

RESPONSE BY THE AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY (APRA)
TO A QUESTION TAKEN ON NOTICE

Senate Economics References Committee
Inquiry on Cooperative, mutual and member owned firms

26 February 2016

Senator XENOPHON: Further to Senator McKenzie's line of questioning, could you provide details on notice about the nature of the correspondence and the dates in respect of these issues with mutuals and co-ops. I am trying to get an idea of how long the process has been evolving for, what the outcomes have been to date, what the likely pathway we will be and what the potential end date may be. I understand very well, Mr Brennan, your point about proceeding cautiously and prudentially with respect to this. If you could provide those on notice to the committee that would be very useful in giving us an idea of how long it has been taking, the sort of impediments in place and the sort of challenges you face as a regulator to appropriately and cautiously deal with these things. Would that be something that you can provide to the committee in due course?

Mr Brennan: Yes, I am happy to take that on notice. To clarify expectations up-front: I will take that as a question that seeks examples of actual experience, the types of issues and the likely outcomes. We would not be providing any private details, including names of any individual institutions.

Senator XENOPHON: No. But I do not think it would be breaching privacy to have an idea of that: that you were contacted by unnamed institutions in a certain month of a certain year and how that has progressed. I do not think it is unreasonable to get an idea of that. That would not, in any way, breach privacy.

Mr Brennan: I agree. I was just confirming that.

Answer:

The Australian Prudential Regulation Authority (APRA) has been in ongoing discussions with mutually-owned authorised deposit-taking institutions (mutual ADIs) over the treatment of capital instruments in the prudential framework since 2011. A summary of consultations and related timelines is set out below.

| Consultation date | APRA Consultation details |
|-------------------|--|
| September 2011 | <p>Discussion Paper: <i>Implementing Basel III capital reforms in Australia</i></p> <ul style="list-style-type: none">• This Discussion Paper outlines APRA's proposals to implement a package of reforms to strengthen the capital framework ADIs in Australia.• The Discussion Paper includes the proposed criteria for ordinary shares for mutually owned ADIs (page 14).• Submissions were due by 2 December 2011. |

| Consultation date | APRA Consultation details |
|-------------------|--|
| March 2012 | Response to Submissions: <i>Implementing Basel III capital reforms in Australia</i> <ul style="list-style-type: none"> APRA responded to an issue raised in submissions regarding Common Equity Tier 1 Capital and the application to mutual ADIs (see page 12-13). Further submissions were due by 31 May 2012. |
| September 2012 | Response to Submissions II: <i>Implementing Basel III capital reforms in Australia</i> <ul style="list-style-type: none"> APRA points out that it is consulting separately with mutual ADIs on alternative measures to address aspects of the Basel III reforms that are problematic for institutions with this corporate structure. APRA undertook industry liaison in November 2012, May 2013 and June 2013 to discuss alternative measures. |
| October 2013 | Letter to mutually owned ADIs: <i>Mutual equity interests</i> <ul style="list-style-type: none"> APRA proposes an arrangement to facilitate mutual ADIs issuing certain capital instruments. Submissions were due by 15 November 2013. |
| April 2014 | Letter to all mutual ADIs: <i>Mutual equity interests</i> <ul style="list-style-type: none"> APRA released revisions to the prudential framework which provide for mutual ADIs to issue capital instruments that provide for conversion into mutual equity interests. |
| November 2015 | APRA liaison with industry representatives <ul style="list-style-type: none"> Following a number of discussions with APRA industry representatives undertook to provide a written submission to APRA on a possible equity-like capital instrument informed by developments in the United Kingdom. |

The key challenge that APRA and the mutual ADIs have found is developing a capital instrument with genuine equity-like features, and therefore may be considered equivalent to Common Equity Tier 1 (CET1), while at the same preserving their mutual status.

Regulated entities typically seek APRA endorsement prior to issuing instruments they intend to treat as capital under the prudential framework. At any one time APRA is generally working simultaneously on a number of capital instruments from various entities.

The timeframe to endorse an instrument can range considerably depending on the complexity of the instrument. Simple instruments that replicate previously-approved instruments can be dealt with relatively quickly, whereas those that set important precedents require time and attention. In the case of mutual ADI instruments, with few capital instruments issued, it is to be expected that precedent setting decisions will be made.

An actual example of this process (for a non-CET1 instrument) is set out below.

| Period after initial submission | |
|---------------------------------|---|
| 6 weeks | APRA initial analysis of instrument, identifies areas for APRA to investigate. |
| 10 weeks | Following full investigation APRA informs entity of initial assessment, requests further information and documentation. |

| Period after initial submission | |
|--|---|
| 12 weeks | Discussion between entity and APRA on material issues. |
| 12 weeks | Entity submits additional information on material issues. |
| 12 weeks | APRA decision made in respect of material issues. |
| 16 weeks | Entity submits updated information and documentation. |
| 18 weeks | APRA informs entity of follow up action required in respect of detailed issues. |
| 18 weeks | Discussion between APRA and entity on detailed issues. |
| 20 weeks | Entity responds to detailed issues. |
| 21 weeks | APRA informs entity of further issues. |
| 21 weeks | Entity and APRA correspond to finalise outstanding issues. |
| 21 weeks | APRA provides sign-off that instrument is eligible. |