mindful of the need to avoid the creation of new government agencies. The specific area in which Government and regulators can facilitate innovation is through the introduction of trusted digital identities. The industry also supports the establishment of a new cooperative regulator-industry-consumer committee where emerging trends, technologies and issues can be discussed and responses agreed.

The need for a cooperative committee recognises that technology driven change is going to occur faster than traditional forms of regulation can adapt. Cooperation and collaboration between regulator, industry and consumer representatives will allow better exchange of information about emerging technologies, products and services, earlier identification of emerging risks, including systemic or consumer protection risks, and the development of precisely targeted, timely and appropriate regulatory or self-regulatory responses.

9.3. Privacy

Policy options:

No change to current arrangements.

Review and assess the new privacy requirements two years after implementation to consider whether the impacts appropriately balance financial system efficiency and privacy protections.

Review record-keeping and privacy requirements that impact on cross-border information flows and explore options for improving cross-border mutual regulatory recognition in these areas.

The banking industry supports the policy option to review and assess the new privacy requirements two years after implementation to consider whether the impacts appropriately balance financial system efficiency and privacy protections. In particular, a post-implementation review should assess:

- The credit reporting provisions in the Act to ensure they are working effectively and efficiently cost wise.
- The balance between Australian Privacy Principle 8 (disclosure of personal information to overseas entities) and the Interim Report's recognition that Australia's financial system is inextricably linked to the global financial services markets.

The banking industry also agrees with the policy option to review record-keeping and privacy requirements that impact on cross-border information flows and to explore options for improving cross-border mutual regulatory recognition in these areas. Cross-border mutual recognition is valuable but problems with Australia's privacy regime as outlined in the Interim Report will need to be addressed.

9.4. Data security

Policy options:

No change to current arrangements.

Implement mandatory data breach notifications to affected individuals and the Australian Government agency with relevant responsibility under privacy laws.

Communicate to APRA continuing industry support for a principles-based approach to setting cloud computing requirements and the need to consider the benefits of the technology as well as the risks.

Breach notifications

The banking industry disagrees with the policy option of making notifications of data breaches mandatory. There is little evidence that these notifications will significantly reduce the risk of data security breaches or benefit consumers. Banks have developed a self-regulatory model for reporting data breaches to customers based on the scale of risk, balanced with the need to avoid unnecessary concern.

Cloud computing

The banking industry recommends the Government confirm support for a principles-based approach to setting requirements for new technologies including cloud computing. This accords with the recommendation included in the banking industry's first round submission.[64]

9.5. Cyber security

Policy options:

No change to current arrangements.

Review and update the 2009 Cyber Security Strategy to reflect changes in the threat environment, improve cohesion in policy implementation and progress public-private sector collaboration.

The banking industry supports a review and update of the 2009 Cyber Security Strategy to reflect changes in the threat environment, to improve cohesion in policy implementation and to progress public-private sector collaboration. This accords with the recommendation included in the banking industry's first round submission.[65]

A component of the strategy should seek to improve coordination, collaboration and information sharing on cyber security issues among the public and private sectors. The banking industry acknowledges that there have been a number of recent or planned, discrete operational forums set up with various industry sectors that have a dedicated cyber security focus. However, there is a need for coordination across these

[64] ABA FSI Submission, March 2014, http://www.bankers.asn.au/FSI/ABA-submissions, page 115
[65] *Ibid.*, page 116

mechanisms, along with a high level, cross-industry forum with cyber policy focus.[66] Such a mechanism should be run by the Department of the Prime Minister and Cabinet and the Attorney-General's Department under their lead and supporting responsibilities for cyber security.

One important aspect of cyber security is the regular exercise of crisis management arrangements. The new cyber strategy should include regular cyber crisis planning and exercises across industry sectors, including clarification of the respective roles of the public and private sectors in the event of a major incident. The last public-private cyber exercise was Cyberstorm III, held in 2010, and another exercise should be conducted as a priority.

Existing cyber coordination and sharing mechanisms are regular, 'point-in-time' events. The banking industry supports the need for ongoing, real-time sharing to enable real time cyber threat intelligence and analysis, situational awareness and network defence. Such a system should be automated and standards-based for its efficient application.[67] There are elements of the US Financial Services – Information Sharing and Analysis Centre that could be relevant, including their Cyber Intelligence Repository[68] that advocates the real-time sharing of cyber security threats through automation. However, this is only focussed on financial services organisations: there is merit in an Australian cross-sectoral system that includes all Australian industries that contribute to critical infrastructure rather than confining it to the banking industry. The Australian Government could play a central role in the development of such a capability.

The Interim Report also asks how useful a voluntary cyber security framework, similar to US National Institute of Standards and Technology, would be in assisting industry to develop cyber capabilities. The banking industry is already subject to APRA's Prudential Practice Guide 234, *Management of security risk in information and information technology*[69] that focuses on areas that APRA identifies as weaknesses as part of its ongoing supervisory activities. The banking industry in principle supports the development of a broader, voluntary framework. This will help participants in other industries manage cyber security risk and develop cyber capabilities, but may also be useful for participants in the financial services industry who fall outside the prudential perimeter.

9.6. Digital identity

Policy options:

No change to current arrangements.

Develop a national strategy for promoting trusted digital identities in consultation with financial institutions and other stakeholders.

The banking industry supports the development of a national strategy for promoting trusted digital identities in consultation with other stakeholders and the Attorney-General's Department. This should include interoperability standards within government agencies, as the Government is the primary source of identity documents.

66 Currently, the Attorney-General's Department oversees the Trusted Information Sharing Network, but its focus is on cross-sector critical infrastructure resilience rather than cyber security.

67 Such as TAXII, STIX and CybOX – see for example http://www.us-cert.gov/Information-Sharing-Specifications-Cybersecurity

68 https://www.fsisac.com/CyberIntelligenceRepository

69 APRA, February 2010, *PPG 234 - Management of security risk in information and information technology*, http://www.apra.gov.au/CrossIndustry/Documents/PPG_PPG234_MSRIT_012010_v7.pdf

The benefits of trusted digital identities are well-stated in the Interim Report, with the key benefits being:

- Improving customer service, from the process of joining a bank to acquiring new products and services and completing every day transactions. This applies equally to retail and corporate customers;
- Improving security, for customers in terms of protection against identity theft and for the community in areas such as anti-money laundering; and
- Lowering costs for banks and customers, including the time spent by customers representing identity documents to the same organisation.

The introduction of trusted digital identities is not without challenges. This is particularly the case with a federated system, with the involvement of both government and private enterprises. Challenges include:

- Determining how potential liabilities are managed if shared interoperable credentials are established. Inherent in the word 'trusted' is an agreement as to the extent of the liability of the issuing institution. This is of particular concern for the industry because, as the Interim Report notes, banks are both users of, and contributors to, identity systems. The process by which liabilities are managed is an important consideration for Government.
- Managing privacy. While the Government is the default issuer of identities, a move towards a single source of identity and possibly a store of information would give rise to privacy concerns.

As part of a national strategy, the next development which should be addressed is the extension of the Document Verification Service (**DVS**) to include verifications from the ATO. This would increase the reliability of online verification considerably. Currently, data from drivers' licences and passports can be verified but not all bank customers own this form of identification, the documents do not contain all necessary data fields and they are not updated annually. It is recognised that not everyone has a tax file number.

It is worth restating that the DVS is not a database and does not store information. All DVS checks must be done with the informed consent of the person involved. Details of tax files would not be made available to the banks – it would simply be a 'yes' or 'no' that basic information such as name, address and age can or cannot be verified.

Another aspect required within the strategy is for all jurisdictions in Australia to agree to move from paper-based face-to-face identification processes and to adopt digital identities. An example involving the banking industry where this has proved challenging is the national electronic conveyancing system currently in operation by PEXA. The identity of a party to an e-conveyancing transaction must be verified by a bank or conveyancing practitioner that is a subscriber to the PEXA system. This will be an important opportunity to roll out trusted digital identities.

Biometrics

The Interim Report has asked if there is a need for Government to enhance identity authentication by facilitating interoperability standards in areas such as biometrics. Where biometrics are currently used by Government, standards would facilitate interoperability. However, the technology supporting biometrics is new. While many banks are introducing biometrics as a means of identification, the technology needs to be better established in terms of use and protections before economy-wide interoperability standards can be put in place.

10. International integration

The banking industry broadly agrees with the policy measures outlined in the Interim Report covering international integration, particularly greater consultation on the implementation of international standards. The industry believes the Interim Report under-represents the extent of offshore activity by Australian banks and recommends this be recognised in the Inquiry's final report and be measured and reported more frequently to better inform policy decisions.

10.1. Impediments

The Inquiry asks for potential impediments to integration with the region, particularly their relative importance, and the benefits to the broader Australian economy that can be demonstrated if they were removed.

While the banking industry understands the Inquiry's reluctance to support tax subsidies or concessions, or market intervention to enhance financial integration, consideration should be given to the competitive forces in Asia, many of which involve government subsidies, which place Australia at a commercial disadvantage. While the Inquiry is also deferring all taxation questions to the Government's Tax White Paper, the banking industry reiterates the suggestion to implement the tax recommendations of the Johnson Report[70], including the removal of interest withholding tax.[71]

Of the impediments listed in the Interim Report[72], the priority should be to revise "the way equity investments in offshore financial services businesses are treated for capital purposes." Beyond that, any reduction in the amount of regulatory change and the cost of red tape would promote better integration with the region. It would make Australia a more attractive destination for investment, as would government-to-government dialogues.

10.2. Regulatory settings

Policy options:

No change to current arrangements.

Improve domestic regulatory process to better consider international standards and foreign regulation – including processes for transparency and consultation about international standard implementation, and mutual recognition and equivalence assessment processes.

The banking industry supports the policy option to improve the domestic regulatory process to better consider international standards and foreign regulation, particularly as it relates to implementation, but also mutual recognition and equivalence assessment processes.

---

70 Australian Financial Centre Forum, November 2009, *Australia as a Financial Centre: Building on our strengths,* Commonwealth Government, Canberra, http://afcf.treasury.gov.au/content/final_report.asp

71 The industry welcomes the ATO's administrative solution for the calculation of deductions for interest payments arising from an intra-bank loan for Australian branches of foreign banks or foreign financial entities. With the end of LIBOR as a benchmark, the ATO has introduced proxy rates based on BBSW.

72 FSI Interim Report, July 2014, http://fsi.gov.au/publications/interim-report/, page 4-84

International standards

While the industry agrees with the view in the Interim Report that it is appropriate for Australia to adopt the minimum standards set out in global frameworks, such as the Basel framework[73], the industry disagrees that it has been necessary to introduce aspects earlier and more conservatively than regulators in other jurisdictions.

A number of the explanations cited throughout the Interim Report for the conservative approach are debatable. That Australian banks are profitable and well placed to meet the new capital requirements is not a reason for regulators to be more conservative. Australian banks avoided many of the issues faced by banks in Europe and the United States as a result of the sound management of the banks and APRA's supervision, and this should be taken into account. The banking industry agrees that accumulating capital during a healthy macroeconomic environment is good risk management but this should be a bank management decision.

The means by which international standards should be implemented are included within this submission in Section 7 - Regulatory architecture. This includes having regard to whole-of-Government objectives such as economic growth and consultation with stakeholders before standards are applied domestically. They do not differ greatly from the process for local regulation.

Mutual recognition

The banking industry supports the objectives outlined in the Interim Report to continue to improve mutual recognition and equivalence assessment processes[74], namely to ensure that:

- Government and regulatory agencies have appropriate powers to enter mutual recognition or substituted compliance arrangements and consider when unilateral recognition is appropriate without mirror concessions for Australian businesses entering foreign jurisdictions;
- There are regular reviews of guidance, processes and existing arrangements to ensure they remain appropriate; and
- There is a regular stocktake of priority jurisdictions and activities.

10.3. Coordination of financial integration

Policy options:

No change to current arrangements.

Amend the role of an existing coordination body to promote accountability and provide economy-wide advice to Government about Australia's international financial integration.

The banking industry supports the policy option to amend the role of an existing coordination body to promote accountability and provide economy-wide advice to Government about Australia's international financial integration. It recommends Treasury be given formal responsibility along with a greater focus on economic growth.

[73] FSI Interim Report, July 2014, http://fsi.gov.au/publications/interim-report/, page 3-39

[74] *Ibid.*, page 4-96

The industry believes this is an important area for attention because without it the economic costs and benefits of financial integration, as well as offshore growth, may not be given due consideration. The industry supports responsibility being given to an existing body, mindful of the NCOA finding that "There are too many government bodies in Australia, (which) leads to duplication and overlap, unnecessary complexity, a lack of accountability, (and) the potential for uncoordinated advice and avoidable costs."[75]

10.4. Recognising Australia's offshore banking businesses

While the Interim Report recognises the financial sector as one of the largest sectors in the Australian economy, it underestimates the value of, and therefore contribution made by, the industry's foreign direct investment. The Interim Reports states "It was the largest sector in the Australian economy in 2012-13, representing 8.7 per cent of gross-value added. However, financial services exports only represent a small proportion of Australia's trade, accounting for around 4.5 per cent of total trade in services at the end of 2013".[76]

While net exports might be small, the value of financial services which are located and conducted offshore is high. A survey conducted by the Department of Foreign Affairs and Trade (**DFAT**) titled "*Australia's Outward Finance and Insurance Foreign Affiliates Trade in Services, 2009-10*", found that while imports and exports for financial services were valued at $1.3 billion in 2009-2010, the commercial presence offshore was valued at $35.1 billion.[77] Because the data is not collected regularly, it is not possible to determine if this is growing or declining either globally, regionally or at a country level. The Australian financial sector also holds AUD140bn direct foreign investment (concentrated in traditional markets rather than in the growth markets of Asia). It represents 28 per cent of Australian foreign direct investment just behind the mining sector at 29 per cent.

The industry believes information about offshore commercial presence of foreign affiliates should be collected by the ABS and reported periodically by the Treasury, for all industries, so Government and the community can better understand offshore activity and make more fully informed policy decisions. DFAT makes a similar point that: "trade by Australian foreign affiliates in its own right is important in terms of understanding Australia's overall global links with the world economy, in particular for services trade."[78]

---

[75] National Commission of Audit, February 2014, *Towards Responsible Government,* Phase One, http://www.ncoa.gov.au/report/docs/phase_one_report.pdf

[76] FSI Interim Report, July 2014, http://fsi.gov.au/publications/interim-report/, page 4-76

[77] DFAT, August 2011, *Australia's Outward Finance and Insurance Foreign Affiliates Trade in Services*, *2009-10* http://www.dfat.gov.au/publications/stats-pubs/australias-outward-finance-and-insurance-foreign-affiliates.pdf, page 7

[78] *Ibid.*, page 1

This page is intentionally blank.

Appendix A:

Australian Bankers' Association: International comparability of capital ratios of Australia's major banks

PwC

August 2014

www.pwc.com.au

Australian Bankers' Association: International comparability of capital ratios of Australia's major banks

Australian Bankers' Association

August 2014

pwc

Contents

1 Overview

1.1 Purpose

The Australian Bankers' Association (ABA) has engaged PwC Australia to measure current levels of capital held by the four major Australian banks under the Basel Committee on Banking Supervision (BCBS) Basel Framework[1] and in relation to capital held by banks in other jurisdictions. We have done this using confidential data supplied by Australian banks to the ABA, together with input from PwC banking specialists both here in Australia and in overseas markets. This reports sets out our findings.

1.2 Background

Capital is fundamental to all businesses. This is particularly the case in banking, where the core businesses of borrowing and lending, payments, and trading all depend on capital as a marker of confidence to customers, counterparties and investors, and as a buffer for losses and unexpected events.

Reflecting the complexity of banking, the calculation and valuation of capital and estimation of capital ratios in banks is also very complex. This especially reflects the fact that the calculation of many elements of bank capital ratios requires judgment about risk, and so often a high degree of subjectivity is also involved.

Complexity also arises from the efforts by global regulators over the last three decades to ensure minimum standards for the amount of capital which banks are required to hold are calculated and applied, to the extent possible, on a consistent basis across countries. However, ultimately the regulation of banks is a matter of national sovereignty and so the global standards explicitly allow for national discretion in the way the rules are applied. In addition there have been many changes to the Basel Framework in recent years and countries are proceeding at different speeds in the application of these changes. Further, different countries adopt different accounting standards and this is another source of complexity and difference in relation to the calculation of capital, albeit that there has been significant convergence in recent years.

Finally, while capital is an important measure of balance sheet strength, it is only one measure of overall risk for a bank and always needs to be interpreted in a wider context. For instance, systemic risks, levels of credit concentration or legal uncertainty may vary significantly between banks and across different countries.

1.3 Overall results

It is clear to us that the four Australian major banks are well capitalized relative to both the global standards and by comparison with banks regulated in many other jurisdictions. This is widely agreed.

Based on the data provided to us by the Australian banks, our best judgment is that, on average, the four Australian banks are at or above the 75th percentile of bank capital relative to the most appropriate comparator set of global banks.

Some Australian major banks are unambiguously in the top quartile in terms of capital, others are closer to the 75th percentile but are still well above the median. Our overall summary calculation gives a weighted average Common Equity Tier 1 (CET1) ratio in the range of 11.5 per cent to 12.5 per cent, and as best as we can judge this is at or above the 75th percentile (see page 10). The estimates of risk weighted assets have a judgemental component and this, in context of Figure 1 (see page 8) explains our conclusion that a range is appropriate.

Hence, our best judgment is that, on average, the Australian banks are at or above the 75th percentile of bank capital relative to the most appropriate comparator set of global banks.

We have not been asked to consider what levels of capital are appropriate.

---

[1] Basel Framework includes Basel II, Basel 2.5 and Basel III and refers a number of documents. Refer to the BCBS, *Regulatory Consistency Assessment Programme (RCAP): Assessment of Basel III regulations – Canada*, BIS, 2014, Annex 3: List of capital standards under the Basel Framework used for assessment.

PwC's role

Independence and objectivity

This report is not an audit. In compiling it we have issued instructions and data templates, via the ABA, to the participating banks, conducted analytical review over the data produced and through the ABA challenged individual banks to ensure that as far as possible the adjustments have been prepared fairly and reasonably and on a consistent basis. We have also compared the banks' results to externally reported information such as Pillar 3 reports, analyst reports and other relevant national and international information.

The views expressed in the report are those of PwC.

Use of our Report

This report has been prepared for the sole purpose of supporting the ABA in preparing its second round submission to the Financial System Inquiry 2014 (FSI). This report must not be used for any other purpose including that it may not be attached to third party submissions to the FSI.

Declaration of Interests

In Australia, PwC operates across all financial services sectors, and works with a high proportion of global and domestic financial institutions. The nature of our business requires the highest levels of objectivity and independence, and we have sought to reflect those standards in this document.

Given that this report has been sought by the ABA in the context of the second-round submission to the FSI, we disclose that we have advised a number of other clients, both formally and informally, on the preparations for their previous submissions to the FSI. We also note that PwC, both domestically and globally, has benefitted from the strong growth in the financial services sector in recent decades, including through the growing global complexity of bank capital and other regulations.

PwC's submission to the FSI (dated 31 March 2014) can be found at: http://www.pwc.com.au/industry/financial-services/publications/funding-australias-future.htm. PwC is also providing a full-time professional secondee to the FSI during 2014, at no cost to the Inquiry or Government.

We also note that we provide advice to all the Australian banks discussed in this report. We are the external auditor of the ABA and two of the Australian major banks.

2 Our methodology

The objective of this study is to assess the current capital ratios of Australia's four major banks ("the majors") using the Basel Framework so that they can be compared on a like-for-like basis with banks in other jurisdictions. It is therefore very important to be precise about the basis of these comparisons. This involves answering three questions:

- What is the best way to measure capital ratios on a consistent basis across banks?
- Which banks or groups of banks should be used for comparison purposes?
- What is the appropriate balance date to use?

2.1 What is the best way to measure capital ratios on a consistent basis across banks?

At the ABA's request, our study is concerned with the Basel III CET1, on a fully implemented basis (i.e. applying Basel III capital requirements as if they applied in full already). We have considered three ways to measure CET1 for these purposes:

1 Measurement using applicable national rules – e.g. **CET1 (APRA), CET1 (UK)** etc.

As noted above, national regulators have discretion in relation to the application of the Basel Framework in their jurisdiction and so this measure reflects full implementation of the Basel Framework in that jurisdiction.

This measure is appropriate for answering a question like "*how would the Australian major banks be measured under the Canadian rules and how do they compare to the Canadian banks on that basis?*" In this instance we would refer to the calculation as CET1 (Canada).

