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Abacus
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21 December 2012

Ms Meghan Quinn
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Langton Crescent
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By email: SafeFinancialSector@treasury.gov.au

Dear Ms Quinn

Strengthening APRA's Crisis Management Powers

Thank you for providing Abacus with the opportunity to comment on the Treasury Paper, *Strengthening APRA's Crisis Management Powers* (the Consultation Paper).

Abacus is the industry association for Australia's mutual banking institutions, representing 87 credit unions, seven mutual building societies and seven mutual banks.

Our members are Authorised Deposit-taking Institutions (ADIs) regulated by the Australian Prudential Regulation Authority under the Banking Act 1959. Abacus member ADIs provide the full range of retail banking services and products to more than 4.5 million customers.

The mutual sector's customer-owned business model focuses on the needs of its members and mutual ADIs consistently outperform other banking institutions in customer satisfaction rankings.

Abacus strongly supports APRA having appropriate powers to manage a crisis situation in the ADI sector. We also recognise that the recent experience of the global financial crisis has highlighted potential shortcomings in crisis managements frameworks in other countries, and that amendments to Australia's crisis management powers may be appropriate to ensure that APRA remains well placed to deal with any situations that may arise.

However, it is equally important that these powers do not go too far, and that safeguards are put in place where required to ensure that they can only be exercised in appropriate circumstances. It is also important that any work in this area is properly integrated into broader policy thinking about the financial sector as a whole.

Our submission is grouped into two broad parts:

- General comments about the Consultation Paper and the review as a whole; and
- Specific comments on several of the individual proposals outlined in the Consultation Paper.

We note that given the preliminary nature of the Consultation Paper, several proposals are set out in relatively general terms, or outline several possible options without recommending a specific change. We also understand that Treasury will be completing a Regulatory Impact Statement as part of this policy development process, and we looking forward to continuing to engage with Treasury on the proposals set out in the Consultation Paper as they are further refined.

Financial sector review

Abacus acknowledges the value of reviewing and clarifying APRA's powers to act in a crisis situation, and we agree with the Consultation Paper that this process should take into account the lessons learnt by the GFC.[1]

However, we believe it would have been better for these matters to have been considered as part of a broad, independent inquiry into Australia's financial system, similar to the Wallis inquiry of 1997.

Earlier this year, Abacus released a report from Deloitte Access Economics[2] which recommended an independent inquiry be established into Australia's financial system to restore the balance between competition and stability, and to prepare Australia's financial system for the challenges ahead. The report found that:

- The Global Financial Crisis has upset the balance between competition and stability;
- The efforts of government and regulators to stabilize the financial system during the GFC favoured the major banks over smaller lending institutions;
- Addressing the distortions in funding costs and regulatory burdens between the major banks and the smaller lenders can help to restore competition in banking markets; and
- A banking sector that is not competitive will have significant implications for consumers.

The report recommended that "Restoring a more even balance between competition and stability in Australia's financial system requires a fundamental review of the structure of the system and its likely evolution over coming years," and noted that "Piecemeal intervention is unlikely to succeed when the landscape has changed so markedly."[3]

This call was supported by the recently completed Senate Inquiry into the post-GFC banking sector. The inquiry's report says that "the transition to the next stage in the development of the Australian financial sector needs to be guided by a clearly articulated vision of what the sector should look like and how it should function rather than being the accidental product of piecemeal regulatory responses."[4] The report recommends "that an independent and well-resourced root and branch inquiry into the Australian financial system be established."[5]

Abacus recommends that such an inquiry should examine:

- whether regulatory and policy settings have shifted too far to stability and away from competition, choice and innovation;
- consumer perceptions about the banking system and choice;
- market power and funding advantages of the major banks, including the 'too big to fail' factor;
- major banks' dominance over the wider financial services and wealth management market;
- performance of regulators (APRA, ASIC, ACCC, RBA, Treasury) in supporting competition and consumer choice;
- need for equal treatment and appropriate recognition for the 'customer-owned' banking business model in the corporate, prudential and taxation regimes;
- funding markets, including deposits, securitisation, retail bonds, and the role and performance of superannuation funds in these markets; and
- impact on competition of the increasingly complex regulatory compliance burden, including measures intended to be pro-competitive (such as laws against "price signalling").

