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Associate Professor, Discipline of Finance, University of Sydney Business School

31 March 2021

General Manager, Policy Development
Policy and Advice Division
Australian Prudential Regulation Authority
Email: ADIpolicy@apra.gov.au

RE: Public Consultation on a more flexible and resilient capital framework for ADIs in Australia

Dear General Manager,

I would like to take this opportunity to offer my comments as part of APRA's public consultation regarding the reforms proposed for Australia's regulatory capital framework. Regulatory reforms aimed at making Australian banks 'unquestionably strong' since the 2014 Financial System Inquiry and the imminent national implementation of the Basel 3 capital agreement has made lifting capital standards a necessary national priority.

Bringing forward the full implementation of the revised Basel 3 driven capital framework from 1 Jan 2023 would thus be helpful for strengthening financial resilience. APRA's proposed alignments with the international implementation of Basel 3 capital rules would help Australian banks to be more competitive coming from an internationally harmonized financial regulatory system.

In particular, the proposed increases in the Capital Conservation Buffer and the Countercyclical Capital Buffer will be effective for improving the resiliency of the Australian banking sector, particularly to weather future economic shocks (stress). The differential treatment for domestic systemically important banks vs. internal ratings-based (IRB) banks and normal ADIs is also consistent with international practice in recognising the heterogenous risk profiles of these types of institutions. Evidence based research conducted by European banking researchers indicates that IRB banks are clearly distinct from standardised banks and have different risk management practices (Cucinelli et al., 2018). Expanding the capital buffer framework affords the appropriate level of flexibility to tighten capital requirements as needed over time without imposing unnecessary regulatory burden on ADIs. The buffer levels proposed are well supported by simulation exercises on potential banking system-wide losses conducted by Bui et al. (2017) on Australian ADIs. The concerted effort made to improve the comparability of the regulatory capital requirements for IRB and standardised banks in Australia and to introduce more granularity into risk-weights that will be applied (for instance, finer calibration with reference to Loan-to-Value ratio buckets) is a positive move forward that will help to enhance banking

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competition, which is critical for keeping the cost of financial services at reasonably affordable levels. The proposed increases in capital requirements are also unlikely to be damaging for maintaining a free flow of credit within the Australian economy upon full implementation.

Reference used:

Bui, C., Scheule, H., Wu, E. (2017). The value of bank capital buffers in maintaining financial system resilience. Journal of Financial Stability, 33, 23-40.

Cucinelli, D., Battistia, M., Marchese, M., Nieri, L. (2018). Credit risk in European banks: The bright side of the internal ratings based approach. Journal of Banking and Finance, 93, 213-229.

Please do not hesitate to contact me via email at [redacted] should you need any additional information regarding my feedback as part of this public consultation.

Sincerely,

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