2 Measurement using Basel Framework rules - **CET1 (Basel Framework)**[2]

This refers to the application of the rules as set out exactly in the Basel Framework (before any national discretion is applied). This methodology seeks to quantify all differences which have been highlighted in the BCBS Regulatory Consistency Assessment Programme report (RCAP) for a particular jurisdiction to produce a comparable set of ratios. For Australia, the RCAP report was published in March 2014[3]. This ratio is in principle similar to the "BCBS internationally harmonised" ratios which are self-reported by many banks, albeit with a greater range of adjustments (as identified by the March 2014 RCAP).

3 Measurement using Basel Framework rules and further adjusting for national regulatory treatments which would impact on how those rules are implemented in that jurisdiction by comparison to international norms - **Internationally comparable CET1.** This refers to a methodology which starts with **CET1 (Basel Framework)** and further adjusts for other recognised differences (such as risk modelling parameters and national discretions) which are applied at a local level by comparison to average international settings. This is more judgemental and harder to quantify precisely, however, the BCBS has published information which allows some level of "normalisation".

Reflecting this more complete treatment, we believe that the **Internationally comparable CET1** measure is generally a preferable measure to the **CET1 (Basel Framework)** measure. We use this measure for answering a question like *"where do the Australian banks sit in comparison to banks drawn from many different countries?"*

Refer to section 4 and appendix B for further discussion about individual adjustments and the degree of judgement and subjectivity involved in calculating them.

---

[2] BCBS, *Basel III: A global regulatory framework for more resilient banks and banking systems*, BIS, December 2010 (rev. June 2011)

[3] BCBS, *Regulatory Consistency Assessment Program (RCAP): Assessment of Basel III regulations - Australia*, BIS, March 2014

2.2 Which banks or groups of banks should be used for comparison purposes?

One way to address this would be to consider the question: *"how would the Australian banks be measured under the Canadian rules and how do they compare to the Canadian banks on that basis?"*. To answer this, we have chosen six jurisdictions - Canada, Europe (using Germany as a proxy), United Kingdom, Switzerland, Singapore and Japan. We have chosen these six jurisdictions because they represent a relatively wide spread of countries across the globe broadly relevant to Australia, and which are well advanced in the implementation of Basel III, including having had an RCAP review undertaken which gives an independent assessment of the extent of national discretion. We have not chosen the US because the US banking system is generally less advanced in applying the full Basel Framework. Further jurisdictions could be examined if the ABA believes that would be useful.

In order to answer the different question: *"where do the Australian banks sit in comparison to banks drawn from many different countries?"*, we have chosen the published Basel III ratios for Global Systemically Important Banks (G-SIBs)[4] and Domestic Systemically Important Banks (D-SIBs)[5] from the six selected jurisdictions noted above.

The FSI Interim Report[6] uses BCBS data[7] covering 102 banks, from 27 countries, including small banks (down to Euro 3bn of capital) as well as large banks, and with a wide range of capital ratios (from 2.5 per cent to 20.2 per cent). Without access to the underlying data for the individual banks in the survey, we (PwC) need to be cautious in making judgements. However, from our understanding of global banking there is a risk that the wide range of capital ratios is driven by smaller banks in less relevant jurisdictions. We also note that the data is now over one year old. We would certainly welcome the opportunity to have access to the full population of that BCBS data.

It is also important to note that the data provided by the Australian major banks included in the BCBS study is not on a strictly comparable basis because it only adjusts for the capital differences and does not adjust for the majority of the risk weighted asset differences noted in this report.

While our study uses data from a smaller group of banks by comparison to the FSI Interim Report, we are satisfied that that our sample represents an appropriate group of peer banks against which to compare the Australian major banks.

Our study has a narrower range of observed Internationally comparable CET1 ratios, and therefore does not include banks with extremely high or extremely low capital ratios, observed in the BCBS larger population. Nevertheless the median CET1 ratio in the BCBS study is 10 per cent, which is very similar to the median in our chosen group of 10.4 per cent. The 75^{th} percentile of the BCBS group is 11.7 percent by comparison to 11.4 per cent for this study.

Refer to appendix G for a detailed listing of the Australian banks and jurisdictional peers used in this analysis.

2.3 What is the appropriate balance date to use?

We have chosen to carry out this study using the most recently available data of capital information. We have collected information from the Australian banks as at their most recent half year or year-end balance date.

We have also collected data from international peer banks using the most recently available information so that the comparisons are on a like-for-like basis.

---

4 BCBS, *Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement*, BIS, July 2013

5 BCBS, *A framework for dealing with domestic systemically important banks*, BIS, October 2012

6 FSI, *The Financial System Inquiry 2014 (Murray): Interim Report*, Australian Government, chapter Post –GFC Regulatory Response, Stability, section.3-36 to 3-37, July 2014

7 BCBS, *Basel III Monitoring Report,* Statistical Annex: Table A3, BIS, March 2014

2.4 Approaches to measuring bank capital ratios

The Basel Framework adopts a standard approach to calculating risk weighted assets based on internationally relevant criteria. However it also acknowledges that larger, more sophisticated banks, with better quality risk data and modelling expertise are able to produce their own risk weighting factors which better reflect how they manage risks. Under the Basel Framework such banks can apply to their national regulator to use their own models for producing risk weighted assets. Banks which have been accredited to use their own models for calculating risk weighted assets are referred to as advanced banks. There are in turn two Internal Ratings-based (IRB) approaches to credit risk; the Advanced (AIRB) and Foundation (FIRB). We adopt this terminology in this report for banks which have received accreditation from Australian Prudential Regulation Authority (APRA) to use their own risk models. The four Australian major banks apply the AIRB approach for credit risk to the vast majority of their portfolios.

In implementing the Basel Framework, national regulators are expected to build conservatism into their respective financial systems by including buffers in the risk assessments under Pillar 1 and to address bank specific risks by requiring banks to operate above the BCBS minimum required capital ratios under Pillar 2. The approach taken will impact the comparability of reported capital ratios both between banks with in a country and between countries.

2.5 Total capital ratio

As instructed by the ABA, this study has focused on CET1. Wider measures of capital (Tier 1 and Total Capital ratios) are also required to be monitored and managed under the Basel Framework.

Comparative assessments of these wider ratios for Australian banks on a fully implemented Basel III basis are complicated by the fact that different jurisdictions are at different stages in confirming the rules which would apply to different bank capital instruments in the event of a bank approaching insolvency. In Australia, for instance, banks have only recently started the process of replacing their Basel II instruments with new instruments compliant with the Basel III rules in this regard. The fact that both confirmation of the rules and consequent implementations are at such different stages in different jurisdictions makes comparisons other than for CET1 ratios much more challenging and beyond the scope of this report.

2.6 Leverage ratio

The Leverage ratio is also required to be calculated and managed under Basel III from 2018 onwards. This is an alternative way of representing capital levels and may show a different picture by comparison to CET1. APRA has not yet issued their detailed rules governing how the Leverage ratio should be calculated and it has not therefore been practical to compare Leverage ratios for Australian banks by comparison to their global peers in this study.

3 Summary of results

3.1 Estimating Australian major bank capital ratios

Figure 1 below sets out our analysis of the weighted average CET1 ratio for the four Australian major banks expressed on a **CET1 (APRA)**, **CET1 (Basel Framework)** and an **Internationally comparable CET1** basis, based on the latest available information. The table also shows a similar analysis undertaken by APRA, based on earlier information, which was included in APRA's submission to the FSI[8].

Figure 1: Impact of differences in the application of the Basel Framework on CET1 (APRA) ratios

		PwC Study, August 2014		APRA submission to the FSI, March 2014	
	(Note D)	Impact on CET1 ratio (bps)	Weighted average ratio (%)	Impact on CET1 ratio (bps)	Weighted average ratio (%)
CET1 (APRA) ratio (Note A)			**8.76**		**8.28**
Adjustments to align with Basel III					
Add back capital deductions not required under Basel III	1	109		113	
Reduce risk weightings for credit risk (residential mortgages and specialised lending exposures)	2	96		61	
Reverse capital charge for interest rate risk in the banking book	3	30		28	
Adjustment for less conservative APRA standards	4	(8)		(22)	
Standardised risk weights	5	12			
Total adjustment		**240**		**180**	
Actual CET1 uplift (**Note B)**			2.79		1.89
CET1 (Basel Framework) ratio (Note C)			**11.55**		**10.17**
Additional areas where credit risk estimates are more conservative in Australia by comparison to norms adopted in other jurisdictions	6	114			n/a
Internationally comparable CET1 ratio			**12.69**		

Source: Individual bank data, PwC analysis, 2014. Roundings have been applied above and throughout this report.
Note A: CET1 ratio (APRA) per the PwC study is based on the most recent half-year or year-end balance date, whereas APRA's figures are for earlier dates.
Note B: The items are not additive as the impact on the CET1 ratio of each item is calculated independently of the impact of the other items.
Note C: Includes RCAP differences.
Note D: Refer to section 4.2 for explanation on adjustments.

Adjustments to risk weighted assets (items 2 and 6) by their nature are more subjective, and hence the range of 11.5 per cent to 12.5 per cent expressed in our overall conclusion.

[8] APRA, *Financial System Inquiry: Submission, APRA, March 2014*

The other main points to note are:

- our preferred measure of capital Internationally comparable CET1, shows the four major Australian banks have a weighted average ratio of 12.69 per cent;
- a number of the uplift factors from CET1 (APRA) to CET1 (Basel Framework) in the PwC and APRA calculations are broadly comparable, the main exception being allowance for those factors where APRA standards are less conservative. We expect these differences are likely to be explained by this study using more recent data (and possibly a wider group of banks being used by APRA);
- our calculation of the Internationally comparable CET1 ratio shows a further 114bp uplift for the four major banks to take the weighted average ratio to 12.69 per cent.

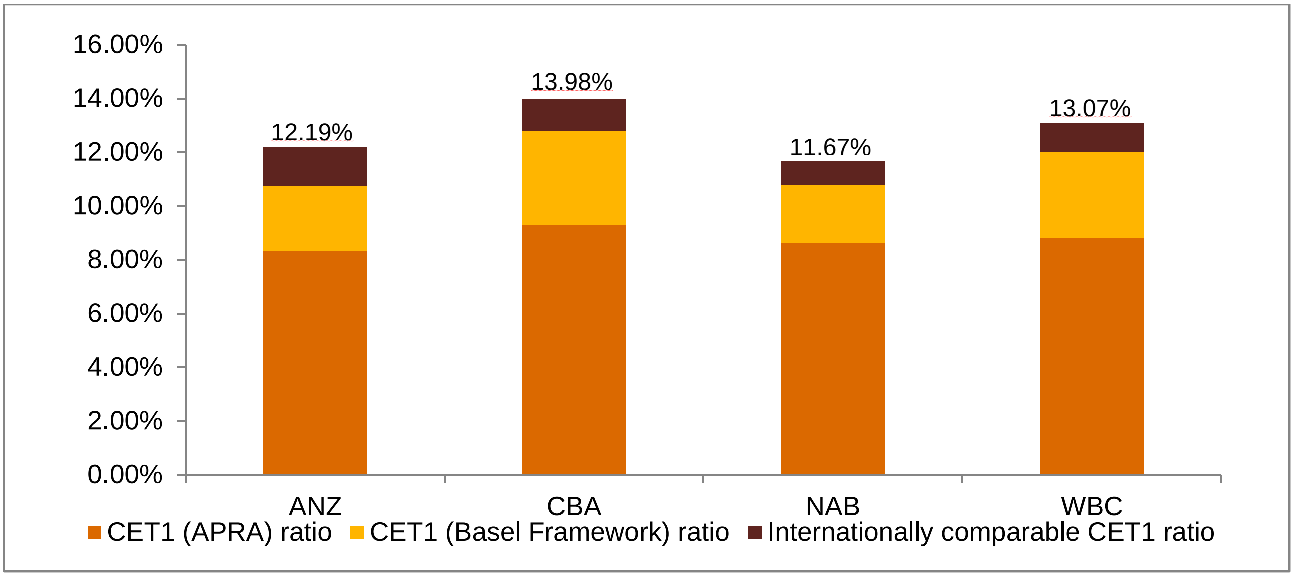
As usual, we need to avoid a sense of false precision and interpret these numbers in the context of the subjectivity and judgements involved. We believe that, in total, the analysis should best be interpreted as a weighted average CET1 ratio in the range of 11.5 per cent to 12.5 per cent for Australian major banks.

3.2 Australian banks' Internationally comparable CET1 ratios

Figure 2 summarises the data from Figure 1 above, for the four Australian banks in our study.

Whilst there is an uplift in the capital ratio for all the banks when measured on an Internationally comparable basis, the quantum of the uplift varies from bank to bank as it is dependent on the individual banks' own particular circumstances including asset mix and risk appetite, as well as modelling assumptions and data.

Figure 2: Major banks' Internationally comparable CET1 ratios



Source: Individual bank data, PwC analysis, 2014.
Note: See definitions in section 2.1.

3.3 Where do Australian major banks sit within an international peer group?

The most objective way to answer this question available to PwC is to compare our Internationally comparable CET1 ratio for the four Australian major banks with the closest equivalent data for a peer group of overseas banks, taking into account known differences in those offshore banks.

Figure 3: International peer group Internationally comparable CET1 ratios

(Refer to the following page for notes)

Rank	Bank (Note 3)	Total assets (AUD bn)	Date	Internationally comparable CET1 (Note 2)
1	Nordea (Note 4)	983	30.06.2014	15.82%
2	Commonwealth Bank of Australia	791	30.06.2014	13.98%
3	UBS AG	1,175	30.06.2014	13.50%
4	Rabobank Group	1,040	31.12.2013	13.50%
5	Danske Bank	638	30.06.2014	13.20%
6	Westpac Banking Corporation	729	31.03.2014	13.07%
7	Intesa Sanpaolo (Note 4)	909	30.06.2014	12.99%
8	State Street Corporation	299	30.06.2014	12.80%
9	DBS Group Holdings Ltd.	355	30.06.2014	12.20%
10	Australia and New Zealand Banking Group	738	31.03.2014	12.19%
11	National Australia Bank Ltd.	846	31.03.2014	11.67%
12	Deutsche Bank AG (Note 4)	2,418	30.06.2014	11.64%
13	HSBC Holdings Plc. (Note 4)	2,920	30.06.2014	11.43%
14	Oversea-Chinese Banking Corporation Limited	296	30.06.2014	11.30%
15	Natixis (owned 70% by Groupe BPCE)	795	30.06.2014	11.20%
16	Groupe BPCE	1,631	30.06.2014	11.10%
17	Lloyds Banking Group PLC	1,531	30.06.2014	11.10%
18	China Construction Bank (Note 1)	2,800	31.03.2014	11.10%
19	Industrial and Commercial Bank of China Limited (Note 1)	3,424	31.03.2014	10.90%
20	Standard Chartered Bank (Note 4)	732	30.06.2014	10.87%
21	Citigroup	2,025	30.06.2014	10.60%
22	Societe Generale (Note 4)	1,920	30.06.2014	10.51%
23	ING Group	1,409	30.06.2014	10.50%
24	Morgan Stanley	876	31.12.2013	10.50%
25	Mitsubishi UFG	2,657	31.03.2014	10.40%
26	UniCredit (Note 4)	1,217	30.06.2014	10.40%
27	BNP Paribas (Note 4)	2,768	30.06.2014	10.30%
28	Sumitomo Mitsui Financial Group	1,706	31.03.2014	10.30%
29	Royal Bank of Scotland Group PLC	1,834	30.06.2014	10.10%
30	Wells Fargo	1,695	30.06.2014	10.10%
31	Barclays PLC (Note 4)	2,385	30.06.2014	10.04%
32	Bank of Communications (Note 1)	1,037	31.03.2014	10.04%
33	Banco Bilbao Vizcaya Argentaria	896	30.06.2014	10.00%
34	Bank of New York Mellon	425	30.06.2014	10.00%
35	Canadian Imperial Bank of Commerce	390	30.04.2014	10.00%
36	Credit Agricole S.A	2,204	30.06.2014	9.90%
37	Bank of America	2,302	30.06.2014	9.90%
38	JP Morgan Chase	2,672	30.06.2014	9.80%
39	Goldman Sachs	912	31.12.2013	9.80%

Rank	Bank (Note 3)	Total assets (AUD bn)	Date	Internationally comparable CET1 (Note 2)
40	Bank of Nova Scotia	778	30.04.2014	9.80%
41	Royal Bank of Canada	881	30.04.2014	9.70%
42	Bank of Montreal	572	30.04.2014	9.70%
43	Bank of China (Note 1)	2,621	31.03.2014	9.58%
44	Credit Suisse Group	1,066	30.06.2014	9.50%
45	Agricultural Bank of China (Note 1)	2,658	31.03.2014	9.48%
46	Commerzbank AG	846	30.06.2014	9.40%
47	Toronto Dominion Bank	881	30.04.2014	9.20%
48	China Merchants Bank (Note 1)	764	31.03.2014	9.09%
49	Banco do Brasil	674	30.06.2014	8.77%
50	National Bank of Canada	191	30.06.2014	8.70%
51	Mizuho FG (Note 1)	1,842	31.03.2014	8.60%
52	China Minsheng Banking Corporation (Note 1)	602	31.03.2014	8.50%

Source: Individual bank data, PwC analysis 2014.

Note 1: CET1 for Chinese banks - Calculated in accordance with the Administrative Measures for the Capital of Commercial Banks (Provisional) which is used as the comparable proxy for comparison to the CET1 (fully-loaded).

Note 2: Recalculated for Australian major banks to adjust for RCAP and other differences.

Note 3: The list of banks comprises of global banks with total assets of over A$ 600bn, G-SIBs published by the Financial Stability Board in November 2011 and November 2013, D-SIBs which have been announced by local regulators (Canada, Singapore and Switzerland) and which have disclosed fully implemented Basel III capital adequacy ratios or sufficient public disclosure for a comparable estimate. Adequate public disclosure was unavailable for Banco Santander, Banque Populaire CdE, United Overseas Bank, Raiffeisen, Zurich Cantonal Bank, Banque Cantonale Vaudoise, Industrial Bank, Shanghai Pudong Development Bank, China CITIC Bank as at the date of this report.

Note 4: Foreseeable dividend deducted in reported fully-loaded CET1 has been added back to obtain the Internationally comparable CET1 ratio. See appendix D for further details.

Note 5: There are other potentially applicable adjustments for some international banks which are not included above due to insufficient available information.

In interpreting this chart, please note that we have been able to drill into the data for the Australian banks to a much greater degree than we have for the offshore comparator group. Nonetheless with proper allowance for these uncertainties, we believe that the data as set above sustains the conclusion that, on average, the Australian banks are at or above the 75th percentile of bank capital relative to the most appropriate comparator set of global banks. This conclusion would be sustained even if one takes the lower end of our 11.5 per cent - 12.5 per cent estimated range.

3.4 How do Australian major banks compare to advanced banks in other jurisdictions?

In this section we apply applicable national rules to the Australian banks for the six jurisdictions identified in section 2.2. The principle differences between Australia and the jurisdictions below are summarised in appendix D.

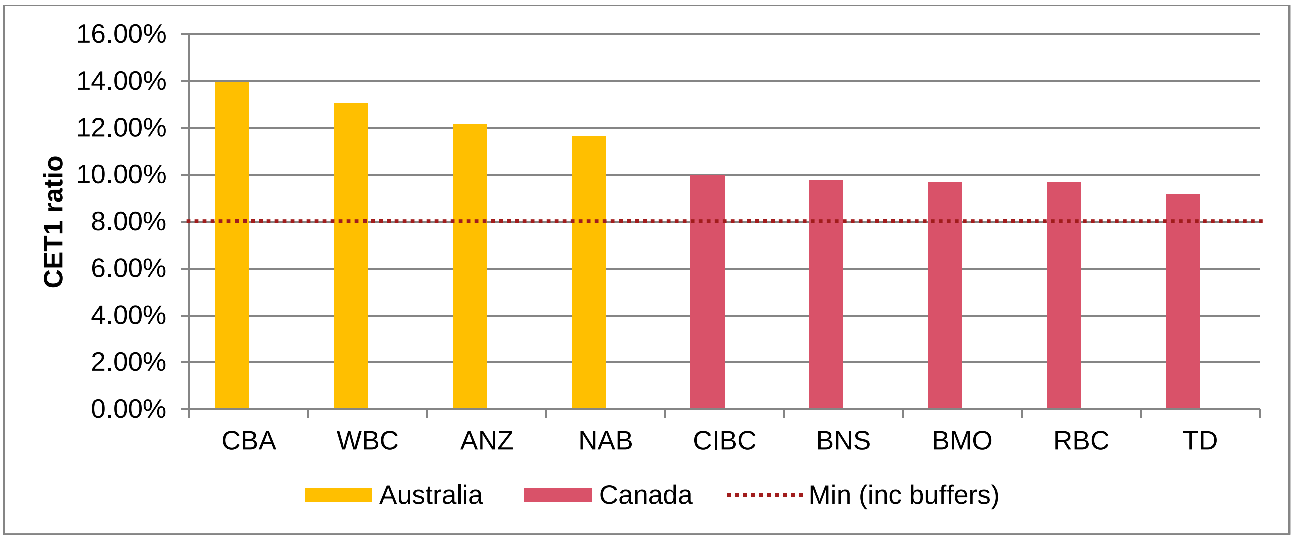
We have noted for information purposes the expected levels of CET1 which may be required following implementation of domestic systemically important banks (D-SIBs) frameworks. The expected level of CET1 post implementation has been added to each jurisdiction graph. It should be noted that in some cases the CET1 ratios are based on recommendations or preliminary guidance. In Australia, APRA's D-SIB framework includes a 1 per cent buffer (to make an 8 per cent expected CET1 ratio, inclusive of the capital conservation buffer of 2.5 per cent).