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[1] *Strengthening APRA's Crisis Powers* – p. 8.

[2] Deloitte Access Economics, *Competition in Banking,* June 2012.

[3] ibid, p. 48.

[4] Senate Economic References Committee, *The post-GFC banking sector,* November 2012, p. 181.

[5] ibid, p. xxviii.

It would be useful to take a holistic look at Australia's financial system and the competition, stability, and choices it offers, rather than continuing to review the various pieces of the system in isolation.

Harmonisation

Around half of the proposals in the Consultation Paper are contained in the chapter titled "Simplification and Streamlining of Acts Administered by APRA," and focus on changes designed to harmonise the legislative frameworks of the three Industry Acts (i.e. the Banking Act, Insurance Act, and Life Insurance Act).

The Consultation Paper recognises that, as a general principle, "the supervisory framework should be broadly consistent across legislation where sensible, while allowing for appropriate differences between the industries that APRA supervises."[6]

While Abacus supports this general proposition, we are concerned that in a number of areas the Consultation Paper appears to have "harmonised for harmonisation's sake" rather than thinking about whether harmonisation would actually be of benefit to the industry and regulator in each case.

Many of the proposed harmonisation changes are poorly explained or justified, with the consultation paper often simply noting that the laws applying to different financial sectors are different and that therefore they should be aligned. This approach is overly simplistic. Each of the sectors regulated by APRA is inherently different, and therefore, differences in the regulation between the sectors will often be appropriate. Before the Government recommends alignment of regulatory provisions across sectors, consideration needs to be given to the reasons for the current differences, and whether retention of the regulatory differences remains appropriate.

In addition, in almost every case, the Consultation Paper proposes achieving harmonisation by moving the more lightly regulated industry to align with the more heavily regulated industry – ie moving to the more intensive regulatory standard. As noted in the Consultation Paper, "the pursuit of a more consistent set of powers also entails a strengthening of some of APRA's supervisory powers."[7] We believe that more consideration should be given to whether harmonisation could be achieved by reducing the regulatory burden imposed on the more heavily regulated sector.

While implementing changes will inevitably impose some costs on APRA regulated sectors, the Consultation Paper also notes that the harmonisation changes it proposes introducing across the various industry sectors should reduce the cost to APRA of administering the legislative framework.[8] It would be useful if APRA could quantify the likely magnitude of this saving, to provide regulated entities with an indication of the likely impact of the changes on aggregate industry levies. This would help to provide assurance to regulated entities that the benefits of the proposed harmonisation (through lower levies) will outweigh any implementation costs.

Our comments on specific proposals raised in the Consultation Paper are set out below.

Appointment of Statutory Managers (Consultation Paper sections 4.1.1 and 4.1.2)

Section 13A of the Banking Act specifies the circumstances that must exist before APRA is able to appoint a statutory manager (SM) to an ADI. Specifically, APRA can exercise this power where the ADI is unable to meet its obligations or suspends payment [13A(1)(c)], where APRA believes that one of these outcomes may occur [13A(1)(b)], or where the ADI

[6] *Strengthening APRA's Crisis Powers* – p. 102.
[7] ibid.
[8] ibid.

informs APRA that one of these circumstances is likely to occur [13A(1)(a)]. APRA may also appoint an SM where it considers it likely that the ADI will be unable to carry on banking business in Australia consistently with the interests of its depositors, or consistently with the stability of the financial system in Australia [13A(1)(b)].

