



## **OPENING STATEMENT**

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**OPENING STATEMENT TO THE SENATE ECONOMICS LEGISLATION COMMITTEE  
22 OCTOBER 2015**

Good morning. I would like to quickly touch on four issues that have been prominent on APRA's agenda since we last met with this Committee.

**Financial System Inquiry**

The first issue is the report of the Financial System Inquiry and, of note this week, the release of the Government's response to it. As you know, the FSI made 44 recommendations: around half of these were of direct interest to APRA. In some cases, the recommendations - such as those relating to capital requirements for authorised deposit-taking institutions (ADIs) - require specific consideration by APRA, while in others - such as those relating to superannuation, or the regulatory architecture more broadly - the matter is primarily in the hands of the Government, but APRA will likely have a role to play in assisting with implementation.

As to those recommendations that are directed at APRA, we have already made two important announcements. In July this year, we released a study on the relative capital strength of the major Australian banks against their overseas peers.<sup>1</sup> This study showed that the major banks' capital ratios were not positioned in the top quartile, as the FSI had advocated in its first recommendation to make ADIs' capital 'unquestionably strong'. But we also said that, while this sort of international comparison is a useful sense check, we shouldn't tie ourselves too tightly to it.

Also in July, we announced a change to the risk weights for mortgage exposures for those banks that are accredited to use internal models to determine their capital ratios. This change - which formally comes into effect from 1 July next year - reflected the second recommendation of the FSI, which advocated that the difference in risk weights between model-using banks and other ADIs using standard risk weights should be narrowed. As an interim measure, we adjusted the risk weight for model-using banks to the bottom of the range recommended by the FSI (ie to an average of at least 25 per cent). We referred to this as an interim measure because it may not be the final calibration: that will ultimately need to wait for more clarity on the full set of reforms to the international framework that are currently being considered by the Basel Committee. But we were comfortable moving ahead on the mortgage risk weight issue, given it was consistent with the direction the international work is taking.

With the major banks choosing to raise capital in response to this change, it also helped substantially close the gap between their current capital ratios and the top quartile positioning that the FSI advocated, providing APRA with more time to consider international developments over the next year before finalising any further changes in Australia. The Government's response to the FSI suggests we should seek to define 'unquestionably strong' by the end of 2016 - notwithstanding all the moving parts, that seems quite manageable at this point in time.

**Sound Lending Standards for Housing**

The change in mortgage risk weights is a useful segue into the second issue I wanted to mention: the steps we have taken to reinforce sound standards in lending for housing. As the Committee will recall, we wrote to all ADIs in December last year to reinforce the importance of maintaining sound lending standards in an environment of heightened risk.

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<sup>1</sup> See APRA (July 2015), '*Information Paper: International Capital Comparison Study*'. Available at [www.apra.gov.au](http://www.apra.gov.au)

As foreshadowed in our letter, we spent the first half of 2015 engaging with ADIs (particularly the largest lenders) on their lending policies and growth aspirations, in order to assess whether they were prudently managing the risks within the current environment. In many cases, this led to ADIs making changes to their lending policies and growth aspirations to ensure that sound practices were being maintained.

Many of these changes have only recently come into effect, so we are watching carefully to see how they play through the system. Based on the latest available data, the rate of growth in credit for housing is, in aggregate, still accelerating. However, within this there is a compositional switch underway, as a moderation in the growth in lending to investors has been offset by somewhat stronger growth and more competition in lending to owner occupiers. In such an environment, APRA remains very alert to any sign of deteriorating credit standards, and is monitoring that those ADIs identified as needing to strengthen their lending policies do indeed do so.

### **Superannuation Governance**

The third issue I wanted to mention was in relation to superannuation. APRA has been consulting with industry on potential changes to the prudential framework to support implementation of the Government's proposed changes to governance requirements for the industry, assuming they are passed by the Parliament. As outlined in our recent submission to the Committee on the *Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, APRA supports the direction of the proposed changes in the Bill as they will more closely align board composition requirements for the superannuation industry with those of other APRA-regulated industries. APRA's experience, over many years and across all industries, suggests that having at least some independent directors on boards supports sound governance outcomes. Superannuation is fundamentally about investing money on other people's behalf and therefore strong governance frameworks are critical to protecting the best interests of fund members.

The recent Stronger Super reforms, including the implementation of APRA's prudential standards, have contributed to a strengthening of governance practices within the superannuation industry, but there remains room for further improvement in a number of areas. The superannuation industry has evolved considerably since the current board composition requirements were introduced into the SIS legislation in 1993. A significant portion of the industry are now public offer funds with broad and open membership, and the industry's importance, from both a financial system and retirement income policy perspective, continues to increase. It is therefore appropriate for the industry to ensure that it draws from the widest possible pool to ensure that boards have the necessary skills, capabilities and experience to meet the future needs of their members.

### **Prudential Supervision of Private Health Insurance**

The final matter I wanted to note has had far less public attention than the issues I have raised thus far, but has been just as important for APRA: that is, the transition of responsibilities for the prudential supervision of private health insurance funds from the Private Health Insurance Administration Council (PHIAC) to APRA with effect from July 1 this year. That this transition was successfully achieved was due to a great deal of hard work and cooperation involving APRA, PHIAC, Treasury, the Department of Health, and the Department of Finance, and I would like to acknowledge those other agencies for the significant role they played. In the months leading up to the transition, APRA established new prudential standards for the private health insurance industry that, to the maximum extent possible, replicated the standards that had been put in place by PHIAC. Data collections, and the administration of the Risk Equalisation Trust Fund, have also been

maintained largely unchanged so that the transition from PHIAC to APRA was as seamless as possible for the insurers themselves.

APRA has committed not to make any material changes to the prudential regime for private health insurers in the short term, but over time will look to align supervisory practices and prudential standards with those of other APRA-regulated industries, where it makes sense to do so.

With those comments, we are happy to answer your questions.