3.4.1 Canada

Reflecting the analysis in Appendix D and Appendix E, we have not identified any adjustments that need to be made to the Internationally comparable CET1 ratio for the Australian banks in calculating their CET1 (Canada) ratio.

However, when comparing to banks in Canada, account needs to be taken of structural differences in the way Lenders Mortgage Insurance (LMI) works. In Canada, mortgages may be insured with the Canada Mortgage and Housing Association, which is fully guaranteed by the Canadian government and are afforded the zero risk weight of the sovereign. The Canadian regulator also allows zero risk weights where a mortgage is comprehensively insured by a private sector mortgage insurer that has a backstop guarantee provided by the Canadian government. In Australia, LMI insurance is not taken into account by IRB banks when modelling risk weights for residential mortgages that are insured. Given that a substantial number of Canadian mortgages are LMI insured, it follows that the capital ratios for Canadian banks are not directly comparable to those of the Australian banks. This is a structural difference which is not appropriate to adjust for in this comparative study.

Figure 4: Australian and Canadian banks on a CET1 (Canada) basis

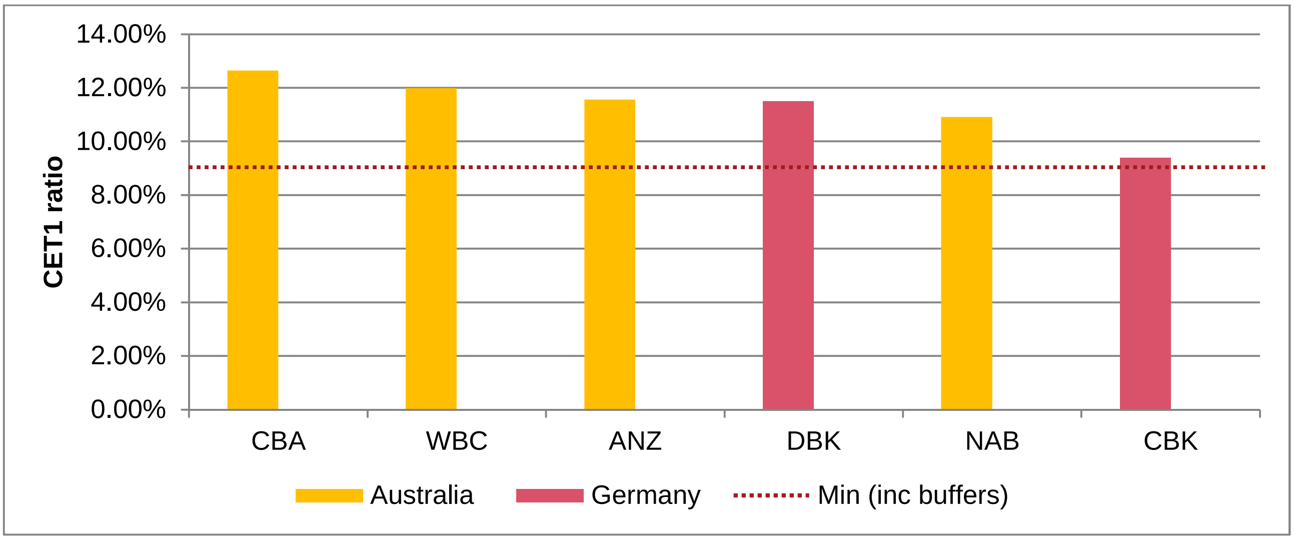


Source: Individual bank data, PwC analysis, 2014.
Refer to appendix G for abbreviated terms.

3.4.2 Germany

Reflecting the analysis in Appendix D and Appendix E, we noted the following adjustment that needs to be made to the Internationally comparable CET1 ratio for the Australian banks in calculating their CET1 (Germany) ratio. Foreseeable dividends are deducted from capital when calculating their CET1 ratio, this reduces the capital ratio. In calculating the CET1 (Germany) ratio for Australian banks, a similar adjustment has been applied to reflect the dividend declared or expected out of current period earnings.

Figure 5: Australian and German banks on a CET1 (Germany) basis



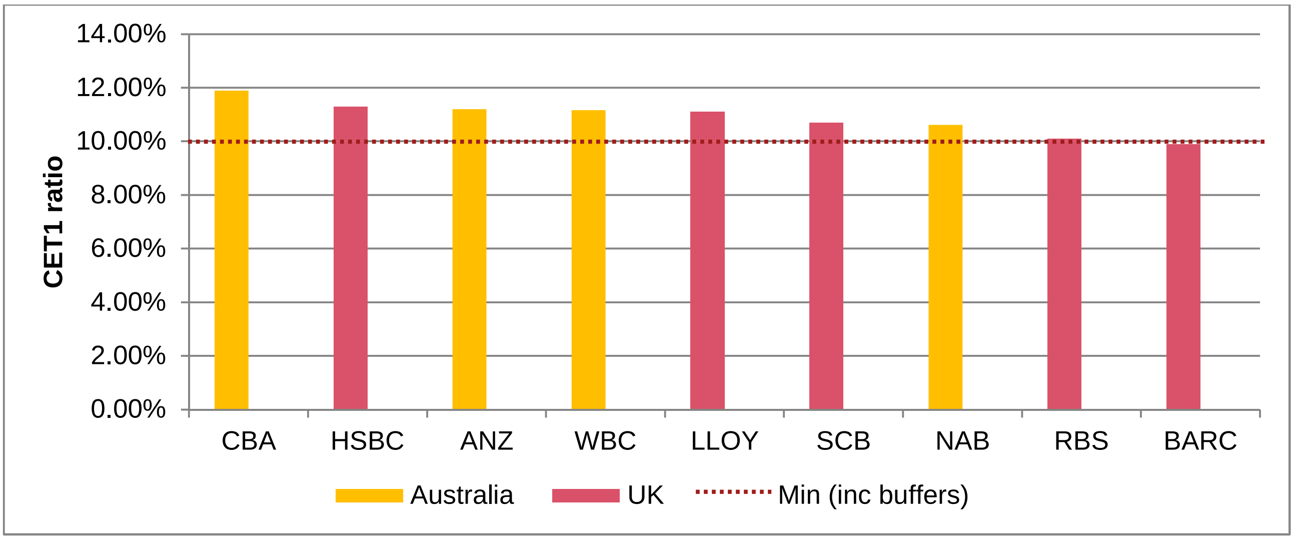
Source: Individual bank data, PwC analysis, 2014.
Refer to appendix G for abbreviated terms.

3.4.3 United Kingdom (UK)

Reflecting the analysis in Appendix D and Appendix E, we noted the following adjustments that need to be made to the Internationally comparable CET1 ratio for the Australian banks in calculating their CET1 (UK) ratio:

- Deduct foreseeable dividends from the capital base (reduces capital ratio);
- Apply a 45 per cent LGD floor to sovereign exposures (reduces capital ratio); and
- Apply the supervisory slotting approach (with BCBS defined risk weights) to a portion of the specialised lending portfolio (reduces capital ratio).

Figure 6: Australian and UK banks on a CET1 (UK) basis



Source: Individual bank data, PwC analysis, 2014.
Refer to appendix G for abbreviated terms.

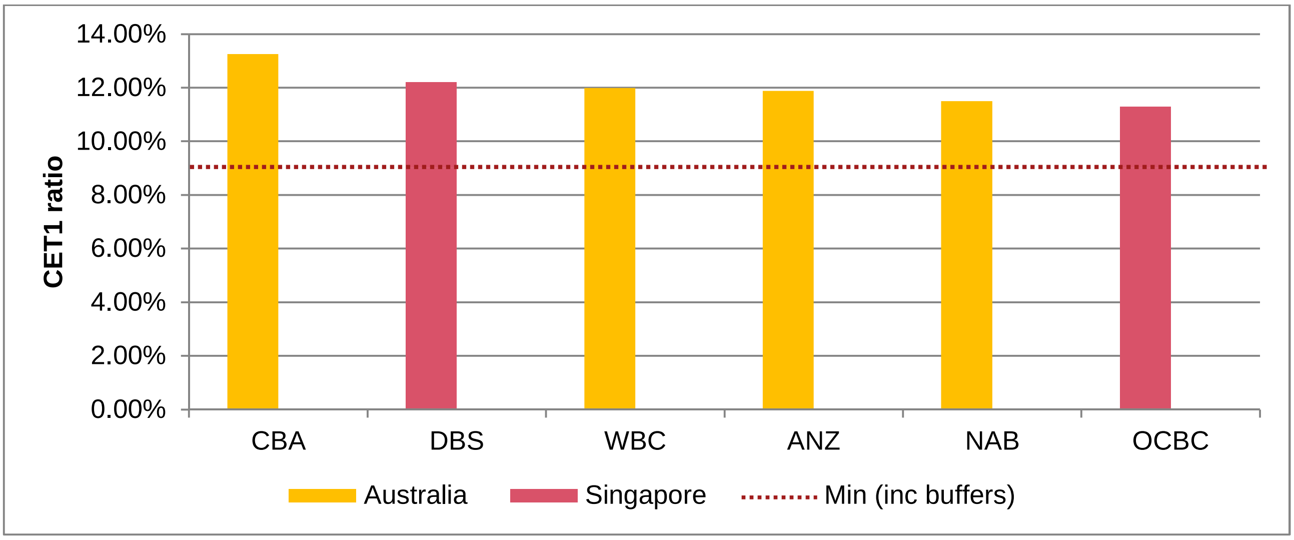
3.4.4 Singapore

Reflecting the analysis in Appendix D and Appendix E, we noted the following adjustment that needs to be made to the Internationally comparable CET1 ratio for the Australian banks in calculating their CET1 (Singapore) ratio.

The supervisory slotting approach for Specialised Lending (with BCBS defined risk weights) is applied to a portion of the specialised lending portfolio, this reduces the capital ratio. In calculating the CET1 (Singapore) ratio for Australian banks, a similar adjustment has been applied to the specialised lending portfolio.

As noted in section 4.1.2, there are structural differences between Australia and Singapore in relation to mortgages.

Figure 7: Australian and Singaporean banks on a CET1 (Singapore) basis

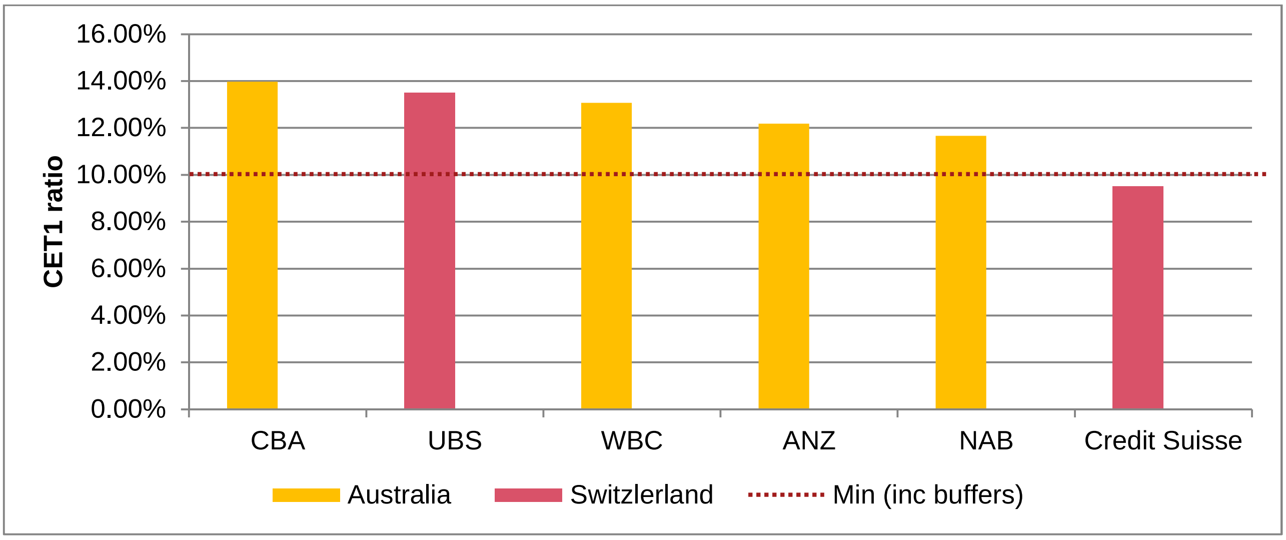


Source: Individual bank data, PwC analysis, 2014.
Refer to appendix G for abbreviated terms.

3.4.5 Switzerland

Reflecting the analysis in Appendix D and Appendix E, we have not identified any adjustments that need to be made to the Internationally comparable CET1 ratio for the Australian banks in calculating their CET1 (Swiss) ratio.

Figure 8: Australian and Swiss banks on a CET1 (Swiss) basis



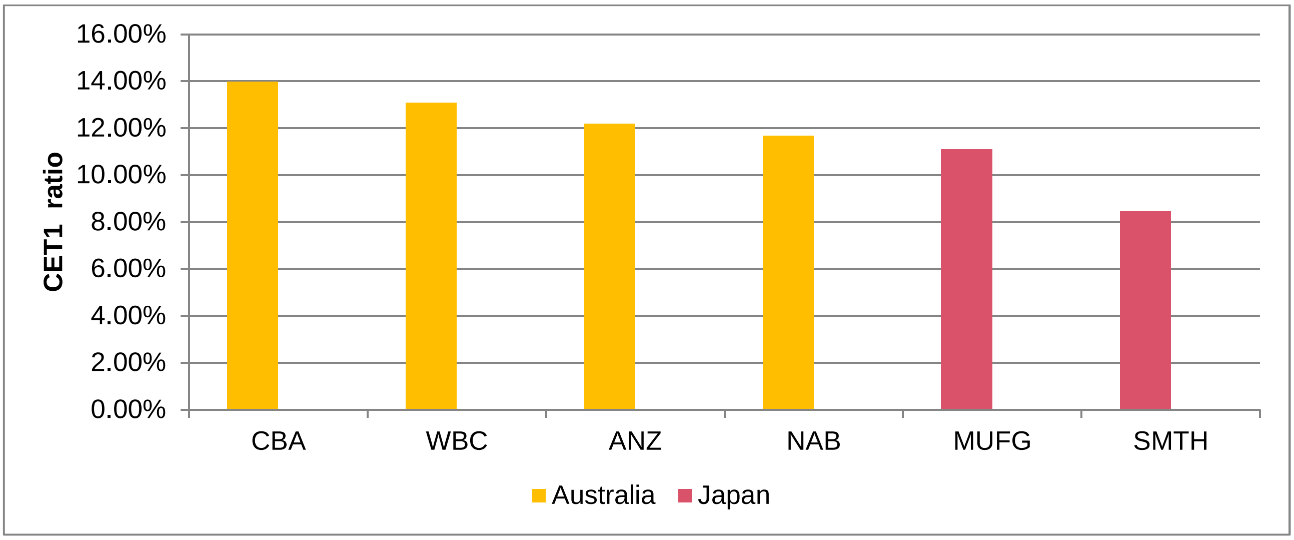
Source: Individual bank data, PwC analysis, 2014.
Refer to appendix G for abbreviated terms.

3.4.6 Japan

Reflecting the analysis in Appendix D and Appendix E, we have not identified any adjustments that need to be made to the Internationally comparable CET1 ratio for the Australian banks in calculating their CET1 (Japanese) ratio.

According to the BCBS's progress report on Basel III implementation (April 2014), a D-SIB approach is still being developed.

Figure 9: Australian and Japanese banks on a CET1 (Japanese) basis



Source: Individual bank data, PwC analysis, 2014.
Refer to appendix G for abbreviated terms.

4 Identification and analysis of differences in calculating CET1 ratios

4.1 Identifying differences and areas of judgement

4.1.1 Overall approach to identifying differences in CET1 ratio calculations

We identified differences in approach to implementing the Basel Framework from a variety of sources:

a The BCBS (March 2014) *Regulatory Consistency Assessment Programme (RCAP), Assessment of Basel III regulations – Australia*, which identified:

  i. twenty-seven areas where APRA was considered to be more conservative than the Basel Framework (not all of these were considered to be material differences), and

  ii. three areas where APRA was considered to be (potentially) materially less conservative than the Basel Framework.

b RCAP assessment reports issued by the BCBS for other countries; Canada, Brazil, China, Switzerland, Singapore, European Union, Japan and the United States (all conducted between October 2012 and June 2014).

c BCBS' thematic study[9] which analysed risk weighted assets for credit risk in the banking book (this is discussed in section 4.1.2. below).

d We also researched literature, considered other methods for calculating capital adopted by rating agencies and consulted the PwC international network. The PwC international network also assisted us in gaining an understanding of the nature of differences identified in their jurisdictions, the overall approach adopted by their respective regulators in implementing the Basel Framework and relevant structural aspects of their banking industry.

The full list of identified differences was categorised as follows:

- **Category A** – RCAP (Australia) findings where APRA is considered to be more conservative than the Basel Framework. Some of these adjustments are not applicable to the CET1 ratio for advanced banks and others were considered to be immaterial. For more information refer to appendices B and C.
- **Category B** – Potentially material RCAP (Australia) findings where APRA is considered to be less conservative than the Basel Framework. For more information refer to appendices B and C.
- **Category C** – Other adjustments identified from other RCAP reports, reviewing other banks reported information and reaching out to the PwC international network. These are discussed in more detail in section 4.1.2 below.

Appendices B to F contain a complete list of all differences we considered, detailed descriptions of individual differences and our assessment of the applicability of each difference to calculating CET1 ratios.

---

[9] BCBS RCAP Analysis of credit risk weighted assets in the banking book, July 2013

4.1.2 Credit risk weighted assets - Australia's model outcomes compared to international norms

Credit risk is the major contributor to risk weighted assets for Australian banks and can be a cause of measureable inconsistencies between the International comparable CET1 ratios for Australian banks and global peers.

AIRB banks use their own data and models to generate the factors used to risk weight their assets. Individual bank models are subject to approval by their national regulator. National regulators can set limits when applying risk factors and require specific assumptions to be built into the models. Both individual bank modelling assumptions and the way national regulators implement the Basel Framework introduce differences which need to be considered when making comparisons.

Residential Mortgage Loss Given Default (LGD) floors

When introducing Basel II, the BCBS[10] set an LGD floor of 10 per cent on residential mortgages due to a lack of long-term historical data relating losses arising in periods of financial stress. This floor prevents banks from setting the LGD assumption too low. APRA has used its national discretion to impose a higher, 20 per cent, LGD floor on residential mortgages in Australia. This 20 per cent LGD floor assumption gives rise to Australian banks holding more capital against their mortgage book than banks in other jurisdictions. This is further exacerbated by the tendency for Australian banks to hold a higher proportion of residential mortgage assets than in other jurisdictions.

In order to allow for this impact in our analysis, we have required the Australian AIRB banks to apply a 15 per cent flat LGD to their residential mortgage books. For most banks that have modelled their portfolios using a 10 per cent LGD floor, the results show LGD's higher than 10 per cent, however these are not accredited models and so not judged to be a prudent basis for our estimate. Taking into consideration structural differences such as the higher loan-to-value ratios (LVRs) between Australia and other countries such as Singapore (where LVRs cannot exceed 80 per cent for first properties)[11] and Canada (where there is a government based LMI scheme), in our judgement we consider a 15 per cent flat LGD assumption to be a reasonable proxy. A 1 per cent change in the mortgage LGD assumption represents 7 bps change in the average CET1 ratio.

Unsecured corporate lending (LGD)

In a number of jurisdictions banks have found it difficult to achieve full AIRB accreditation for their unsecured corporate lending portfolios due in part to a lack of reliable loss data over a sufficient time period. In keeping with the Basel Framework, banks in this situation use the FIRB approach for determining risk weighted assets for the portfolio. The FIRB approach uses a 45 per cent LGD modelling assumption for unsecured corporate exposures.

The BCBS (July 2013) RCAP report, *Analysis of risk-weighted assets for credit risk in the banking book*[12], confirmed that variation in LGDs for corporate exposures in the hypothetical portfolio is a driver of inconsistency in the comparability of risk weightings.