The Consultation Paper notes that the powers under s13A *"do not enable APRA to appoint an SM to an ADI facing an emerging distress situation or in circumstances where an ADI's board of directors are ineffectual or obstructive,"*[9] and proposes that the section be broadened to include the following grounds for appointment:

- There has been, or APRA has reasonable grounds to believe there will be, a material deterioration in the ADI's financial condition that could pose a risk to the ADI's depositors or to the stability of the financial system in Australia.
- The ADI has failed to comply with a direction given to it by APRA.
- An administrator, receiver or liquidator is appointed to the authorised NOHC of an ADI, and APRA believes that this poses a significant threat to the operation or soundness of the ADI.

The Consultation Paper states that adding the first two criteria would *"make the triggers for appointment of an SM in the Banking Act more consistent with those applicable to judicial management in the Insurance Act and Life Insurance Act."*[10] However, Abacus believes that the proposed changes go beyond what would be needed to achieve alignment with the other Industry Acts. Specifically:

With respect to "belief of a material deterioration:"

- s62M(a)(v) of the Insurance Act and s159(a)(iv) of the Life Insurance Act provide a power to appoint where there are "reasonable grounds for believing that the financial position or management of the general insurer/company *may be* unsatisfactory" (emphasis added). As the power currently exists in these two Acts, it is only available where there is a belief the position may *currently* be unsatisfactory, not where there is a belief that the position *will become* unsatisfactory.
- Furthermore, in both the Insurance and Life Insurance Acts the scope of this power is limited – by section 62M(b) of the Insurance Act and section 159(b) of the Life Insurance Act. These clauses limit the application of s62M(a)(v) and s159(a)(iv) to situations where the Court is satisfied "that the time needed to make or complete an investigation … would be likely to be such as to prejudice the interests of [the company's policyholders]…"
- In both cases, the Consultation Paper does not explain the differences between the existing Insurance Act and Life Insurance Act powers, and the proposed new Banking Act power. It is not clear why the Consultation Paper proposes the introduction of a new power for the Banking sector which is broader than the existing powers which exist under the other Industry Acts.
- If the Government sees it as necessary to include a power of this kind into the Banking Act, it would be sensible to limit its application in a similar manner to the way it is already limited in these other Industry Acts.

With respect to "failure to comply with a Direction:"

- s62M(a)(iv) of the Insurance Act and s159(a)(iii) of the Life Insurance Act cover breach of Directions. While the power under the Insurance Act is triggered by the breach of any Direction, in the case of the Life Insurance Act it only applies where a company has failed to comply with a direction "in relation to solvency."
- This distinction is not addressed in the Consultation Paper. It is unclear why limiting the power to "solvency directions" is appropriate for the Life Insurance Act, but not for the Banking Act.
- In addition, section 62M(b) and 159(b), (discussed above), also apply to s62M(a)(iv) and s159(a)(iii).

[9] *Strengthening APRA's Crisis Powers* – p. 57.
[10] ibid.

- Once again, the consultation paper does not canvass these issues or explain why similar caveats would not be appropriate in the case of the Banking Act.

While we recognise the need for APRA to have appropriate power to respond to a crisis situation, we do not see why the changes to the Banking Act broadening the grounds for the appointment of a SM should go further than the existing powers under the other Industry Acts, and we note that the Consultation Paper does not attempt to make a case in support of such a distinction. The consultation paper instead argues that these reforms are simply designed to create a "more consistent" framework across the three Industry Acts. In the absence of a stronger case for the proposed changes to the Banking Act, their scope should be limited to ensure that they do not go beyond alignment with the other Industry Acts.

We suggest the two additional powers discussed above be limited in the following ways:

- The "belief of a material deterioration" should only be available where the belief is related to the *current* position, not a belief about what the position *will become*;
- The "failure to comply with a direction" power should only be available where the direction relates to solvency; and
- In both cases, the exercise of the power should be limited to where an investigation of the ADI has already been completed, or where completing an investigation before acting could compromise deposit holder's interests.

