



OPENING STATEMENT

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Competition in the Australian Financial System
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Thank you for the opportunity to participate in today's Roundtable hearing. The Australian Prudential Regulation Authority (APRA) is supportive of the Commission's work, and available to assist and contribute wherever we can.

To set the scene for my remarks today, I would like to start with APRA's mandate. We are an independent statutory authority established for the purposes of prudential supervision of certain financial institutions - that is, providing assurance that institutions have the financial and operational resources to deliver on their financial promises to the community - and for promoting financial system stability in Australia more generally. In particular, we are responsible for protecting the interests of depositors, insurance policyholders and superannuation fund members.

In pursuing financial safety and stability, Parliament was mindful that safety should not be pursued at all costs. In particular, the *Australian Prudential Regulation Authority Act 1998* (APRA Act) requires us to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and, in balancing these objectives, to promote financial system stability in Australia.¹

However, in the context of this Inquiry, it is important to highlight a couple of points:

- Firstly, that APRA does not have oversight of the entirety of the Australian financial system. Prudential supervision is considered warranted where, in the words of the **Wallis Inquiry which led to APRA's establishment, the 'intensity of the promise' is high**, and information asymmetry impedes the ability of the typical customer to make an informed decision as to the soundness of their financial service provider.² This includes bank deposits, insurance policies, and superannuation balances. Deposit-takers, insurance companies and superannuation funds make up a large proportion of the financial system, of course, but it is important to bear in mind - particularly in the context of any consideration of competition - that there are a great many financial products and service providers that are free to **operate outside APRA's purview**.
- And secondly, the various industry Acts from which APRA derives its specific powers **focus more directly on APRA's role to protect and promote the interests of** a certain class of liability holders.³ We do this by maintaining a robust framework of prudential standards that establish minimum requirements - covering among other things financial soundness, risk management and governance - and a program of active supervision. Together, they are designed to minimise the risk of loss to depositors, policyholders and fund members, and promote financial stability.

APRA's prudential framework and activities necessarily focus in the first instance on financial safety and stability. APRA has no mandate to create or impose standards in

¹ APRA Act (1998), section 8.

² See, for example, Financial System Inquiry Final Report (March 1997), section 8.32 *The Scope of Prudential Regulation*, p303.

³ The main industry-based Acts are the *Banking Act 1959*, the *Insurance Act 1973*, the *Life Insurance Act 1995*, the *Superannuation Industry (Supervision) Act 1993*, and the *Private Health Insurance (Prudential Supervision) Act 2015*.

relation to its ‘balancing considerations’ (that is, efficiency, competition, contestability and competitive neutrality). Rather, these balancing considerations are taken into account in designing and implementing our prudential requirements. We provide opportunities for industry feedback on competitive implications as part of our public consultation process. We are also giving more prominence to our own consideration of these issues when we issue proposals for consultation.

Although APRA uses both regulation and supervision to achieve its objectives, it primarily seeks to fulfil its mandate using a supervision-led approach. Common baseline regulatory standards are important but a common one-size-fits-all prescriptive rulebook, while **notionally delivering a ‘level playing field’, is unlikely to be optimal.** A focus on supervision provides us greater ability to tailor requirements to suit individual circumstances: in other words, supervision has greater capacity to be both risk-based and outcomes-focussed. This, in turn, is likely to maximise both the efficiency and effectiveness of the prudential framework. Our observation is that the supervision-led approach seemed to be a common feature of jurisdictions that emerged relatively unscathed from the financial crisis. The role of proactive supervision in helping to deliver a stable financial system was also acknowledged in the 2014 Financial System Inquiry report, and is consistent with the **Government’s** current *Statement of Expectations* for APRA.

In establishing and implementing the prudential framework for regulated institutions, APRA takes the approach that the framework should allow for proportionate supervision, such that smaller institutions are subject to expectations commensurate with the scope and complexity of their business. To give a few examples:

- small authorised deposit-taking institutions (ADIs) are subject to much simpler liquidity requirements than larger ADIs;
- statistical reporting requirements are also commonly stratified by size of institution, to reduce reporting burden where the level of risk and complexity do not require more detailed information; and
- APRA has been working with the mutual ADI industry (and ASIC) to develop a form of equity capital that can be issued without jeopardising mutual status of these entities.

It is sometimes asserted that there must be a trade-off between stability and competition in the financial system. That is not our view. Competition in the financial sector can bring welcome innovation and enhanced outcomes for customers, and good regulatory settings can deliver financially strong competitors, creating both financial stability and a dynamic and innovative marketplace for financial services. APRA prudential framework has in mind the maintenance of sustainable competition: that is, competitors who are there for the long term - that is, both in good times and bad. The 2008 financial crisis revealed too many business models that only worked in the good times, and ceased to provide services to consumers when adversity arose. The long-term outcome has unfortunately been a more concentrated system.

Having said that, there are times when it is important for APRA to actively temper competitive spirits within the financial sector. Our current interventions in relation to housing lending are a case in point. We have not been concerned with lenders competing on price or service standards, but we have been concerned that intense competition was leading to a material erosion in lending standards. This was unhealthy both for individual institutions, and the long-run interests of the community as a whole.

My comments thus far have largely focussed on competition between APRA-regulated entities. But the big competitive shifts in the Australian financial system have tended to come from new entrants - either non-prudentially-regulated entities competing against the regulated, or new regulated entrants arriving with a different business model from that of the incumbents. With that in mind, APRA is currently reviewing its licensing processes. As part of the review, we are considering the benefits and risks of adopting a two-phased approach to licensing for certain types of new entrant. Such an approach could bring new sources of competition by allowing new entrants time to establish the full complement of resources and systems necessary to be able to comply with all aspects of the prudential framework. At the same time, we need to be able to still assure the community that their bank deposits, insurance policies or superannuation funds placed with these new entrants are adequately safeguarded, and not create competitive advantages for small new entrants over small incumbents.

Finally, we see technology has a critical driver of the future shape of the financial system. We are very keen to see investment in new technology by financial firms - both newcomers and existing players - because it has the potential to achieve multiple objectives, by offering considerable benefit to the soundness, the efficiency and the competitiveness of the financial system.

With those remarks as background, I would be happy to take your questions.