As unsecured corporate loans are a significant portfolio relative to overall balance sheet size for Australian banks, differences in this modelling assumption would be expected to impact the overall international comparability of the capital ratio.

To negate this impact in our analysis we have required the Australian banks to model their risk weighted assets for unsecured corporate exposures adopting the FIRB approach of using a 45 per cent LGD. In our judgement, given that approximately half of the international peer group currently use the FIRB approach, we consider this to be a reasonable measure to bring the Australian banks more in line with banks in other jurisdictions.

---

[10] BCBS, *Basel II: International Convergence of Capital Measurement and Capital Standards,* BIS, June 2006

[11] More specific guidance is outlined in Monetary Authority of Singapore (MAS), *MAS Notice 632, Residential Property Loans,* MAS, para 30(t), February 2014

[12] BCBS, *Regulatory Consistency Assessment Programme (RCAP) Analysis of risk-weighted assets for credit risk in the banking book,* BIS, *July 2013*

Undrawn corporate lending (EAD)

Another area of inconsistency in international comparability of risk weighted assets identified by the BCBS RCAP thematic report was the assessment of exposure at default (EAD) for undrawn commitments (referred to as credit conversion factors, or CCF in the Basel Framework). The BCBS report identified that 'for AIRB banks, the average conversion factor applied to undrawn commitments is roughly 50 per cent; this can be contrasted with the 75 per cent CCF for such commitments under the FIRB approach'[13]. We understand that Australian AIRB banks use higher conversion factors for the EAD relating to undrawn commitments, typically 100 per cent.

In order to negate the impact of higher EADs for undrawn commitments, in our judgement we consider it reasonable to apply the FIRB conversion factor of 75 per cent to the undrawn commitments in the AIRB banks' corporate loan books.

4.2 Explanation of the key differences identified in Figure 1 *(Impact of differences in the application of the Basel Framework)*

A complete list of all differences identified and considered in this study can be found in appendices C and D.

The following table further analyses the major adjustments reflected in Figure 1: Impact of differences in the application of the Basel Framework on CET1 (APRA) ratios, section 3.

Description		Weighted average impact on CET1 (APRA) (bps)
	Ref App.B	**Major banks**
Differences between APRA prudential standards and the Basel Framework		
1 Capital deductions APRA requires 100 per cent deductions from capital for deferred tax assets, intangibles relating to capitalised expenses and all investments (e.g. financial institutions, funds management and insurance subsidiaries). The Basel Framework allows a concessional threshold before these deductions apply. Assets below the threshold can be risk weighted.	A3, A4, A5	109
Credit risk weightings		
2 Mortgage Loss Given Default (LGD) 20 per cent floor The Basel Framework imposes a 10 per cent floor in downturn LGD models used for residential mortgages, whereas APRA imposes a 20 per cent floor. In our judgement, a 15 per cent flat LGD is a reasonable proxy. Refer to section 4.1.2 above.	A1	40
2 Specialised Lending APRA rules for 'specialised lending' (corporate lending to project finance, certain real estate exposures, commodity finance etc) are more conservative than those contained in the Basel Framework and/or which are applied by most other prominent jurisdictions included in this study	A2	50
3 Interest rate risk in the banking book (IRRBB) APRA's rules require the inclusion of IRRBB within the Pillar 1 risk weighted assets framework for banks using AIRB approaches; IRRBB is not required to be assessed under Pillar 1 in the Basel Framework. It is highlighted as a risk that may be taken into account in assessing Pillar 2 capital ratios.	A11	30

[13] BCBS, *Regulatory Consistency Assessment Programme (RCAP) Analysis of risk-weighted assets for credit risk in the banking book,* BIS, p.46, *July 2013*

Description		Weighted average impact on CET1 (APRA) (bps)
4 Scaling factor related to specialised lending exposures APRA does not apply the 1.06 scaling factor for risk weighted assets calculated under the IRB approach, to specialised lending assets classes, as prescribed in the Basel Framework.	B2	(7)
4 Non owner occupied home loans The RCAP rated APRA's approach to residential mortgage exposures eligible for retail treatment under the IRB approach as a potentially material deviation, as APRA does not include an owner-occupancy constraint. A literal interpretation of the relevant paragraph in the Basel Framework can exclude non-owner occupied exposures. APRA commented in its response that its view is that the paragraph is ambiguous and a large number of other Basel Committee member jurisdictions have implemented the relevant paragraph in the same manner as APRA. Further commentary of this issue is contained on pages 14 to 15 of the BCBS RCAP (Singapore), March 2013. The banks in the study group were requested to quantify this potential deviation. In some cases, banks calculated an increase in risk weighted assets and in another case a reduction. None of the adjustments was more than 10 basis points and because of the difficulties in agreeing a consistent methodology for the adjustment, no adjustment was included for this item in the final analysis. Given APRA's comments about other Basel Committee member jurisdictions adopting a similar approach, this appears to be reasonable in the context of this study.	B3	n/a
5 Standardised risk weights Some advanced banks have retail portfolios that are assessed using the .Standardised approach. APRA applies more conservative risk weights than the Basel Framework for some standardised retail exposures.	A6	11
Other areas where credit risk estimates are more conservative in Australia by comparison to norms adopted in other countries		
6 Unsecured corporate lending LGD In our judgement, we consider it reasonable to apply the assumption of 45 per cent LGD, given that approximately half of the international peer group currently use the FIRB approach, which applies this assumption. This brings Australian banks more in line with banks in other jurisdictions. Refer to section 4.1.2 above.	C2	79
6 Undrawn corporate lending EAD In our judgement we consider it reasonable to apply the FIRB conversion factor of 75 per cent to the undrawn commitments in the AIRB banks corporate loan books. Refer to section 4.1.2 above.	C1	31

This concludes the main body of our report

Appendix A Australian major banks - detailed analysis of differences between Australian CET1 (APRA) and International comparable CET1 ratio

Table A1 – Summary of CET1 adjustments (in per cent)

	*Ref.	ANZ 31/03/2014	CBA 30/06/2014	NAB 31/03/2014	WBC 31/03/2014	Weighted Average
CET1 (APRA) ratio		**8.33%**	**9.30%**	**8.64%**	**8.82%**	**8.76%**
Category A adjustments: APRA more conservative						
Mortgage LGD (20% floor)	A1	0.32%	0.55%	0.28%	0.47%	0.40%
Specialised lending	A2	0.32%	0.70%	0.34%	0.69%	0.50%
Intangible assets	A3	0.15%	0.10%	0.03%	0.27%	0.14%
Equity holdings	A4	0.84%	0.80%	0.51%	0.36%	0.63%
Deferred tax assets	A5	0.20%	0.26%	0.33%	0.52%	0.32%
Standardised – retail exposures	A6	0.02%	0.12%	0.20%	0.09%	0.11%
Margin lending	A7	0.00%	0.02%	0.00%	0.02%	0.01%
Currency threshold adjustments	A8	0.01%	0.06%	0.04%	0.08%	0.05%
Operational risk	A9	0.00%	0.00%	0.06%	0.00%	0.01%
Counterparty credit risk	A10	0.00%	0.00%	0.00%	0.00%	0.00%
IRRBB	A11	0.40%	0.43%	0.16%	0.24%	0.30%
Category B adjustments: APRA less conservative						
Investment in own shares	B1	0.00%	(0.05%)	0.00%	0.00%	(0.01%)
Specialised lending – scaling factor	B2	(0.04%)	(0.08%)	(0.07%)	(0.09%)	(0.07%)
Investment home loans	B3	n/a	n/a	n/a	n/a	n/a
Total adjustment (standalone)		2.21%	2.91%	1.88%	2.64%	2.40%
CET1 (Basel Framework) ratio		**10.76%**	**12.78%**	**10.80%**	**12.00%**	**11.55%**
CET1 uplift		*2.43%*	*3.48%*	*2.16%*	*3.18%*	*2.79%*
Self-reported internationally harmonised CET1 ratio		**10.50%**	**12.10%**	**10.46%**	**11.26%**	**11.06%**
Additional adjustments						
Undrawn corporate lending EAD	C1	0.34%	0.32%	0.23%	0.36%	0.31%
Unsecured corporate lending LGD	C2	1.02%	0.83%	0.61%	0.67%	0.79%
Total adjustment (standalone)		**1.37%**	**1.15%**	**0.84%**	**1.02%**	**1.09%**
Internationally comparable CET1 ratio		**12.19%**	**13.98%**	**11.67%**	**13.07%**	**12.69%**

Source: Individual bank data, PwC analysis, 2014.
**Note: Refer to appendix B for more detail.*
Refer to appendix G for abbreviated terms.

Table A2 – Summary of CET1 adjustments (in A$ billions)

Capital and RWA values have been rounded to the nearest $ billion. All totals and capital ratios have been rounded to 2 decimal places from source data.
(Refer to the following page for notes)

As at:		ANZ 31/03/2014		CBA 30/06/2014		NAB 31/03/2014		WBC 31/03/2014	
$ billions	**Ref**	**Capital**	**RWA**	**Capital**	**RWA**	**Capital**	**RWA**	**Capital**	**RWA**
CET1 (APRA)		30.0	360.7	31.4	337.7	31.7	367.2	28.5	322.5
Category A adjustments: APRA more conservative									
Mortgage LGD (20% floor)	A1	0.0	(13.3)	0.0	(19.0)	0.0	(11.7)	0.0	(16.3)
Specialised lending	A2	0.0	(13.2)	0.0	(23.7)	0.0	(13.8)	0.0	(23.4)
Intangible assets	A3	0.6	1.0	0.4	0.4	0.1	0.2	1.0	1.1
Equity holdings	A4	4.0	10.4	3.8	11.0	2.4	6.1	1.7	5.9
Deferred tax assets	A5	0.9	2.3	1.2	2.9	1.5	3.9	2.2	5.5
Standardised – retail exposures	A6	0.0	(0.8)	0.0	(4.4)	0.0	(8.5)	0.0	(3.3)
Margin lending	A7	0.0	(0.0)	0.0	(0.7)	0.0	(0.2)	0.0	(0.6)
Currency threshold adjustments	A8	0.0	(0.6)	0.0	(2.1)	0.0	(1.7)	0.0	(2.9)
Operational risk	A9	0.0	0.0	0.0	0.0	0.0	(2.4)	0.0	0.0
Counterparty credit risk	A10	0.0	0.0	0.0	0.0	0.0	(0.0)	0.0	0.0
IRRBB	A11	0.0	(16.4)	0.0	(14.8)	0.0	(6.8)	0.0	(8.5)
Category B adjustments: APRA less conservative									
Investment in own shares	B1	0.0	0.0	(0.2)	0.0	0.0	0.0	0.0	0.0
Specialised lending – scaling factor	B2	0.0	1.7	0.0	2.9	0.0	2.8	0.0	3.2
Investment home loans	B3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Adjustment for expected loss*		0.1	0.0	0.5	0.0	0.4	0.0	0.7	0.0
Total adjustment		**5.7**	**(28.8)**	**5.7**	**(47.3)**	**4.5**	**(32.0)**	**5.5**	**(39.3)**
CET1 (Basel Framework)		35.7	331.9	37.1	290.4	36.2	335.2	34.0	283.2
CET1 ratio (Basel Framework)		**10.76%**		**12.78%**		**10.80%**		**12.00%**	
Category C adjustments									
Undrawn corporate lending EAD	C1	0.0	(10.2)	0.0	(7.1)	0.0	(6.8)	0.0	(8.2)
Unsecured corporate lending LGD	C2	0.0	(28.8)	0.0	(17.8)	0.0	(18.0)	0.0	(14.9)
Total other		0.0	(39.1)	0.0	(24.9)	0.0	(24.9)	0.0	(23.1)
Internationally comparable CET1 / RWA		**35.7**	**292.8**	**37.1**	**265.6**	**36.2**	**310.3**	**34.0**	**260.1**
Internationally comparable CET1 ratio**		**12.19%**		**13.98%**		**11.67%**		**13.07%**	

Table A2 continues on the following page.

Australian major banks - detailed analysis of differences between Australian CET1 (APRA) and International comparable CET1 ratio

As at:		ANZ 31/03/2014		CBA 30/06/2014		NAB 31/03/2014		WBC 31/03/2014	
$ billions	**Ref**	**Capital**	**RWA**	**Capital**	**RWA**	**Capital**	**RWA**	**Capital**	**RWA**
Other jurisdiction specific adjustments from International comparable CET1 ratios									
UK Adjustment									
Total adjustment (standalone)		**(1.9)**	**9.2**	**(3.5)**	**16.7**	**(2.3)**	**8.8**	**(2.8)**	**19.3**
CET1 (UK)		33.8	302.0	33.6	282.2	33.9	319.1	31.2	279.5
CET1 ratio (UK)		**11.20%**		**11.90%**		**10.61%**		**11.16%**	
Singapore Adjustment									
Total adjustment (standalone)		**0.0**	**7.6**	**0.0**	**14.6**	**0.0**	**4.5**	**0.0**	**15.3**
CET1 (Singapore)		35.7	300.5	37.1	280.1	36.2	314.9	34.0	275.5
CET1 ratio (Singapore)		**11.88%**		**13.25%**		**11.50%**		**12.34%**	
Germany Adjustment									
Total adjustment (standalone)		**(1.9)**	0.0	**(3.5)**	0.0	**(2.3)**	0.0	**(2.8)**	0.0
CET1 (Germany)		33.8	292.8	33.6	265.6	33.9	310.3	31.2	260.1
CET1 ratio (Germany)		**11.55%**		**12.65%**		**10.91%**		**11.99%**	

Source: Individual bank data, PwC analysis, 2014.
Refer to appendix G for abbreviated terms.
**Note: Any adjustment to risk weighted assets also potentially reduces expected loss (EL), which in turn may reduce the deduction taken by Australian major banks for the excess of expected loss over eligible provisions. We have made one single adjustment to reduce this EL deduction, rather than allocating the benefit to specific adjustments. The total EL add back to CET1 is limited to the deduction already taken in APRA reporting. The impact in table A1 (in bps) of this item is included in the cumulative capital ratio, and so is a reconciling item between the sum of stand-alone adjustments and the cumulative impact.*
***Note: The ratios for CET1 (Canada), CET1 (Swiss) and CET1 (Japanese) are equal to the Internationally comparable CET1 ratio above.*

Appendix B Summary of differences and related adjustments

*Ref	Description	Nature of adjustment	Primary impact	Degree of judgement required
Category A: APRA more conservative				
A1	Mortgage LGD (20% floor)	Reduce LGD floor from 20 per cent floor to 15 per cent flat for residential mortgage portfolios.	↓RWA	
A2	Specialised lending	Move loan portfolio(s) from supervisory slotting to IRB approach	↓RWA	
A3	Intangible assets	Add back to CET1 additional deductions as required by APRA (e.g. capitalised expenses).	↑Capital	
A4	Equity holdings	Add back to CET1 additional deductions as required by APRA.	↑RWA↑Capital	
A5	Deferred tax assets	Add back to CET1 additional deductions as required by APRA.	↑RWA ↑Capital	
A6	Standardised – retail exposures	Reduce risk weights to 35 per cent for residential mortgages; and 100 per cent to 75 per cent for other retail loans.	↓RWA	
A7	Margin lending	Reduce risk weight below APRA 20 per cent (standardised portfolios).	↓RWA	
A8	Currency threshold adjustments	Increasing $A threshold for inclusion in retail/SME portfolios.	↓RWA	
A9	Operational risk	Remove more conservative loss definitions and modelling assumptions.	↓RWA	
A10	Counterparty credit risk	Reduce EAD for some counterparty credit risk.	↓RWA	
A11	IRRBB	Remove IRRBB risk weighted assets from Pillar 1 capital requirements.	↓RWA	
Category B: APRA less conservative (material or potentially material)				
B1	Investment in own shares	Additional deductions for selected own shares held by group members.	↓Capital	
B2	Specialised lending – scaling factor	Apply 1.06 scaling factor for specialised lending.	↑RWA	

*Ref	Description	Nature of adjustment	Primary impact	Degree of judgement required
Category C: Other adjustments				
C1	Undrawn corporate lending EAD	Reduce EAD on corporate undrawn exposures to 75 per cent.	↓RWA	
C2	Unsecured corporate lending LGD	Reduce LGD to 45 per cent for unsecured corporate credit.	↓RWA	
C3	Sovereign LGD floor 45%	Increase LGD to 45 per cent for sovereign exposures.	↑RWA	
C4	Foreseeable dividend	Deduct foreseeable dividend from CET1.	↓Capital	

**Note: Refer to appendices C and D for more detail.*

KEY

Primary impact

This represents the impact of the adjustment on the capital ratio.

Improve capital ratio (decrease risk weighted assets or increase capital base)

Reduce capital ratio (increase risk weighted asset or decrease capital base)

Note: The table above indicates the primary impact.

Degree of judgement required

Each adjustments includes an element of judgement to be made when quantifying its' impact on either the capital base or the risk weighted asset. The degree of judgement required is indicated using the scale below:

Lower

Higher

Appendix C Areas where APRA's approach to calculating CET1 differs from RCAP (Australia) and other adjustments for international comparability

The table below details the list of differences where APRA adopts a more conservative approach than the BCBS minimum capital requirements ("Category A"). A "more conservative" approach is deemed to be those differences leading to higher risk weighted assets or lower capital base.

In addition, these differences having been assessed as being applicable to the four major banks, and which are material or potentially material, have therefore been considered in the analysis (items marked with ✓).

Those differences identified as immaterial have not been examined further. Furthermore, any differences not applicable (n/a) to the four major banks for the purposes of this study, have also been identified. For full details on the treatment of these differences in the analysis performed, refer to the "Approach" section in appendix E.

Category A: APRA more conservative

Ref	Description	Source Ref: RCAP	Applicability
A1	Mortgage LGD - 20% floor	P.17	✓
A2	Specialised lending – prescribe slotting approach	P.17	✓
A3	Intangible assets – additional deductions	10.1	✓
	Own shares trading limits – additional deductions	10.2	Immaterial
A4	Reciprocal cross-holdings – additional deductions	10.3	✓
A4	Equity holdings (financial entities) – additional deductions	10.4	✓
A5	Deferred tax assets – additional deductions	10.5	✓
	Basel III capital ratios transitional arrangements - not applied	10.6	n/a
	Basel III capital instruments transitional arrangements - not applied	10.7	n/a
	Basel III capital buffers transitional arrangements – not applied	10.8	n/a

Areas where APRA's approach to calculating CET1 differs from RCAP (Australia) and other adjustments for international comparability

Ref	Description	Source Ref: RCAP	Applicability
A6	Standardised retail exposures – risk weight 100%	10.9	✓
A6	Standardised retail mortgage risk – risk weight ≥ 35%	10.10	✓
A7	Margin lending exposures - risk weight ≥ 20%	10.11	✓
A7	Margin lending – IRB approach not allowed	10.12	✓
A8	Small business exposures - threshold of $1M	10.13	✓
A8	Retail revolving exposure – threshold of $100K	10.14	✓
A8	SMEs– $50M turnover threshold	10.15	✓
	Foundation IRB - other collateral not recognised	10.16	FIRB banks only
	Foundation IRB - 100% CCF for commitments etc	10.17	FIRB banks only
	Excess eligible provisions – not included in capital	10.18	Total capital only
	Securitisation originating bank– wider definition	10.19	Immaterial
	Securitisation implicit support– additional prohibitions	10.20	Immaterial
	Operational risk foreign bank subsidiaries – additional conditions	10.21	n/a
	Operational risk AMA criteria	10.22	Immaterial
A9	Operational risk AMA quantitative standards	10.23	Low materiality (only quantified by one bank)
A9	Operational Risk - fraud related losses	10.24	Low materiality (only quantified by one bank)
A10	Counterparty Credit Risk -EAD > 0	10.25	Low materiality (only quantified by one bank)
	Correlation trading portfolio	10.26	Immaterial
A11	IRRBB - Pillar 1 inclusion	10.27	✓

CATEGORY B: RCAP Findings – APRA less conservative (material or potentially material)

The table below details the list of differences where APRA adopts a less conservative approach than the BCBS minimum capital requirements ("Category B"). A "less conservative" approach is deemed to be those differences leading to lower risk weighted assets or higher capital base. Note, these differences were identified as part of the RCAP findings as material or potentially material, and have therefore been considered in the analysis (items marked with ✓). A range of RCAP findings identified as immaterial have not been examined further.

Ref	Description	Source Ref: RCAP	Applicability
B1	Investment in own shares	P.24	✓
B2	1.06 scaling factor	P.30	✓
B3	Non-owner occupied mortgages (potentially material)	P.31	✓
	Minimum requirement for loss absorbency at the point of non-viability (material)	P.25	Total capital only
	Indirect funding of own capital instruments (not material)	P.13	Immaterial

CATEGORY C: Other adjustments for international comparability

We have identified further adjustments for other recognised differences (such as risk modelling parameters and national discretions).