Section 4.1.2 of the consultation paper also proposes an additional power to appoint an SM where an external administrator has been appointed to the NOHC:

- The Consultation Paper notes that *"where an external administrator ... is appointed to the authorised NOHC of a regulated entity, this has the potential to trigger financial distress in the regulated entity,"*[11] and that where this external administration poses serious risk to an ADI, that APRA be given the power to appoint an SM.
- This power does not currently exist under any of the Industry Acts, but is seen as necessary because *"it may be necessary for APRA to move quickly to assume control of the ADI"*[12] where these circumstances exist.
- It would appear that APRA already has the power under existing provisions of the Banking Act to appoint a SM to an ADI in these circumstances. It is hard to envisage a situation where the appointment of an external administrator poses a serious risk to the ADI, yet none of the existing criteria under section 13A of the Banking Act have been met. The existing provisions under 13A appear sufficiently broad to address this issue and it is unclear why the creation of an additional power to specifically cover this situation is seen as necessary.

Winding-up ADIs (Consultation Paper section 5.2.2)

Under section 14F of the Banking Act, APRA may only apply to have an ADI wound up if:

- APRA considers the ADI is insolvent and could not be restored to solvency within a reasonable period [s14F(1)(b)]; and
- An ADI SM is in control of the ADI's business [s14F(1)(a)].

The Consultation Paper proposes removing the requirement that a SM control the ADI before winding up can be sought. The paper notes that, while it would normally be sensible to appoint an SM before seeking to wind-up an ADI, this may not always be the case. For example, the Consultation Paper notes that *"...having to appoint an SM before applying for a winding up order does not make sense where, for example, there is no scope to attempt an open resolution of the ADI..."*[13] and that *"...where APRA has already formed the view that the ADI is insolvent (after having investigated the ADI, for example), there should be the*

[11] *Strengthening APRA's Crisis Powers* – p. 57.
[12] ibid.
[13] ibid, p. 78.

flexibility to apply to the Court to wind up the ADI without having to first appoint an SM to the ADI."[14]

The power to seek winding up under section 14F was introduced in 1998, and the second reading speeches and explanatory memorandum around the Bill provide little context on why the requirement for SM appointment was introduced:

- Treasurer Costello's second reading speech notes that: *"APRA may initiate the wind-up of an institution that is insolvent and cannot be restored to solvency within a reasonable period. Such action may prevent further losses from accruing and would therefore be in the best interests of depositors."*
- The Explanatory Memorandum notes that: *"when APRA considers that an ADI under statutory management is insolvent and could not be restored to solvency within a reasonable period, it will be able to apply to the Federal Court for an order that the ADI be wound up."* and *"The new insolvency provision ... is accompanied by a power for APRA to apply to the Federal Court for an ADI to be wound up (in accordance with the Corporations Law) when an institution is under statutory management."*

It is difficult to comment on the need for the retention of this power, when the rationale for its introduction is not understood. The Consultation Paper does not provide any further clarity around this issue.

Abacus notes that the proposed change would broaden APRA's powers under the Banking Act beyond the comparable powers available under the Insurance and Life Insurance Acts. APRA may seek winding up without first appointing a JM under the Life Insurance Act where an investigation into the company has been completed and APRA is *"satisfied that it is necessary or proper that the application [for winding up] be made"* [s181(2)]. Similarly, under the Insurance Act APRA may seek winding up where an investigation has been completed and the Court may order the winding up where it is satisfied that *"it is in the interests of the general insurer's policy holders."* [s62ZU(2)].

In both cases, a JM does not need to have been appointed for winding up to be sought, however, an investigation does need to have been completed. While the Consultation Paper notes that an investigation into an ADI is one way that APRA could reach a conclusion about insolvency, it is not proposed that this be a prerequisite. However, it is difficult to imagine a situation where APRA would need to seek winding up of an ADI without first investigating the ADI or appointing an SM.