Ref	Description	Cross ref:	Applicability
APRA more conservative – adjustments applied in deriving Internationally comparable CET1			
C1	Undrawn corporate lending EAD	See section 4.1.2 of this report	✓
C2	Unsecured corporate lending LGD	See section 4.1.2 of this report	✓
APRA less conservative than some jurisdictions – adjustments applied to jurisdiction comparatives as applicable (see Appendix D)			
C3	Sovereign LGD floor 45%: increase LGD to 45 per cent for sovereign exposures (UK only)	n/a	✓
C4	Foreseeable dividend: deduct foreseeable dividend from CET1 (UK / Europe)	n/a	✓

Appendix D Areas of difference between Australia and peer group jurisdictions (refers to section 3.4)

Table D1 – Jurisdiction specific material differences

*Ref	Description	Australia	UK	Germany	Switzerland	Canada	Singapore	Japan
APRA more conservative								
A1	LGD mortgage floor	20%	10%	10%	10%	10%	10%	10%
A2	Slotting required for specialised lending	Y: additionally APRA risk weights more conservative than BCBS	Partial: income producing real-estate only. UK risk weights equivalent to BCBS	N	N	N	Y: apply BCBS risk weights	N
A4	Equity holdings: full deduction, no threshold treatment	Y	N	N	N	N	N	N
A5	Deferred tax assets: full deduction, no threshold treatment	Y	N	N	N	N	N	N
A12	IRRBB: included in Pillar 1 RWAs	Y	N	N	N	N	N	N
C1	EAD for undrawn corporate	Y	N	N	N	N	N	N
C2	LGD for unsecured corporate	Y	N	N	N	N	N	N
APRA less conservative								
C3	Sovereign LGD floor of 45%	N	Y	N	N	N	N	N
C4	Deduct foreseeable dividend	N	Y	Y	N	N	N	N

Table D2 – Foreseeable dividend adjustments applied

The table below summarises the foreseeable dividend adjustments which have been applied in Figure 3. Not all banks who deduct foreseeable dividends publish the impact of this adjustment on fully loaded CET1. In such cases we have used the adjustment disclosed to transitional CET1 and applied to fully loaded CET1. The difference is likely to be negligible.

Bank	Reported fully loaded CET1	Foreseeable dividend adjustment	Internationally comparable CET1
Nordea	15.20%	0.62%	15.82%
Intesa Sanpaolo	12.90%	0.09%	12.99%
Deutsche Bank AG	11.50%	0.14%	11.64%
HSBC Holdings Plc.	11.30%	0.13%	11.43%
Standard Chartered	10.70%	0.17%	10.87%
Societe Generale	10.20%	0.31%	10.51%
UniCredit	10.37%	0.03%	10.40%
BNP Paribas	10.00%	0.30%	10.30%
Barclays	9.90%	0.14%	10.04%

Appendix E Analysis of international jurisdictions RCAPs

Jurisdictions which we have used for comparison purposes have had RCAP Reports completed. In this Appendix we have summarised the findings from those RCAPs for two purposes: (i) findings where a jurisdiction has not fully applied the Basel Framework (and so APRA may be more conservative if they have fully applied the Framework) and (ii) areas where that jurisdiction has been identified as being more conservative than the Basel Framework (and where APRA may be less conservative than that jurisdiction if they have applied the Basel minimum). We have assessed each finding and assessed whether it is a factor which requires adjustment in this study.

Canada (June 2014)

RCAP differences

Area	Finding	PwC Comment
Definition of capital		
Inclusion of Preference Share Capital	Does not require preferred shares (accounted as liabilities & incl. in Additional Tier 1) to include the automatic conversion trigger at the capital ratio of 5.125 per cent of risk weighted assets (as required by Basel).	The focus of this report is on fully implemented CET1. Accordingly no adjustment has been made for this item.

Areas where the Canadian rules are stricter than the Basel minimum

Area	Finding	PwC Comment
Definition of capital and transitional arrangements	Office of the Superintendent of Financial Institutions (OSFI) expects all banking institutions to attain target capital ratios equal to or greater than the 2019 capital ratios from 2013.	Equivalent to APRA. Does not impact calculation of disclosed capital ratios. No adjustment made.
	The Canadian Capital Adequacy Requirements (CAR) Guideline requires that any discretionary repurchases of common shares are subject to the prior approval of the Superintendent.	Does not impact calculation of disclosed capital ratios. No adjustment made.
	Paragraphs 16 and 29 of the CAR Guideline require that amendments to the terms and conditions of additional Tier 1 and Tier 2 instruments are subject to the prior approval of the Superintendent.	Does not impact calculation of disclosed capital ratios. Not applicable to CET1. No adjustment made.
Counterparty credit risk (Annex 4)	OSFI's expectation that banks will provide documented justification for their use of two different pricing models, in the case where the pricing model used to calculate counterparty credit risk exposure is different to the pricing model used to calculate market risk over a short horizon.	Qualitative requirement. Does not impact calculation of disclosed capital ratios. No adjustment made.
	OSFI's expectation that banks will provide documented justification for their choice of calibration methods, when two different calibration methods are used for different parameters within the effective expected positive exposure model.	Qualitative requirement. Does not impact calculation of disclosed capital ratios. No adjustment made.
Market Risk	OSFI does not allow banks using the Standardised Approach to include unrated securities in the "qualifying" category for the computation of interest rate risk.	Australian major banks are advanced. Not applicable. No adjustment made.
	OSFI does not fully implement the futures-related arbitrage strategies that attract lower market risk capital charges.	OFSI approach similar to APRA. No adjustment made.

Switzerland (June 2013)

Areas where the Swiss rules are potentially less strict than the Basel minimum

The RCAP process identified 10 “negative deviations” from the Basel text for the “International Approach”, which had not yet been rectified by amendments to the Swiss rules at the time of the assessment. The RCAP measured the cumulative average impact of these items on CET1 as 5bps. We consider this immaterial for this exercise.

Areas where the Swiss rules are stricter than the Basel minimum

None noted in the RCAP.

Europe (includes Germany: preliminary report October 2012)

Areas where the EU rules are potentially less strict than the Basel minimum

The RCAP process identified a number of material and potentially material findings. The EU has challenged a number of the findings, and the assessment remains preliminary. We have not made any additional adjustments to reflect these findings (which may increase Australian major bank capital ratios in comparison to EU institutions).

Areas where the European rules are stricter than the Basel minimum

Area	Finding	PwC Comment
Credit risk: IRB	Basel allows the risk weight for short-term, self-liquidating letters of credit with unrated banks to be lower than the risk weight of the bank’s sovereign of incorporation; the Capital Requirements Regulation (CRR) does not include a similar provision.	Negligible

Singapore (March 2013)

RCAP differences

Area	Finding	PwC Comment
Credit risk: Standardised Approach		
Expanded list of eligible financial collateral	Structured deposits inclusion in the list of eligible financial collateral deemed inappropriate since the structured deposits are not comparable to deposits treated as "cash" and have higher risk.	Only impacts 2 per cent of the deposits in Singapore. Applicable to standardised approach. Negligible impact for Australian majors. No further adjustment necessary for Australian major bank ratios to compare to Singapore.
Credit risk: Internal Ratings-Based Approach		
Definition of Retail Exposures (PM**)**	Allows some exposures to individuals ineligible for retail exposure treatment to be risk weighted at 100 per cent rather than being considered corporate exposures category under the IRB Approach. Also does not restrict the residential mortgage treatment of retail exposures only to exposures to individuals that are owner-occupiers of the property.	Similar to APRA approach. Determined as potentially material in Singapore (some banks noted an increase in ratio, others a decrease). No further adjustment necessary for Australian major bank ratios to compare to Singapore.

Areas where the Singapore rules are stricter than the Basel minimum

Area	Finding	PwC Comment
Definition of capital and transitional arrangements	Explicit CET1 capital adequacy requirement, to be set at 6.5 per cent (as compared to the Basel III minimum of 4.5 per cent)	Does not impact calculation of disclosed capital ratios. No adjustment applicable for this report.
	Tier 1 capital adequacy requirement increased from the Basel III minimum of 6 per cent to 8 per cent.	As above.

Japan (October 2012)

Areas where the Japanese rules are potentially less strict than the Basel minimum

The RCAP process noted that all identified gaps were noted to be non-material. No further adjustment necessary for Australian major bank ratios to compare to Japan.

Areas where the Japanese rules are stricter than the Basel minimum

Extract from RCAP (Japan) Annex G: "The Japanese authorities have not listed any areas as super-equivalent compared to the Basel Framework."

Appendix F Extracts of rules pertaining to differences

The table below explains the differences between APRA's implementation of Basel and the core Basel text, together with the approach we have adopted in this study. "APRA v BCBS differences" are extracted directly from the BCBS's RCAP (Australia).

RCAP / *PwC* Refs.	Description	Basel Ref.	APRA v BCBS difference	Approach taken in this study
Main Findings: Credit risk: Internal Ratings-Based approach				
RCAP pg.17 *A1*	Mortgage LGD - 20% floor	**Basel II para 266:** Owing to the potential for very long-run cycles in house prices which short-term data may not adequately capture, during this transition period, LGDs for retail exposures secured by residential properties cannot be set below 10% for any sub-segment of exposures to which the formula in paragraph 328 is applied. During the transition period the Committee will review the potential need for continuation of this floor.	Basel Framework prescribes a 10% floor for loss-given default of exposures secured by residential mortgages that must be applied at the sub segment of exposures to which the risk weight asset formula is applied. APRA prescribes a 20% floor. This floor, however, is applied at the portfolio level. While this is not strictly in conformity with the letter and intent of the Basel Framework, the risk that loss-given-default estimates for sub-segments of exposures declining below the Basel 10% floor is deemed immaterial.	Apply a flat LGD assumption. See section 4.1.2 for further discussion of approach.
RCAP pg.17 *A2*	Specialised lending – prescribe slotting approach	**Basel II para 215 and 275:** 215. Under the IRB approach, banks must categorise banking-book exposures into broad classes of assets with different underlying risk characteristics, subject to the definitions set out below. The classes of assets are (a) corporate, (b) sovereign, (c) bank, (d) retail, and (e) equity. Within the corporate asset class, five sub-classes of specialised lending are separately identified. Within the retail asset class, three sub classes are separately identified. Within the corporate and retail asset classes, a distinct treatment for purchased receivables may also apply provided certain conditions are met. 275. Banks that do not meet the requirements for the estimation of PD under the corporate IRB approach will be required to map their internal grades to five supervisory categories, each of which is associated with a specific risk weight.	APRA took a decision not to allow any internal modelling of the specialised lending (SL) risk parameters and to prescribe the more conservative slotting approach for all SL sub-asset classes.	The difference between the risk weighted asset calculated using the supervisory slotting methodology and the risk weighted asset calculated using participant banks internal corporate models was deducted from the regulatory risk weighted asset. The following modelling assumptions were used : • Current internally calculated PD, LGD and EAD • Exposures were moved to the Corporate Other curve or the Other SME curve depending on their characteristics. It is noted that the supervisory slotting approach is a method defined by the Basel

RCAP / *PwC* Refs.	Description	Basel Ref.	APRA v BCBS difference	Approach taken in this study
				Framework, and so arguably not a departure. However, as noted in RCAP (Australia), the unavailability of internal modelling approaches for this portfolio is an area of APRA conservatism. Additionally, many comparable jurisdictions (except Singapore) permit the use of internal modelling for SL. We have therefore concluded that it is appropriate to estimate the impact on risk weighted assets of using AIRB rather than slotting for this portfolio.
Definition of capital and transitional arrangements				
RCAP Annex 10.1 *A3*	Intangible assets – additional deductions	**Basel III para 67:** Goodwill and all other intangibles must be deducted in the calculation of Common Equity Tier 1, including any goodwill included in the valuation of significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation. With the exception of mortgage servicing rights, the full amount is to be deducted net of any associated deferred tax liability which would be extinguished if the intangible assets become impaired or derecognised under the relevant accounting standards. The amount to be deducted in respect of mortgage servicing rights is set out in the threshold deductions section below.	Basel requires exposures classified as intangible assets under International Financial Reporting Standards to be deducted from Common Equity Tier 1 (CET1) capital. In addition to these exposures, APRA requires the deduction from CET1 capital of certain other items which APRA deems should be treated in a similar fashion to intangibles (for example, capitalised expenses, capitalised transaction costs and mortgage servicing rights).	Add back to CET1 the additional deductions required by APRA. These items were identified from the following items included in capital adequacy reports submitted to APRA (ARF110). 2.6.1. Loan and lease origination fees and commissions paid to mortgage originators and brokers 2.6.2. Costs associated with debt raisings 2.6.3. Costs associated with issuing capital instruments 2.6.5. Securitisation start-up costs 2.6.6. Other capitalised expenses The above items were added to risk weighted assets, calculated at a risk weight of 100 per cent.
RCAP Annex 10.2 *n/a*	Own shares trading limits – additional deductions	**Basel III para 78:** All of a bank's investments in its own common shares, whether held directly or indirectly, will be deducted in the calculation of Common Equity Tier 1 (unless already derecognised under the relevant accounting standards). In addition, any own stock which the bank could be contractually	Basel requires that banks deduct investments in own shares (treasury stock) from CET1 capital. APRA also requires the deduction of any unused portion of any trading limits in own shares that have been agreed with APRA.	Participant banks calculated the portion of unused trading limits in their own shares which are deducted from CET1. This item was deemed immaterial, and so no adjustment to add back to CET1 has been applied in this study.

RCAP / *PwC* Refs.	Description	Basel Ref.	APRA v BCBS difference	Approach taken in this study
		obliged to purchase should be deducted in the calculation of Common Equity Tier 1. The treatment described will apply irrespective of the location of the exposure in the banking book or the trading book. In addition: • Gross long positions may be deducted net of short positions in the same underlying exposure only if the short positions involve no counterparty risk. • Banks should look through holdings of index securities to deduct exposures to own shares. However, gross long positions in own shares resulting from holdings of index securities may be netted against short position in own shares resulting from short positions in the same underlying index. In such cases the short positions may involve counterparty risk (which will be subject to the relevant counterparty credit risk charge). This deduction is necessary to avoid the double counting of a bank's own capital. Certain accounting regimes do not permit the recognition of treasury stock and so this deduction is only relevant where recognition on the balance sheet is permitted. The treatment seeks to remove the double counting that arises from direct holdings, indirect holdings via index funds and potential future holdings as a result of contractual obligations to purchase own shares. Following the same approach outlined above, banks must deduct investments in their own Additional Tier 1 in the calculation of their Additional Tier 1 capital and must deduct investments in their own Tier 2 in the calculation of their Tier 2 capital.		
RCAP Annex 10.3 *A4*	Reciprocal cross-holdings – additional deductions	**Basel III para 79:** Reciprocal cross holdings of capital that are designed to artificially inflate the capital position of banks will be deducted in full. Banks must apply a "corresponding deduction approach" to such investments in the capital of other banks, other financial institutions and insurance entities. This means the deduction should be applied to the same component of capital for which the capital would qualify if it was issued by the bank itself.	Basel requires reciprocal cross-holdings in the capital of banking, financial and insurance entities to be deducted from CET1 capital. APRA requires the full deduction of all holdings of capital of banking, financial and insurance entities, regardless of whether they are reciprocal.	Any reciprocal cross holdings as disclosed on participant banks QIS were deducted from CET1. Other deductions (not reciprocal) are treated as below.

RCAP / *PwC* Refs.	Description	Basel Ref.	APRA v BCBS difference	Approach taken in this study
RCAP Annex 10.4 *A4*	Equity holdings (financial entities) – additional deductions	**Basel III para 80–81:** 80. The regulatory adjustment described in this section applies to investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation and where the bank does not own more than 10% of the issued common share capital of the entity. In addition: • Investments include direct, indirect and synthetic holdings of capital instruments. For example, banks should look through holdings of index securities to determine their underlying holdings of capital. • Holdings in both the banking book and trading book are to be included. Capital includes common stock and all other types of cash and synthetic capital instruments (e.g. subordinated debt). It is the net long position that is to be included (i.e. the gross long position net of short positions in the same underlying exposure where the maturity of the short position either matches the maturity of the long position or has a residual maturity of at least one year). • Underwriting positions held for five working days or less can be excluded. Underwriting positions held for longer than five working days must be included. • If the capital instrument of the entity in which the bank has invested does not meet the criteria for Common Equity Tier 1, Additional Tier 1, or Tier 2 capital of the bank, the capital is to be considered common shares for the purposes of this regulatory adjustment. • National discretion applies to allow banks, with prior supervisory approval, to exclude temporarily certain investments where these have been made in the context of resolving or providing financial assistance to reorganise a distressed institution. 81. If the total of all holdings listed above in aggregate exceed 10% of the bank's common equity (after applying all other regulatory adjustments in full listed prior to this one) then the amount above 10% is required to be deducted, applying a corresponding deduction approach. This means the deduction should be applied to the same component of capital for which the capital would qualify if it was issued by the bank itself. Accordingly, the amount to be deducted from common equity should be calculated as the total of all holdings which in	Basel does not require the deduction of the aggregate amount of investments in the capital of banking, financial and insurance entities in which the bank owns less than 10% of the issued share capital of each entity where this (aggregate) amount is less than 10% of the bank's adjusted CET1 capital. APRA requires the full amount of such investments to be deducted from CET1 capital.	The portion of equity investments in financial and insurance entities below the 10 per cent threshold, as identified in each participant banks' QIS, was added back to CET1. A corresponding adjustment was added to risk weighted asset based on Basel defined risk weights.

RCAP / *PwC* Refs.	Description	Basel Ref.	APRA v BCBS difference	Approach taken in this study
		aggregate exceed 10% of the bank's common equity (as per above) multiplied by the common equity holdings as a percentage of the total capital holdings. This would result in a common equity deduction which corresponds to the proportion of total capital holdings held in common equity. Similarly, the amount to be deducted from Additional Tier 1 capital should be calculated as the total of all holdings which in aggregate exceed 10% of the bank's common equity (as per above) multiplied by the Additional Tier 1 capital holdings as a percentage of the total capital holdings. The amount to be deducted from Tier 2 capital should be calculated as the total of all holdings which in aggregate exceed 10% of the bank's common equity (as per above) multiplied by the Tier 2 capital holdings as a percentage of the total capital holdings.		
RCAP Annex 10.5 *A5*	Deferred tax assets – additional deductions	**Basel III para 87–89:** 87. Instead of a full deduction, the following items may each receive limited recognition when calculating Common Equity Tier 1, with recognition capped at 10% of the bank's common equity (after the application of all regulatory adjustments set out in paragraphs 67 to 85): • Significant investments in the common shares of unconsolidated financial institutions (banks, insurance and other financial entities) as referred to in paragraph 84; • Mortgage servicing rights (MSRs); and • DTAs that arise from temporary differences. 88. On 1 January 2013, a bank must deduct the amount by which the aggregate of the three items above exceeds 15% of its common equity component of Tier 1 (calculated prior to the deduction of these items but after application of all other regulatory adjustments applied in the calculation of Common Equity Tier 1). The items included in the 15% aggregate limit are subject to full disclosure. As of 1 January 2018, the calculation of the 15% limit will be subject to the following treatment: the amount of the three items that remains recognised after the application of all regulatory adjustments must not exceed 15% of the CET1 capital, calculated after all regulatory adjustments. See Annex 2 for an example. 89. The amount of the three items that are not deducted in the calculation of Common Equity Tier 1 will be risk weighted at 250%.	APRA did not adopt the threshold deduction approach for deferred tax assets for temporary differences, significant investments in unconsolidated financial entities and mortgage servicing rights. Instead, these exposures must be deducted in full from CET1 capital.	The portion of Deferred Tax Assets within the Basel threshold as calculated in the participant banks QIS was added back to CET1; a corresponding addition was added to risk weighted assets, at a weighting of 250 per cent.

RCAP / *PwC* Refs.	Description	Basel Ref.	APRA v BCBS difference	Approach taken in this study
RCAP Annex 10.6 *n/a*	Basel III capital ratios transitional arrangements - not applied	**Basel III para 94:** The transitional arrangements for implementing the new standards will help to ensure that the banking sector can meet the higher capital standards through reasonable earnings retention and capital raising, while still supporting lending to the economy. The transitional arrangements include: a) National implementation by member countries will begin on 1 January 2013. Member countries must translate the rules into national laws and regulations before this date. As of 1 January 2013, banks will be required to meet the following new minimum requirements in relation to risk weighted assets (RWAs): – 3.5% Common Equity Tier 1/RWAs; – 4.5% Tier 1 capital/RWAs, and – 8.0% total capital/RWAs. b) The minimum Common Equity Tier 1 and Tier 1 requirements will be phased in between 1 January 2013 and 1 January 2015. On 1 January 2013, the minimum Common Equity Tier 1 requirement will rise from the current 2% level to 3.5%. The Tier 1 capital requirement will rise from 4% to 4.5%. On 1 January 2014, banks will have to meet a 4% minimum Common Equity Tier 1 requirement and a Tier 1 requirement of 5.5%. On 1 January 2015, banks will have to meet the 4.5% Common Equity Tier 1 and the 6% Tier 1 requirements. The total capital requirement remains at the existing level of 8.0% and so does not need to be phased in. The difference between the total capital requirement of 8.0% and the Tier 1 requirement can be met with Tier 2 and higher forms of capital. See Basel III for paras (c) -(g) for further details of transitional arrangements.	APRA did not provide transition for the Basel III minimum capital ratios, regulatory adjustments (deductions) or the treatment of minority interest and other capital held by third parties. These requirements came into effect on 1 January 2013.	This area of conservatism impacts absolute levels of capital required, but does not impact the actual calculation of a disclosed ratio for comparison purposes. Additionally the focus of this report is on a full implementation basis. Accordingly no adjustment has been made for this item.
RCAP Annex 10.7 *n/a*	Basel III capital instruments transitional arrangements - not applied	**Basel III para 95–96:** 95. Capital instruments that do not meet the criteria for inclusion in Common Equity Tier 1 will be excluded from Common Equity Tier 1 as of 1 January 2013. However, instruments meeting the following three conditions will be phased out over the same horizon described in paragraph	Basel details transitional arrangements for capital instruments issued before 1 January 2013. APRA had more stringent transitional arrangements for capital instruments issued before this date.	The focus of this report is on fully implemented CET1. Accordingly no adjustment has been made for this item.

RCAP / *PwC* Refs.	Description	Basel Ref.	APRA v BCBS difference	Approach taken in this study
		94(g): (1) they are issued by a non-joint stock company33; (2) they are treated as equity under the prevailing accounting standards; and (3) they receive unlimited recognition as part of Tier 1 capital under current national banking law. 96. Only those instruments issued before 12 September 2010 qualify for the above transition arrangements.		
RCAP Annex 10.8 *n/a*	Basel III capital buffers transitional arrangements – not applied	**Basel III para 133–135 and 150:** 133. The capital conservation buffer will be phased in between 1 January 2016 and year end 2018 becoming fully effective on 1 January 2019. It will begin at 0.625% of RWAs on 1 January 2016 and increase each subsequent year by an additional 0.625 percentage points, to reach its final level of 2.5% of RWAs on 1 January 2019. Countries that experience excessive credit growth should consider accelerating the build up of the capital conservation buffer and the countercyclical buffer. National authorities have the discretion to impose shorter transition periods and should do so where appropriate. 134. Banks that already meet the minimum ratio requirement during the transition period but remain below the 7% Common Equity Tier 1 target (minimum plus conservation buffer) should maintain prudent earnings retention policies with a view to meeting the conservation buffer as soon as reasonably possible. 135. The division of the buffer into quartiles that determine the minimum capital conservation ratios will begin on 1 January 2016. These quartiles will expand as the capital conservation buffer is phased in and will take into account any countercyclical buffer in effect during this period. 150. The countercyclical buffer regime will be phased-in in parallel with the capital conservation buffer between 1 January 2016 and year end 2018 becoming fully effective on 1 January 2019. This means that the maximum countercyclical buffer requirement will begin at 0.625% of RWAs on 1 January 2016 and increase each subsequent year by an additional 0.625 percentage points, to reach its final maximum of 2.5% of RWAs on 1 January 2019. Countries that experience excessive credit growth during this transition period will consider accelerating the build up of the capital conservation buffer and the countercyclical buffer. In	APRA will not implement the transitional arrangements for the capital conservation and countercyclical capital buffers. Authorised deposit-taking institutions (ADIs) will be required to meet these in full from 1 January 2016.	This area of conservatism impacts absolute levels of capital required, but does not impact the actual calculation of a disclosed ratio for comparison purposes. Additionally the focus of this report is on a full implementation basis. Accordingly no adjustment has been made for this item.

RCAP / *PwC* Refs.	Description	Basel Ref.	APRA v BCBS difference	Approach taken in this study
		addition, jurisdictions may choose to implement larger countercyclical buffer requirements. In such cases the reciprocity provisions of the regime will not apply to the additional amounts or earlier time-frames.		
Credit risk: Standardised Approach				
RCAP Annex 10.9 *A6*	Retail exposures – risk weight 100%	**Basel II para 69:** 69. Claims that qualify under the criteria listed in paragraph 70 may be considered as retail claims for regulatory capital purposes and included in a regulatory retail portfolio. Exposures included in such a portfolio may be risk-weighted at 75%, except as provided in paragraph 75 for past due loans.	APRA did not adopt the 75% risk weight for retail exposures; such exposures are risk weighted at 100%.	Reduce risk weighting to 75 per cent on relevant portfolios subject to the standardised approach.
RCAP Annex 10.10 *A6*	Retail mortgage risk – risk weight ≥ 35%	**Basel II para 72:** 72. Lending fully secured by mortgages on residential property that is or will be occupied by the borrower, or that is rented, will be risk weighted at 35%. In applying the 35% weight, the supervisory authorities should satisfy themselves, according to their national arrangements for the provision of housing finance, that this concessionary weight is applied restrictively for residential purposes and in accordance with strict prudential criteria, such as the existence of substantial margin of additional security over the amount of the loan based on strict valuation rules. Supervisors should increase the standard risk weight where they judge the criteria are not met.	Basel allows claims secured by residential property to be risk weighted at 35%. APRA introduced a residential mortgage risk weight matrix whereby the risk weights for exposures secured by residential property range from 35% to 100%.	Reduce risk weighting to 35 per cent on relevant portfolios subject to the standardised approach.
RCAP Annex 10.11 *A7*	Margin lending exposures - risk weight ≥ 20%	**Basel II Credit risk mitigation:** 145. The following collateral instruments are eligible for recognition in the simple approach: a) Cash (as well as certificates of deposit or comparable instruments issued by the lending bank) on deposit with the bank which is incurring the counterparty exposure b) Gold. c) Debt securities rated by a recognised external credit assessment institution where these are either: – at least BB- when issued by sovereigns or PSEs that are treated as sovereigns by the national supervisor; or – at least BBB- when issued by other entities (including	Basel II credit risk mitigation techniques would generally result in a minimal capital charge for margin lending exposures. Instead, APRA has set a 20% risk weight for margin lending exposures secured by listed instruments on recognised exchanges (unless subject to deduction under APS 111). Otherwise (e.g. where the underlying instruments are unlisted) the ADI must treat the exposure as a secured loan (unless subject to deduction under APS 111).	Reduce risk weighting to reflect impact of applying qualifying collateral to margin lending in line with Basel text.

RCAP / *PwC* Refs.	Description	Basel Ref.	APRA v BCBS difference	Approach taken in this study
		banks and securities firms); or – at least A-3/P-3 for short-term debt instruments. d) Debt securities not rated by a recognised external credit assessment institution where these are: – issued by a bank; and – listed on a recognised exchange; and – classified as senior debt; and – all rated issues of the same seniority by the issuing bank must be rated at least BBB- or A-3/P-3 by a recognised external credit assessment institution; and – the bank holding the securities as collateral has no information to suggest that the issue justifies a rating below BBB- or A-3/P-3 (as applicable); and – the supervisor is sufficiently confident about the market liquidity of the security. e) Equities (including convertible bonds) that are included in a main index. f) Undertakings for Collective Investments in Transferable Securities (UCITS) and mutual funds where: – a price for the units is publicly quoted daily; and – the UCITS/mutual fund is limited to investing in the instruments listed in this paragraph *Note: RCAP refers to Basel II 'Credit Risk Mitigation' as the relevant Basel reference. Only Basel II paragraph 145 has been included in this table.*		
Credit risk: Internal Ratings-Based approach				
RCAP Annex 10.12 *A7*	Margin lending – IRB approach not allowed	**Basel II para 215:** Under the IRB approach, banks must categorise banking-book exposures into broad classes of assets with different underlying risk characteristics, subject to the definitions set out below. The classes of assets are (a) corporate, (b) sovereign, (c) bank, (d) retail, and (e) equity. Within the corporate asset class, five sub-classes of specialised lending are separately identified. Within the retail asset class, three sub-classes are separately identified. Within the corporate and retail asset classes, a distinct treatment for purchased receivables may also apply provided certain conditions are met.	Under the Basel IRB approach, banks must categorise banking book exposures into five broad asset classes: (a) corporate, (b) sovereign, (c) bank, (d) retail and (e) equity. APRA does not include margin lending exposures in these IRB portfolios. The risk weights for such exposures are the same as under APRA's standardised approach (refer to item 11 above). This results in a considerably higher capital charge than would be expected under the Basel IRB treatment.	As APRA does not permit inclusion of margin lending in the IRB portfolio participant banks were not able to quantify the risk weighted asset impact if these exposures to be measured using the IRB approach. The impact was quantified under the standardised approach in item 11 above.

RCAP / *PwC* Refs.	Description	Basel Ref.	APRA v BCBS difference	Approach taken in this study
RCAP Annex 10.13 *A8*	Small business exposures - threshold of $1M	**Basel II para 232:** The exposure must be one of a large pool of exposures, which are managed by the bank on a pooled basis. Supervisors may choose to set a minimum number of exposures within a pool for exposures in that pool to be treated as retail. • Small business exposures below €1 million may be treated as retail exposures if the bank treats such exposures in its internal risk management systems consistently over time and in the same manner as other retail exposures. This requires that such an exposure be originated in a similar manner to other retail exposures. Furthermore, it must not be managed individually in a way comparable to corporate exposures, but rather as part of a portfolio segment or pool of exposures with similar risk characteristics for purposes of risk assessment and quantification. However, this does not preclude retail exposures from being treated individually at some stages of the risk management process. The fact that an exposure is rated individually does not by itself deny the eligibility as a retail exposure.	Basel II set a threshold of EUR 1 million for small business exposures to be included in the retail portfolio. APRA converted this threshold to Australian dollars on a 1:1 basis (effectively setting a lower threshold).	Participant banks calculated the risk weighted asset impact if the current retail threshold was increased to $1.6m from $1m.
RCAP Annex 10.14 *A8*	Retail revolving exposure – threshold of $100K	**Basel II para 234:** All of the following criteria must be satisfied for a sub-portfolio to be treated as a qualifying revolving retail exposure (QRRE). These criteria must be applied at a sub-portfolio level consistent with the bank's segmentation of its retail activities generally. Segmentation at the national or country level (or below) should be the general rule. a) The exposures are revolving, unsecured, and uncommitted (both contractually and in practice). In this context, revolving exposures are defined as those where customers' outstanding balances are permitted to fluctuate based on their decisions to borrow and repay, up to a limit established by the bank. b) The exposures are to individuals. c) The maximum exposure to a single individual in the sub-portfolio is €100,000 or less. d) Because the asset correlation assumptions for the QRRE risk weight function are markedly below those for the other retail risk weight function at low PD values, banks	Basel II sets the maximum exposure to a single individual in the qualifying revolving retail sub-portfolio at EUR 1 million. APRA converted this threshold to Australian dollars on a 1:1 basis (effectively setting a lower threshold). In addition, APRA does not allow exposures for business purposes to be included in the qualifying revolving retail portfolio. Such (otherwise qualifying) exposures fall into the other retail portfolio (or possibly the corporate portfolio), which results in a higher capital requirement. *Note: Error noted in RCAP - per Basel II para 234: maximum exposure to single individual in the sub-portfolio is €100,000 or less.*	Participant banks calculated the risk weighted asset impact if the current retail threshold was increased to $160k from $100k.

RCAP / *PwC* Refs.	Description	Basel Ref.	APRA v BCBS difference	Approach taken in this study
		must demonstrate that the use of the QRRE risk weight function is constrained to portfolios that have exhibited low volatility of loss rates, relative to their average level of loss rates, especially within the low PD bands. Supervisors will review the relative volatility of loss rates across the QRRE subportfolios, as well as the aggregate QRRE portfolio, and intend to share information on the typical characteristics of QRRE loss rates across jurisdictions. e) Data on loss rates for the sub-portfolio must be retained in order to allow analysis of the volatility of loss rates. f) The supervisor must concur that treatment as a qualifying revolving retail exposure is consistent with the underlying risk characteristics of the sub-portfolio.		
RCAP Annex 10.15 *A8*	SMEs– $50M turnover threshold	**Basel II para 273:** Under the IRB approach for corporate credits, banks will be permitted to separately distinguish exposures to SME borrowers (defined as corporate exposures where the reported sales for the consolidated group of which the firm is a part is less than €50 million) from those to large firms. A firm-size adjustment (i.e. 0.04 x (1 – (S – 5) / 45)) is made to the corporate risk weight formula for exposures to SME borrowers. S is expressed as total annual sales in millions of euros with values of S falling in the range of equal to or less than €50 million or greater than or equal to €5 million. Reported sales of less than €5 million will be treated as if they were equivalent to €5 million for the purposes of the firm-size adjustment for SME borrowers.	The Basel II firm size adjustment for small and medium-sized entities that are risk weighted on the corporate curve cuts out for firms with turnover above EUR 50 million. APRA converted this threshold to Australian dollars on a 1:1 basis (effectively setting a lower threshold).	Participant banks calculated the impact on RWAs of increasing the SME threshold from $50m turnover to $80m.
RCAP Annex 10.16 *n/a*	Foundation IRB - other collateral not recognised	**Basel II para 295 :** The methodology for determining the effective LGD under the foundation approach for cases where banks have taken eligible IRB collateral to secure a corporate exposure is as follows. • Exposures where the minimum eligibility requirements are met, but the ratio of the current value of the collateral received (C) to the current value of the exposure (E) is below a threshold level of C* (i.e. the required minimum collateralisation level for the exposure) would receive the appropriate LGD for unsecured exposures or those	Although Basel II allows other collateral to be recognised under the foundation IRB approach, APRA does not recognise other collateral in these circumstances. Under APRA's standards, if collateral does not meet the requirements for eligible financial collateral, financial receivables or residential or commercial real estate, the exposure must be considered unsecured and assigned a higher loss-given-default estimate under the foundation IRB approach.	No participant banks use the Foundation IRB approach for these portfolios – no adjustment made for this item.

RCAP / *PwC* Refs.	Description	Basel Ref.	APRA v BCBS difference	Approach taken in this study
		secured by collateral which is not eligible financial collateral or eligible IRB collateral. • Exposures where the ratio of C to E exceeds a second, higher threshold level of C** (i.e. the required level of over-collateralisation for full LGD recognition) would be assigned an LGD according to the following table. The following table displays the applicable LGD and required over collateralisation levels for the secured parts of senior exposures: (Also see paras 521–522)		
RCAP Annex 10.17 *n/a*	Foundation IRB - 100% CCF for commitments etc	**Basel II para 312:** 312. A CCF of 75% will be applied to commitments, NIFs and RUFs regardless of the maturity of the underlying facility. This does not apply to those facilities which are uncommitted, that are unconditionally cancellable, or that effectively provide for automatic cancellation, for example due to deterioration in a borrower's creditworthiness, at any time by the bank without prior notice. A CCF of 0% will be applied to these facilities. (also see paras 366–367 for purchased receivables)	Under the foundation IRB approach, banks may assign a 75% credit conversion factor for commitments, note issuance facilities and revolving underwriting facilities. APRA has set the standard supervisory credit conversion factor to 100% for such exposures.	No participant banks use the Foundation IRB approach for these portfolios – no adjustment made for this item.
RCAP Annex 10.18 *n/a*	Excess eligible provisions – not included in capital	**Basel II para 384–385 (and 43):** 384. As specified in paragraph 43, banks using the IRB approach must compare the total amount of total eligible provisions (as defined in paragraph 380) with the total EL amount as calculated within the IRB approach (as defined in paragraph 375). In addition, paragraph 42 outlines the treatment for that portion of a bank that is subject to the standardised approach to credit risk when the bank uses both the standardised and IRB approaches. 385. Where the calculated EL amount is lower than the provisions of the bank, its supervisors must consider whether the EL fully reflects the conditions in the market in which it operates before allowing the difference to be included in Tier 2 capital. If specific provisions exceed the EL amount on defaulted assets this assessment also needs to be made before using the difference to offset the EL amount on non-defaulted assets.	Banks must compare the total amount of eligible provisions with a total expected loss amount. Where the expected loss amount is less than the provision amount, Basel says that the difference may be included in Tier 2 capital subject to supervisors' satisfaction that the bank's expected loss fully reflects the conditions in the market. APRA is arguably more conservative in that prohibits any excess provision related to defaulted exposures to be included in Tier 2 capital.	This impacts Total Capital. An impact for this difference was not calculated for this study as the focus is on CET1.

RCAP / *PwC* Refs.	Description	Basel Ref.	APRA v BCBS difference	Approach taken in this study
		43. Under the internal ratings-based (IRB) approach, the treatment of the 1988 Accord to include general provisions (or general loan-loss reserves) in Tier 2 capital is withdrawn. Banks using the IRB approach for securitisation exposures or the PD/LGD approach for equity exposures must first deduct the EL amounts subject to the corresponding conditions in paragraphs 563 and 386, respectively. Banks using the IRB approach for other asset classes must compare (i) the amount of total eligible provisions, as defined in paragraph 380, with (ii) the total expected losses amount as calculated within the IRB approach and defined in paragraph 375. Where the total expected loss amount exceeds total eligible provisions, banks must deduct the difference. Deduction must be on the basis of 50% from Tier 1 and 50% from Tier 2. Where the total expected loss amount is less than total eligible provisions, as explained in paragraphs 380 to 383, banks may recognise the difference in Tier 2 capital up to a maximum of 0.6% of credit risk weighted assets. At national discretion, a limit lower than 0.6% may be applied.		
Credit risk: securitisation				
RCAP Annex 10.19 *n/a*	Securitisation originating bank– wider definition	**Basel II para 543:** For risk-based capital purposes, a bank is considered to be an originator with regard to a certain securitisation if it meets either of the following conditions: a) The bank originates directly or indirectly underlying exposures included in the securitisation; or b) The bank serves as a sponsor of an asset-backed commercial paper (ABCP) conduit or similar programme that acquires exposures from third-party entities. In the context of such programmes, a bank would generally be considered a sponsor and, in turn, an originator if it, in fact or in substance, manages or advises the programme, places securities into the market, or provides liquidity and/or credit enhancements.	Basel defines an originating bank as one that directly or indirectly originates exposures in the securitisation or one that sponsors an asset-backed commercial paper conduit or similar program that acquires exposures from third-party entities. APRA's definition is wider and includes ADIs that manage non-asset backed commercial paper structures as the definition of origination is not dependent on the structure of the securitisation but rather on the ADI's role.	Participant banks estimated that the risk weighted asset benefit is immaterial should the narrower BCBS definition of originating bank be applied.
RCAP Annex 10.20	Securitisation implicit support– additional	**Basel II para 554(f):** An originating bank may exclude securitised exposures from the calculation of risk weighted assets only if all of the following conditions have been met. Banks meeting these	Basel defines implicit support (which is prohibited). APRA goes beyond the Basel definition and also prohibits an increase in yield as a result of changes in the credit rating of the originator.	This difference impacts transaction structure and documentation, as such any RWA benefit is not quantifiable.

RCAP / *PwC* Refs.	Description	Basel Ref.	APRA v BCBS difference	Approach taken in this study
n/a	prohibitions	conditions must still hold regulatory capital against any securitisation exposures they retain. f) The securitisation does not contain clauses that (i) require the originating bank to alter systematically the underlying exposures such that the pool's weighted average credit quality is improved unless this is achieved by selling assets to independent and unaffiliated third parties at market prices; (ii) allow for increases in a retained first loss position or credit enhancement provided by the originating bank after the transaction's inception; or (iii) increase the yield payable to parties other than the originating bank, such as investors and third-party providers of credit enhancements, in response to a deterioration in the credit quality of the underlying pool.		
Operational risk: Advanced Measurement Approaches				
RCAP Annex 10.21 *n/a*	Foreign bank subsidiaries – additional conditions	**Basel II para 656:** A bank adopting the AMA may, with the approval of its host supervisors and the support of its home supervisor, use an allocation mechanism for the purpose of determining the regulatory capital requirement for internationally active banking subsidiaries that are not deemed to be significant relative to the overall banking group but are themselves subject to this Framework in accordance with Part 1. Supervisory approval would be conditional on the bank demonstrating to the satisfaction of the relevant supervisors that the allocation mechanism for these subsidiaries is appropriate and can be supported empirically. The board of directors and senior management of each subsidiary are responsible for conducting their own assessment of the subsidiary's operational risks and controls and ensuring the subsidiary is adequately capitalised in respect of those risks.	Basel allows foreign bank subsidiaries to use the parent bank's allocation mechanism for the purpose of determining the regulatory capital requirement for operational risk at that level if the host regulator accepts the mechanism. APRA has set out detailed conditions and criteria a foreign bank subsidiary must satisfy before its allocation mechanism is recognised for regulatory capital purposes. This includes requirements around sufficiency of allocated capital, appropriate risk-sensitivity of the allocation mechanism, controls on data and governance and the operational risk management framework aligning to the Advanced Measurement Approaches (AMA) (not simply the allocation mechanism). APRA also requires that the home supervisor's requirements (relating to the AMA) are sufficiently similar to those of APRA.	Not applicable - none of the participant banks are subsidiaries of foreign parent banks.