If the requirement for appointment of an SM under s14F(a)(1) was removed, we would propose that it be replaced by a requirement that an investigation into the ADI has been completed, and APRA is satisfied that winding up is in the interests of deposit holders.

Revoking authorization (Consultation Paper section 8.1.4)

Section 9A of the Banking Act allows APRA to revoke authorisations under certain circumstances. The Consultation Paper proposes reducing inconsistencies across the Industry Acts by introducing a harmonised, "simplified and effective" set of criteria for revocation.

This revised list would see three additions made to the existing set of grounds for revocation under section 9A of the Banking Act, namely:

- Where the entity has inadequate capital by reference to APRA's regulatory requirements and is unlikely to have adequate capital within a reasonable period of time.
- Where the entity has, in connection with a prudential matter, knowingly or recklessly provided APRA with information that was false or misleading.
- Where the entity is authorised as a foreign branch, its authorisation to carry on the relevant regulated business has been revoked by its home regulatory authority.

[14] *Strengthening APRA's Crisis Powers* – p. 78.

Of these three, only the first is consistent with an existing power in another Industry Act. It is unclear why the addition of the second and third powers has been proposed, and the Consultation Paper provides no additional context or background on this issue.

The removal of the existing section 9A(2)(b) is also proposed, which currently allows for revocation where *"it would be contrary to the national interest for the authorisation to remain in force."* Further, the Consultation Paper proposes removal of a similar power in the Insurance Act [s15(1)(b)]. Once again, no rationale for this change is provided.

While Abacus is generally supportive of the idea of moving to a broadly harmonised set of criteria across the Industry Acts, it is difficult to comment on the merits of specific changes when the Consultation Paper is silent on the shortcomings of the current arrangements and the reasons for proposing the changes. However, it is clear that the suggestions outlined in the Consultation Paper go well beyond what would be required to simply achieve harmonisation.

Data submissions (section 8.3.4)

Under the *Financial Sector (Collection of Data) Act (FSCODA),* failure to submit data to APRA with required timeframes is an offence. However, this penalty can be avoided through the submission of incomplete or incorrect information, and doing this provides an ADI with an effective 28 day extension before an offence has been committed.

Abacus agrees that the existence of this loophole has the capacity to undermine APRA's ability to collect timely and accurate data, and that some changes to the legislation to tighten reporting requirements may be appropriate.

However, the current system already appears to be delivering reasonably solid outcomes, with APRA recently noting that *"97 per cent of submissions are received by their due dates and over 99 per cent are submitted within a week of the due date."*[15]

Given current levels of compliance, we do not believe that the significant tightening of the reporting rules proposed in the Consultation Paper is warranted. Instead, we would propose that a more moderate strengthening of the current framework be introduced.

We agree that the current 28 day period for correcting inadequate information is too long, and should be reduced. However, the proposed four day deadline is very short, particularly given that the four day deadline is in fact made up of two sequential two day deadlines. Abacus believes that it would be more appropriate to set a timeframe somewhere between these two extremes.

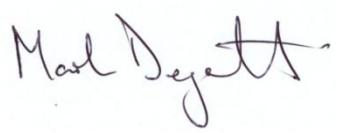
The Consultation Paper also proposes that the submission of incorrect, incomplete, misleading or non-compliant information would be an offence, even where the issue is rectified within the legislated timeframe. This proposal appears harsh given that many of these errors or omissions will be the result of honest mistakes.

We would proposed that a penalty only be imposed where an error or omission is not corrected within the required timeframe, or where an ADI has made an unsatisfactory data submission multiple times in a twelve month period.

[15] APRA, *Insight*, Issue 1 2012, p. 64.

Please contact me on 02 8299 9053 or Micah Green, Senior Policy Adviser, on 02 8299 9032 to discuss any aspect of our submission.

Yours sincerely



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