RCAP / *PwC* Refs.	Description	Basel Ref.	APRA v BCBS difference	Approach taken in this study
RCAP Annex 10.22 *n/a*	Operational risk AMA criteria	**Basel II para 664:** 664. In order to qualify for use of the AMA a bank must satisfy its supervisor that, at a minimum: • Its board of directors and senior management, as appropriate, are actively involved in the oversight of the operational risk management framework; • It has an operational risk management system that is conceptually sound and is implemented with integrity; and • It has sufficient resources in the use of the approach in the major business lines as well as the control and audit areas.	Basel II includes specific risk management and governance criteria for use of the AMA. APRA's requirements are in some respects more precise and detailed including specific requirements relating to Board and senior management responsibilities and the operational risk management function.	This difference is seen procedural in nature and as such not quantifiable in RWA or capital terms.
RCAP Annex 10.23 *A9*	Operational risk AMA quantitative standards	**Basel II para 667–668:** 667. Given the continuing evolution of analytical approaches for operational risk, the Committee is not specifying the approach or distributional assumptions used to generate the operational risk measure for regulatory capital purposes. However, a bank must be able to demonstrate that its approach captures potentially severe 'tail' loss events. Whatever approach is used, a bank must demonstrate that its operational risk measure meets a soundness standard comparable to that of the internal ratings based approach for credit risk, (i.e. comparable to a one year holding period and a 99.9th percentile confidence interval). 668. The Committee recognises that the AMA soundness standard provides significant flexibility to banks in the development of an operational risk measurement and management system. However, in the development of these systems, banks must have and maintain rigorous procedures for operational risk model development and independent model validation. Prior to implementation, the Committee will review evolving industry practices regarding credible and consistent estimates of potential operational losses. It will also review accumulated data, and the level of capital requirements estimated by the AMA, and may refine its proposals if appropriate.	Basel II sets quantitative standards regarding AMA soundness. APRA explicitly requires a number of elements regarding conservatism in modelling choices and assumptions including comprehensive and rigorous sensitivity analysis. These requirements are also applied to changes to the operational risk measurement system. APRA also requires ADIs to consider and document evolving industry practices in assessing its own practices.	Participant banks were asked to quantify the impact of not applying the APRA conservatism in modelling assumptions.

RCAP / *PwC* Refs.	Description	Basel Ref.	APRA v BCBS difference	Approach taken in this study
RCAP Annex 10.24 *A9*	Operational Risk - fraud related losses	**Basel II para 673:** To qualify for regulatory capital purposes, a bank's internal loss collection processes must meet the following standards: • To assist in supervisory validation, a bank must be able to map its historical internal loss data into the relevant level 1 supervisory categories defined in Annexes 8 and 9 and to provide these data to supervisors upon request. It must have documented, objective criteria for allocating losses to the specified business lines and event types. However, it is left to the bank to decide the extent to which it applies these categorisations in its internal operational risk measurement system. • A bank's internal loss data must be comprehensive in that it captures all material activities and exposures from all appropriate sub-systems and geographic locations. A bank must be able to justify that any excluded activities or exposures, both individually and in combination, would not have a material impact on the overall risk estimates. A bank must have an appropriate de minimis gross loss threshold for internal loss data collection, for example €10,000. The appropriate threshold may vary somewhat between banks, and within a bank across business lines and/or event types. However, particular thresholds should be broadly consistent with those used by peer banks. • Aside from information on gross loss amounts, a bank should collect information about the date of the event, any recoveries of gross loss amounts, as well as some descriptive information about the drivers or causes of the loss event. The level of detail of any descriptive information should be commensurate with the size of the gross loss amount. • A bank must develop specific criteria for assigning loss data arising from an event in a centralised function (e.g. an information technology department) or an activity that spans more than one business line, as well as from related events over time. • Operational risk losses that are related to credit risk and have historically been included in banks' credit risk databases (e.g. collateral management failures) will	Basel provides guidance on operational risk losses that are related to credit risk. In addition to the Basel guidance, APRA requires fraud perpetrated by parties other than the borrower to be treated as operational risk (rather than credit-related) for the purpose of determining regulatory capital.	Participant banks were asked to quantify the impact of not applying the APRA requirement of allocating fraud perpetrated by parties other than borrowers of the bank.

RCAP / *PwC* Refs.	Description	Basel Ref.	APRA v BCBS difference	Approach taken in this study
		continue to be treated as credit risk for the purposes of calculating minimum regulatory capital under this Framework. Therefore, such losses will not be subject to the operational risk capital charge.109 Nevertheless, for the purposes of internal operational risk management, banks must identify all material operational risk losses consistent with the scope of the definition of operational risk (as set out in paragraph 644 and the loss event types outlined in Annex 9), including those related to credit risk. Such material operational risk-related credit risk losses should be flagged separately within a bank's internal operational risk database. The materiality of these losses may vary between banks, and within a bank across business lines and/or event types. Materiality thresholds should be broadly consistent with those used by peer banks. • Operational risk losses that are related to market risk are treated as operational risk for the purposes of calculating minimum regulatory capital under this Framework and will therefore be subject to the operational risk capital charge.		
Counterparty credit risk				
RCAP Annex 10.25 *A10*	Counterparty Credit Risk - EAD > 0	**Basel II Annex 4 para 7–8:** 7. Under all of the three methods identified in this Annex, when a bank purchases credit derivative protection against a banking book exposure, or against a counterparty credit risk exposure, it will determine its capital requirement for the hedged exposure subject to the criteria and general rules for the recognition of credit derivatives, i.e. substitution or double default rules as appropriate. Where these rules apply, the exposure amount or EAD for counterparty credit risk from such instruments is zero. 8. The exposure amount or EAD for counterparty credit risk is zero for sold credit default swaps in the banking book where they are treated in the framework as a guarantee provided by the bank and subject to a credit risk charge for the full notional amount.	Basel sets the exposure at default estimate for counterparty credit risk for credit derivative protection at zero. APRA imposes a more stringent requirement as the exposure at default amount for such exposures is not set at zero.	Participant banks were asked to quantify the risk weighted asset impact of changing the EAD for credit derivative protection at zero.

RCAP / *PwC* Refs.	Description	Basel Ref.	APRA v BCBS difference	Approach taken in this study
Market risk				
RCAP Annex 10.26 *n/a*	Correlation trading portfolio	**Revisions to the Basel II market risk framework (updated December 2010):** Paragraph 709(ii) of the Basel II Framework will be changed as follows, and a new paragraph 709(ii-1-) will be introduced. Changed and new wording is underlined. 709(ii). The minimum capital requirement is expressed in terms of two separately calculated charges, one applying to the "specific risk" of each security, whether it is a short or a long position, and the other to the interest rate risk in the portfolio (termed "general market risk") where long and short positions in different securities or instruments can be offset. The bank must, however, determine the specific risk capital charge for the correlation trading portfolio as follows: The bank computes (i) the total specific risk capital charges that would apply just to the net long positions from the net long correlation trading exposures combined, and (ii) the total specific risk capital charges that would apply just to the net short positions from the net short correlation trading exposures combined. The larger of these total amounts is then the specific risk capital charge for the correlation trading portfolio.	Given that managing a correlation trading portfolio introduces additional complexity and risk, ADIs must seek APRA's approval in order to use the more favourable capital treatment.	Participant banks were asked to quantify the impact of applying more favourable BCBS treatment for correlation trading portfolios. Participants determined the impact was not material.
Pillar 2				
RCAP Annex 10.27 *A11*	IRRBB - Pillar 1 inclusion	**Basel II para 763–764:** 763. The revised guidance on interest rate risk recognises banks' internal systems as the principal tool for the measurement of interest rate risk in the banking book and the supervisory response. To facilitate supervisors' monitoring of interest rate risk exposures across institutions, banks would have to provide the results of their internal measurement systems, expressed in terms of economic value relative to capital, using a standardised interest rate shock. 764. If supervisors determine that banks are not holding capital commensurate with the level of interest rate risk, they must require the bank to reduce its risk, to hold a specific additional amount of capital or some combination of the two. Supervisors should be particularly attentive to the sufficiency	Basel includes interest rate risk in the banking book (IRRBB) as a Pillar 2 consideration. APRA requires a mandatory Pillar 1 capital charge for IRRBB for those ADIs using the IRB approach to credit risk and the AMA for operational risk.	The current Pillar 1 IRRBB risk weighted asset was reduced to zero.

RCAP / *PwC* Refs.	Description	Basel Ref.	APRA v BCBS difference	Approach taken in this study
		of capital of 'outlier banks' where economic value declines by more than 20% of the sum of Tier 1 and Tier 2 capital as a result of a standardised interest rate shock (200 basis points) or its equivalent, as described in the supporting document Principles for the Management and Supervision of Interest Rate Risk.		

Appendix G Names of Australian banks and jurisdictional peers used in this analysis

Australian major banks

No.	Bank full name	Abbreviation
1	Australia and New Zealand Banking Group	ANZ
2	Commonwealth Bank of Australia	CBA
3	National Australia Bank Ltd.	NAB
4	Westpac Banking Corporation	WBC

Jurisdictional peers in Canada, Singapore, UK, Japan, Switzerland and Germany

No.	Jurisdiction	Bank full name	Abbreviation
1	Canada	Royal Bank Canada	RBC
2	Canada	Toronto-Dominion Bank	TD
3	Canada	The Bank of Nova Scotia	BNS
4	Canada	Bank of Montreal	BMO
5	Canada	Canadian Imperial Bank of Commerce	CIBC
6	Singapore	DBS Group Holdings Ltd	DBS
7	Singapore	Oversea-Chinese Banking Corporation Limited	OCBC
8	UK	HSBC Holdings PLC	HSBC
9	UK	Barclays PLC	BARC
10	UK	Royal Bank of Scotland Group PLC	RBS
11	UK	Lloyds Banking Group PLC	LLOY
12	UK	Standard Chartered Bank	SCB
13	Japan	Mitsubishi UFJ Financial Group Inc.	MUFG
14	Japan	Sumitomo Mitsui Trust Holdings Inc.	SMTH
15	Switzerland	Credit Suisse Group AG	Credit Suisse
16	Switzerland	UBS Group AG	UBS
17	Germany	Deutsche Bank AG	DBK
18	Germany	Commerzbank AG	CBK

Appendix H Glossary

ABA	Australian Bankers' Association
ABCP	Asset-backed commercial paper
ADC	Acquisition, development and construction
ADI	Authorised deposit-taking institution
Advanced banks	Banks which have been accredited to use their own models for calculating risk weighted assets
AIRB (or Advanced IRB)	Advanced internal ratings-based approach
AMA	Advanced measurement approaches
APRA	Australian Prudential Regulation Authority
Basel Framework	Basel Framework includes Basel II, Basel 2.5 and Basel III and refers a number of documents. Refer to the BCBS' Regulatory Consistency Assessment Programme (RCAP), Assessment of Basel III regulations – Canada June 2014, Annex 3: List of capital standards under the Basel Framework used for assessment.
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
CAR	Canadian Capital Adequacy Requirements
CCF	Credit conversion factor
CET1	Common Equity Tier 1
CET1 (APRA)	Measurement using applicable Australian rules
CET1 (Basel Framework)	Measurement using Basel Framework rules
CET1 (Canadian)	Australian and Canadian banks on a CET1 (Canadian) basis
CET1 (German)	Australian and German banks on a CET1 (German) basis
CET1 (Japanese)	Australian and Japanese banks on a CET1 (Japanese) basis
CET1 (Singaporean)	Australian and Singaporean banks on a CET1 (Singaporean) basis
CET1 (Swiss)	Australian and Swiss banks on a CET1 (Swiss) basis
CET1 (UK)	Australian and UK banks on a CET1 (UK) basis
CRR	Capital Requirements Regulation
D-SIB	Domestic systemically important bank
DTAs	Deferred tax assets
EAD	Exposure at default
EL	Expected loss
FIRB (or Foundation IRB)	Foundation internal ratings-based approach

FSI	Financial System Inquiry
G-SIB	Global systemically important bank
HVCRE	High-volatility commercial real estate
Internationally comparable CET1	Measurement using Basel Framework rules and allowing for national regulatory treatments which would impact on how those rules are implemented in that jurisdiction by comparison to international norms
IRB	Internal Ratings-Based
IRRBB	Interest rate risk in the banking book
LGD	Loss-given-default
LVR	Loan to value ratio
MSR	Mortgage servicing rights
NIF	Note issuance facility
OSFI	Office of the Superintendent of Financial Institutions
PD	Probability of default
PSE	Public sector entity
QRRE	Qualifying revolving retail exposures
RCAP	Regulatory Consistency Assessment Programme
RUF	Revolving underwriting facility
RWA	Risk weighted assets
SL	Specialised lending
SME	Small- and medium-sized entity
UCITS	Undertakings for collective investments in transferable securities

Appendix I Bibliography

Australia and New Zealand Banking Group (ANZ), 2014, *Debt Investor Update: Half year results,* ANZ, retrieved *Aug-14*, http://www.debtinvestors.anz.com/phoenix.zhtml?c=248688&p=debt-presentation14

Australia and New Zealand Banking Group (ANZ), 2014, *Basel III Pillar 3 Disclosure*, ANZ, retrieved Aug-14, http://www.shareholder.anz.com/sites/default/files/ANZ%27s%20March%202014%20Pillar%203%20Disclosure.pdf

Australian Prudential Regulation Authority (APRA), 2014, *Financial System Inquiry: Submission,* APRA, retrieved Aug-14, http://apra.gov.au/Submissions/Documents/APRA-2014-FSI-Submission-FINAL.pdf

Bank of Montreal, 2014, *Supplementary Regulatory Capital Disclosure,* Bank of Montreal, retrieved *Aug-14*, http://www.bmo.com/ir/qtrinfo/1/2014-q2/Supp%20Reg%20Capital%20Disclosure%20Q2%202014.pdf

Barclays PLC (BARC), 2013, *Building the 'Go-To' bank*, BARC, retrieved Aug-14, http://reports.barclays.com/ar13/servicepages/downloads/files/barclays_pillar_3_report_2013.pdf

BCBS, 2014, *Basel III Monitoring Report,* BIS, retrieved Aug-14, http://www.bis.org/publ/bcbs278.pdf

BCBS, 2014, *Regulatory Consistency Assessment Programme (RCAP) Assessment of Basel III regulations – Canada*, BIS, retrieved Aug-14, http://www.bis.org/bcbs/implementation/l2_ca.pdf

BCBS, 2014, *Regulatory Consistency Assessment Programme (RCAP) Assessment of Basel III regulations – Australia*, BIS, retrieved Aug-14, http://www.bis.org/bcbs/implementation/l2_au.pdf

BCBS, 2013, *Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement,* BIS, retrieved Aug-14, http://www.bis.org/publ/bcbs255.pdf

BCBS, 2013, *Regulatory Consistency Assessment Programme (RCAP) Assessment of Basel III regulations – Singapore*, BIS, retrieved Aug-14, http://www.bis.org/bcbs/implementation/l2_sg.pdf

BCBS, 2013, *Regulatory Consistency Assessment Programme (RCAP) Assessment of Basel III regulations – Switzerland*, BIS, retrieved Aug-14, http://www.bis.org/bcbs/implementation/l2_ch.pdf

BCBS, 2013, *Regulatory Consistency Assessment Programme (RCAP) Assessment of Basel III regulations – China*, BIS, retrieved Aug-14, http://www.bis.org/bcbs/implementation/l2_cn.pdf

BCBS, 2013*, Regulatory Consistency Assessment Programme (RCAP) – Second report on risk-weighted assets for market risk in the trading book*, BIS, retrieved Aug-14, http://www.bis.org/publ/bcbs267.pdf

BCBS, 2013, *Basel III Regulatory Consistency Assessment Programme (RCAP),* BIS, retrieved Aug-14, http://www.bis.org/publ/bcbs264.pdf

BCBS, 2013, *Progress report on implementation of the Basel regulatory framework*, BIS, retrieved Aug-14, http://www.bis.org/publ/bcbs263.pdf

BCBS, 2013, *Regulatory Consistency Assessment Programme (RCAP) Analysis of risk-weighted assets for credit risk in the banking book*, Aug-14, http://www.bis.org/publ/bcbs256.pdf

BCBS, 2013 (rev 2013), *Regulatory consistency assessment programme (RCAP) – Analysis of risk-weighted assets for market risk*, BIS, retrieved Aug-14, http://www.bis.org/publ/bcbs240.pdf

BCBS, 2012, *Basel III regulatory consistency assessment programme*, BIS, retrieved Aug-14, http://www.bis.org/publ/bcbs216.pdf

BCBS, 2012, *A framework for dealing with domestic systemically important banks,* BIS, retrieved Aug-14, http://www.bis.org/publ/bcbs233.pdf

BCBS, 2012, *Basel III regulatory consistency assessment (Level 2) Preliminary report: European Union*, BIS, retrieved Aug-14, http://www.bis.org/bcbs/implementation/l2_eu.pdf

BCBS, 2012, *Basel III regulatory consistency assessment (Level 2) Japan*, BIS, retrieved Aug-14, http://www.bis.org/bcbs/implementation/l2_jp.pdf

BCBS, 2012, *Basel III regulatory consistency assessment (Level 2) Preliminary report: United States of America*, BIS, retrieved Aug-14, http://www.bis.org/bcbs/implementation/l2_us.pdf

BCBS, 2010 (rev 2011), *Basel III: A global regulatory framework for more resilient banks and banking systems,* BIS, retrieved Aug-14, http://www.bis.org/publ/bcbs189.pdf

BCBS, 2006, *Basel II: International Convergence of Capital Measurement and Capital Standards*, BIS, retrieved Aug-14, http://www.bis.org/publ/bcbs128.pdf

Canadian Imperial Bank of Commerce (CIBC), 2014, *Supplementary Regulatory Capital Disclosure*, CIBC, retrieved Aug-14, https://www.cibc.com/ca/pdf/investor/q214disclosure.pdf

Commerzbank AG (CBK), 20*14, Figures – Facts – Targets*, CBK, retrieved Aug-14, https://www.commerzbank.com/media/aktionaere/service/archive/konzern/2014_2/Figures_Facts_Targets_Q2-2014.pdf

Commerzbank AG (CBK), 2014, *Interim Report as of June 30*, 2014, CBK, retrieved Aug-14, https://www.commerzbank.com/media/aktionaere/service/archive/konzern/2014_2/Zwischenbericht_Q2_2014_englisch.pdf

Commonwealth Bank of Australia (CBA), 2014, *Results Presentation: For the full year ended 30 June 2014*, CBA, retrieved Aug-14, https://www.commbank.com.au/content/dam/commbank/about-us/shareholders/pdfs/results/fy14_results_presentation.pdf

Credit Suisse Group AG (Credit Suisse), 2014, *Financial Report 2Q14,* Credit Suisse, retrieved Aug-14, https://www.credit-suisse.com/media/cc/docs/investors/csg-financialreport-2q14.pdf

DBS Group Holdings Ltd (DBK), 2014, *Second quarter 2014 Financial Performance Summary*, DBK, retrieved Aug-14, http://www.dbs.com/investor/2014/2Q14_performance_summary.pdf

Deutsche Bank AG, 2014*, Interim Report as of June 30*, 2014, Deutsche Bank AG, retrieved Aug-14, https://www.deutsche-bank.de/medien/en/downloads/DB_Interim_Report_2Q2014.pdf

Financial Services Authority, 2010*, Internal ratings-based probability of default models for income-producing real estate portfolios,* Financial Services Authority, retrieved Aug-14, http://www.fsa.gov.uk/pubs/guidance/fg10_02.pdf

Financial Stability Board, 2013, *2013 update of group of global systemically important banks (G-SIBs),* Financial Stability Board, retrieved Aug-14, http://www.financialstabilityboard.org/publications/r_131111.pdf

Frodsham, M & Gimblett, K., 2012, *The Slotting Approach to IPRE Risk Weighted Capital A UK Simulation Study Using IPD Data,* IPD, retrieved Aug-14, http://www.msci.com/resources/pdfs/IPD-UK-Slotting-Paper-September-2012.pdf

FSI, 2014, *The Financial System Inquiry 2014 (Murray): Interim Report,* Australian Government, retrieved Aug-14, http://fsi.gov.au/publications/

HSBC Holdings PLC (HSBC), 2013, *Capital and Risk Management Pillar 3 Disclosures at 31 December 2013,* HSBC, retrieved Aug-14, http://www.hsbc.com/investor-relations/financial-and-regulatory-reports

HSBC Holdings PLC (HSBC), 2013*, Annual Report and Accounts 2013*, HSBC, retrieved Aug-14, http://www.hsbc.com/investor-relations/financial-and-regulatory-reports/annual-report-and-accounts-2013

Lloyds Banking Group PLC (LLOY), 2013*, Pillar 3 Disclosures 2013*, LLOY, retrieved Aug-14, http://www.lloydsbankinggroup.com/globalassets/documents/investors/2013/2013_lbg_pillar3_disclosures.pdf

Mitsubhishi UFJ Financial Group Inc. (MUFG), 2014, *Financial Highlights under Japanese GAAP for Fiscal Year Ended March 31, 2014*, MUFG, retrieved Aug-14, http://mufg.marsflag.com/en_all/search.x?q=financial+highlights+may+2014&ie=iso-8859-1&page=1&unitid=en_all#3

Monetary Authority of Singapore (MAS), 2014, *MAS Notice 632*, *Residential Property Loans,* MAS, retrieved Aug-14, http://www.mas.gov.sg/~/media/MAS/Regulations%20and%20Financial%20Stability/Regulations%20Guidance%20and%20Licensing/Commercial%20Banks/Regulations%20Guidance%20and%20Licensing/Notices/MAS%20Notice%20632_10%20Feb%202014.pdf

Monetary Authority of Singapore (MAS), 2012, *MAS Notice 637 on risk based capital adequacy requirements for banks*, MAS, retrieved Aug-14, http://www.mas.gov.sg/~/media/MAS/Regulations%20and%20Financial%20Stability/Regulations%20Guidance%20and%20Licensing/Commercial%20Banks/Regulations%20Guidance%20and%20Licensing/Notices/MAS%20Notice%20637_14%20Sept%202012.ashx

Morningstar Institutional Equity Research, 2011, *Basel III Around the World*, Morningstar Institutional Equity Research, retrieved Aug-14, http://news.morningstareurope.com/news/im/Basel%20III_20110414_Peters.pdf

National Australia Bank Ltd. (NAB), 2014, *Half Year Results: Investor Presentation,* NAB, retrieved Aug-14, http://www.nab.com.au/content/dam/nab/about-us/shareholder-centre/financial-results/documents/2014-half-year-results-investor-presentation.pdf

National Australia Bank Ltd. (NAB), 2014, *Pillar 3 Report: Incorporating the requirements of APS 330, Half Year Update as at 31 March 2014*, NAB, retrieved Aug-14, http://www.nab.com.au/content/dam/nab/about-us/shareholder-centre/regulatory-disclosures/documents/march-2014-pillar-3-report.pdf

Oversea-Chinese Banking Corporation Limited (OCBC), 2014, *Media release: OCBC Group Reports Record Second Quarter 2014 Net Profit after Tax of S$921 million*, OCBC, retrieved Aug-14, http://www.ocbc.com/assets/pdf/Media/2014/Aug/OCBC%202Q14%20Media%20Release.pdf

Oversea-Chinese Banking Corporation Limited (OCBC), 2013, *Pillar 3 Disclosures (OCBC Group – As at 31 December 2013),* OCBC, retrieved Aug-14, http://www.ocbc.com/assets/pdf/Capital%20and%20Regulatory%20Disclosures/Pillar%203%20Quantitative%20Disclosures/As%20of%2031%20Dec%202013/Pillar%203%20Disclosures%20as%20at%2031%20Dec%202013.pdf

Radley & Associates, 2013, *Potential Effects of the Slotting Capital Regime on UK Commercial Property Lending*, Radley & Associates, retrieved Aug-14, http://www.promsinvestor.com/publications/Potential%20Effects%20of%20the%20Slotting%20Capital%20Regime%20on%20UK%20Commercial%20Property%20Lending.pdf

Royal Bank Canada (RBC), 2014, *Supplementary Financial Information, Q2 2014*, RBC, retrieved Aug-14, http://www.rbc.com/investorrelations/pdf/q214supp.pdf

Royal Bank of Scotland Group PLC (RBS), 2013, *Annual Report and Accounts 2013*, RBS, retrieved Aug-14, http://www.investors.rbs.com/results-centre/annual-report-subsidiary-results/2013.aspx

Royal Bank of Scotland Group PLC (RBS), 2013, *Pillar 3 Report 2013*, RBS, retrieved Aug-14, http://investors.rbs.com/~/media/Files/R/RBS-IR/2013-reports/pillar-3-2013-final.pdf

Standard & Poors Financial Services LLC (S&P), 2011, *Standard & Poor's Risk-Adjusted Capital Framework Provides Insight Into Basel III*, S&P, retrieved Aug-14, http://img.en25.com/Web/StandardandPoors/StandardPoorsRiskAdjustedCapitalFrameworkProvidesInsightIntoBaselIII_6_9_11.pdf

Standard & Poors Financial Services LLC (S&P), 2009, *Standard and Poor's Risk-Adjusted Capital Framework For Financial Institutions*, S&P, retrieved Aug-14, http://www.financialexecutives.org/eweb/upload/FEI/Standard%20and%20Poor's%20Risk-Adjusted%20Capital%20Framework%20For%20Financial%20Institutions_21-Apr-09.pdf

Standard Chartered Bank (SCB), 2013, *Annual Report 2013, SCB, retrieved Aug-14,* http://reports.standardchartered.com/annual-report-2013/pdf/2013-Annual-Report.pdf

Sumitomo Mitsui Trust Holdings Inc. (SMTH), 2014, *Composition of capital as of March 31, 2014*, SMTH, retrieved Aug-14, http://www.smth.jp/en/ir/basel/1403/1403_hd_01.pdf

Sumitomo Mitsui Trust Holdings Inc. (SMTH), 2014, *IR Material for 1QFY2014,* SMTH, retrieved Aug-14, http://www.smth.jp/en/ir/presentation/E140731.pdf

The Bank of Nova Scotia (BNS), 2014, *Supplementary Regulatory Capital Disclosure*, BNS, retrieved Aug-14, http://www.scotiabank.com/ca/en/files/14/05/BNS_Q2-14_Supplementary_Regulatory_Capital_Dislosures.pdf

Toronto-Dominion Bank (TD), 2014, *TD Bank Group Reports, Second Quarter 2014 Results: Report to Shareholders*, TD, retrieved Aug-14, http://www.td.com/document/PDF/investor/2014/2014-Q2_Report_to_Shareholders_F_EN.pdf

UBS Group AG (UBS), 2014*, Second Quarter 2014 Report*, UBS, retrieved Aug-14, http://www.ubs.com/global/en/about_ubs/investor_relations/quarterly_reporting/2014.html

Westpac Banking Corporation (WBC), 2014, *First half 2014 Financial Results*, WBC, retrieved Aug-14, http://www.westpac.com.au/docs/pdf/aw/ic/140509_Final_IDP_Presentation_1H14.pdf

Westpac Banking Corporation (WBC), 2014*, Basel III Pillar 3, March 2014*, WBC, retrieved Aug-14, http://www.westpac.com.au/docs/pdf/aw/ic/Pillar_3_report_for_31_March_2014.pdf

Appendix B:

Position on Financial Literacy

This page is intentionally blank.

AUSTRALIAN BANKERS' ASSOCIATION INC.

Position on Financial Literacy

Introduction

The banking industry has, and continues, to invest in financial literacy programs and activities and to support a substantial program of collaboration with community organisations and government agencies. We are committed to improving financial literacy for all Australians.

The Australian Bankers' Association (ABA) believes financial literacy is a vital life skill. All Australians need to have the knowledge, skills, capabilities and capacities to understand how to manage their money, build their savings, make sound investment decisions, and manage their debts, now and into the future.

The ABA is supportive of the role played by the Australian Securities and Investments Commission (ASIC), as the lead Australian Government agency, to promote and encourage a coordinated and collaborative approach to improving the financial literacy of all Australians through the *National Financial Literacy Strategy 2014-2017* (*Strategy*).

Consistent with its statutory objective to promote the confident and informed participation of consumers and investors in financial services and markets, ASIC has national responsibility for coordinating financial literacy, working closely with the Australian Government Financial Literacy Board.

The banking industry has engaged with ASIC on the development of the *Strategy*[79]*.* We support the *Strategy* and endorse its five strategic priorities: educate the next generation, particularly through the formal education system; increase use of free, impartial information, tools and resources; provide quality targeted guidance and support; strengthen coordination and effective partnerships; and improve research, measurement and evaluation.

Our definition of financial literacy

> Financial literacy is a combination of financial knowledge, skills, attitudes and behaviours necessary to make sound financial decisions, based on personal circumstances, to improve financial wellbeing.

The banking industry supports the definition of financial literacy contained in the *Strategy*, which builds on the definition used by the OECD International Network on Financial Education and makes the link between the importance of financial literacy and concepts of confident and informed decision making. Financial decision making is an important factor in achieving financial wellbeing. Therefore, building financial literacy is a pathway for promoting, supporting and achieving financial wellbeing based on an individual's personal circumstances.

Our principles on financial literacy

The banking industry believes that it will take a comprehensive approach through coordinated and sustained efforts of a number of stakeholders across financial education; training, support and counselling; and lifelong learning across our community to build financial literacy in Australia. It will also take additional approaches and opportunities in other policy frameworks to support financial literacy efforts, promote financial and social inclusion, and build economic and financial resilience.

Strong leadership and engagement

The ABA supports strong leadership and engagement between the banking industry, businesses, governments, educators and the community sector.

Improving levels of financial literacy in Australia is a shared responsibility. Best practices in financial literacy programs and activities should be developed though leadership and coordination frameworks which seek to deliver programs and provide information, tools and resources to consumers at the right time and in the right way. Engagement between sectors will ensure that partnership approaches leverage existing efforts, build new

[79] www.financialliteracy.gov.au

competencies, target programs and activities to those within our community with most need, and promote access for greater financial and economic participation by all Australians.

Good policy and practice

The ABA supports good policy and practice which focuses on efforts to enable individuals, families and communities to improve their financial literacy and financial wellbeing and fosters efficient and effective policy and program development.

Developing and enhancing the efficiency and effectiveness of financial literacy programs and activities will take a range of expertise from across different sectors and different access points across life stages and personal and financial circumstances. For example, the education sector for children and young adults; businesses, employers and employee representatives, superannuation funds for workers; financial counsellors and social workers for people experiencing financial difficulties or in financial crisis; the retail sector for consumers; seniors organisations and retiree representatives for older Australians; disabilities organisations for people with a disability; and governments, regulators, banking and financial institutions and community groups across our community and target groups within our community. Good policy and practice will be deepened through sharing of experiences by those individuals and organisations delivering programs and activities.

Effective promotion and collaboration

The ABA supports promotion and collaboration which facilitates greater awareness and enriches the delivery of financial literacy programs and information for all Australians.

Collaborating and designing solid and sustainable cross-sector partnerships is essential in order to drive generational behavioural change. Behavioural influence and change, not just knowledge and understanding of banking concepts, products and services, but real impacts, should be evaluated through research, measurement and evaluation frameworks which seek to improve awareness of, and access to, meaningful and relevant financial literacy programs and activities. Promotion and collaboration will ensure that more Australians see the importance of greater financial literacy awareness, knowledge, skills, attitudes and behaviours in improving financial decision making and driving financial wellbeing.

Our financial literacy program

Financial literacy is one of the banking industry's long-term priorities and we are committed to continuing to invest in these financial literacy programs and activities to help all Australians take control of their money and finances.

The ABA's "Broadening Financial Understanding" program introduced in 2004, aims to help Australians make confident and informed decisions regarding their money and finances.

A decade later and the industry program focuses on making sure the banking industry has resources to address core knowledge areas and areas of interest with banking and financial products and services and has the mechanisms for making sure that all Australians are able to access this information and these resources. We understand that information is not financial literacy; financial literacy is building knowledge and skills and transferring these into financial capabilities and capacities. Our member banks' programs and activities are about outcomes and shifting attitudes and behaviours towards money. Individual banks and their partnerships are focusing efforts across education, banking and financial products and services, financial inclusion, and research.

The industry program consists of three key components:

Materials development program: Objective to develop materials and resources to promote banking concepts across the community and address areas of interest and need for target audiences.

The ABA will work with member banks and consumer stakeholders to identify areas of interest and need for consumers.

The ABA will develop free and impartial information, tools and resources and seek to assist consumers to understand and find the right banking product or service for them, to grow their financial knowledge and skills to make informed decisions or seek additional information and advice, to understand the consequences of their financial decisions now and into the future, and to prepare themselves for different life stages.

Member banks will ensure consumers have access to tailored programs and activities which seek to build individual financial capabilities and capacities as well as family and community financial resilience.

Information dissemination program: Objective to enhance distribution and dissemination of materials in collaboration with partners.

The ABA will work with member banks and consumer stakeholders to disseminate easy to understand facts, information, tools and resources to consumers so they are aware of their financial opportunities and choices.

Member banks will assist consumers in making their financial decisions.

Access and awareness program: Objective to increase access to financial literacy materials, programs and activities as well as raise awareness about financial literacy and financial capability for individuals, families and communities.

The ABA will work with member banks and consumer stakeholders to raise awareness and understanding of the importance of attaining and maintaining knowledge, skills, attitudes and behaviours which support sound financial decisions by providing consumers with messages about the long-term importance of taking control of their money and finances.

Member banks will ensure consumers have access to banking products and services and reinforce financial literacy messages with education, information, and guidance.

Our 10 key actions

The banking industry believes one of the biggest challenges for promoting financial literacy across Australia is getting the right information and support to the right people at the right times.

Cross-sector partnership approaches should be promoted to help achieve the objectives of the "Broadening Financial Understanding" program by:

- Increasing the relevance of the program by targeting certain audiences (i.e. the target group or the wider audience); and
- Expanding the reach of the program.

The ABA believes that the value of partnerships is evident in terms of content, distribution, promotion and measurement. Cross-sector partnership approaches underpin the banking industry's key actions and should support organic innovation in delivery of information, tools and resources for consumers and investors.

The banking industry is committed to the following key actions:

1. Develop and promote the ABA's "Broadening Financial Understanding" program and resources, including the ABA's Financial Literacy Info Centre[80]. The Centre will provide information and guidance on banking and financial products and services as well as useful links to member bank's financial literacy and financial inclusion programs and the industry's other targeted information and tools, such as the ABA's "DoingItTough" website[81] and the ABA's "Affordable Banking" website[82].
2. Support expanding training to reach more teachers and school and vocational students and promote the learnings from partnership programs between member banks and educators and delivering financial literacy through business and economics in the national curriculum to students across Australia. For example, Commonwealth Bank Foundation's StartSmart program provides innovative and interactive face-to-face financial literacy workshop lessons; complementing ASIC's MoneySmart Teaching program which provides professional learning and curriculum linked resources for teachers so they are skilled and confident in integrating financial literacy, where relevant, into their teaching programs.
3. Leverage campaigns and partnerships to target audiences on certain topics as a way of generating more access and usage, including through ASIC's MoneySmart website, the media, and consumer stakeholder networks. For example, promoting the availability of targeted information and guidance to disadvantaged and low-income Australians, young Australians, women, and other groups in our community, including new arrivals,

[80] http://www.bankers.asn.au/Consumers/Financial-Literacy
[81] http://www.doingittough.info/
[82] http://www.affordablebanking.info/

refugees and asylum seekers, and people with special banking needs (i.e. ESL, disability, etc.). Key topics include: understanding banking rights and responsibilities, banking for seniors, banking for Indigenous Australians, understanding banking basics and managing finances, accessibility of banking, retirement and estate planning, understanding risk, and protecting yourself and your money.

4. Promote the availability of information, tools and resources to assist bank customers to better understand and manage their money and finances, such as sophisticated and easy-to-use budgeting tools and information and guidance for people experiencing financial difficulties or in financial crisis. For example, ANZ's MoneyMinded program, which is helping people build financial skills, knowledge and confidence, and was established to respond to the need for financial skills education among marginalised and financially excluded Australians. We will continue to work with consumer stakeholders to raise awareness of industry approaches and resources and encourage our member banks to further develop and innovate technology solutions to assist bank customers better manage their money and finances.
5. Encourage the development of improved information, tools and resources to better target the financial literacy needs of Indigenous people and communities. For example, the Commonwealth Bank's Indigenous Customer Assistance Line, which is removing access barriers by providing a service specifically designed for remote Indigenous customers; ANZ's MoneyBusiness program, which is building money management skills and confidence of Indigenous people and developing a stronger savings culture in remote communities; and Westpac's Indigenous Capital Assistance Scheme, which comprises the Family Income Management workshops and small business mentoring programs. We will continue to work with, and advocate on behalf of, the Indigenous Financial Services Network, and continue to progress appropriate actions in the report *Banking for the Future* as well as commitments and actions contained in the ABA's *Indigenous Statement of Commitment* and individual banks' Reconciliation Action Plans, and other customer service charters.
6. Support, promote and enhance MoneySmart Week by implementing industry-wide and institutional efforts. We will support MoneySmart Week through industry and individual banks' awareness raising activities, partnership events, and via consumer directed outcomes and targeted resources. Specifically, the ABA's financial literacy conference held biennially, promotes sharing of research, ideas and experiences, fosters cross-sector and strategic partnerships, develops competencies for activities, and encourages best practice in program design and delivery, collaboration and promotion.
7. Review and update training for relevant bank staff to ensure consumer rights, responsibilities and financial literacy messages are known as necessary in various roles. We will improve relevant training modules for frontline staff and raise awareness of the importance of consumer rights in banking.
8. Simplify and modernise disclosure obligations on banks and other financial institutions to assist the banking industry provide improved information and guidance, including factual information, regulated disclosures relating to financial products, general and personal advice, as well as education materials aimed at lifting levels of financial literacy in Australia. We will work with the Government to ensure that regulated disclosures provide clear, meaningful information to customers and clients of banks and banking groups.
9. Build on existing partnership approaches and programs, including cross-sector efforts between the ABA and consumer and government stakeholders, to raise awareness of financial literacy and promote access to banking products and services. For example, supporting the sharing of outcomes and promoting and leveraging partnership programs, including matched savings (such as, ANZ's Saver Plus program developed in partnership by the Brotherhood of St Laurence and NAB's AddsUP Savings Plan developed in partnership by Good Shepherd Microfinance), no or low interest loan programs and other micro-finance programs (such as, the No Interest Loans Scheme (NILS)®run by Good Shepherd Microfinance in partnership with the Federal Government and NAB and the StepUP loan program run by Good Shepherd Microfinance in partnership with the Federal Government and NAB) and micro economic development and business enterprise programs (such as, NAB's micro-enterprise loans and Westpac's micro-finance program developed in partnership with Many Rivers. We will foster strategic alliances and partnerships and support the national Financial Literacy Community of Practice to share information, experiences and lesson
10. Encourage the implementation of studies and surveys to provide insights into financial literacy in Australia and establish research, measurement and evaluation frameworks. For example, ANZ's *Adult Financial Literacy in Australia* and NAB's *Measuring Financial Exclusion in Australia*. We will acknowledge and promote these research studies, frameworks and surveys as leading examples of research providing important insights into

understanding financial literacy in Australia and encourage additional research to supplement these studies and help target our financial literacy efforts.

The ABA supports the cross-sector promotion of existing sources, contact points and strategic partnerships to leverage existing efforts and distribution channels as well as cross-sector collaboration to promote greater awareness across audiences.

Key stakeholders

The banking industry believes that improvements in financial literacy depend upon the coordinated and sustained efforts of a number of stakeholders, including consumer and community groups, educators, government, the banking and financial services industry, and other businesses.

The ABA's program seeks to leverage cross-sector partnership opportunities with these stakeholders, and in particular, consumer stakeholders with valued and trusted relationships within their communities.

The ABA recognises the importance of the Australian Government's Financial Literacy Board[83] and the importance of the ASIC consumer website "MoneySmart", which provides useful information to help people make smart choices about money[84].

The ABA also recognises the importance of our member banks. A number of member banks produce publications, information and tools as well as offer education seminars and workshops which customers can use to assist them in making financial decisions.

The following provides more information on member banks' financial education, financial literacy and financial inclusion activities: ANZ Banking Group, Bendigo Bank, BOQ, Citibank Australia, Commonwealth Bank of Australia, HSBC, ME Bank, NAB and Westpac.

The ABA's website has a list of member banks' programs, resources and links to their websites (http://www.bankers.asn.au/Consumers/Financial-Literacy).

The ABA recognises that lifting the levels of financial literacy in Australia does not only have benefits for individuals and families, but improvements in financial literacy can deliver significant benefits to the economy and the wider community.

83 http://www.financialliteracy.gov.au/financial-literacy-board

84 http://www.moneysmart.gov.au