

22 March 2024

██████████
General Manager, Policy
Policy and Advice Division
Australian Prudential Regulation Authority

Via email: adipolicy@apra.gov.au

cc:

██████████ a/g GM Financial Risk Specialist Teams
██████████, Head of Liquidity Risk

Dear Mr Holland

Targeted changes to ADI liquidity and capital standards – Consultation

COBA welcomes the opportunity to respond to APRA's consultation on targeted changes to ADI liquidity and capital standards.

COBA is the industry association for Australia's customer owned banks (mutual banks, credit unions and building societies). Collectively, our sector has over \$175 billion in assets and is the fifth largest holder of household deposits. Customer owned banks (i.e. mutual ADIs) account for around two thirds of the total number of domestic Authorised Deposit-taking Institutions (ADIs) and deliver competition and market leading levels of customer satisfaction in the retail banking market.

Our sector provides competition and diversity in a major bank and investor-owned bank dominated market. We represent a diverse group of mutual ADIs who all are currently using the Minimum Liquidity Holdings (MLH) regime. These mutual ADIs have a range of views and many will put in their own submissions and/or engage with their supervisors on this issue.

Our sector's unique point of difference is our customer ownership. Our members are owned by their customers rather than a separate set of shareholders. The result is that our sector provides a unique counterpoint to the major banks and other investor-owned banks with decisions made for the collective customer good rather than for shareholders and their profits.

Our members play a key role to provide banking services to their communities. Our members were formed many years ago to serve their communities with some focusing on specific geographic regions, while others focusing on banking particular demographics such as emergency service workers, nurses or teachers. Some members look more widely to bring purpose-led banking to a national level.

Importantly, the type of banking communities our members operate in are vastly different from the highly concentrated, corporate driven, uninsured deposit business that caused issues for Silicon Valley Bank. Mutual ADIs focus on true retail deposits, members of the community doing their everyday banking, the majority of which falls under the Government's Financial Claims Scheme. Similarly, our sector is also a world away from globally significant Swiss investment bank Credit Suisse that has been beset by numerous scandals over the last two decades.

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APRA's letter outlines a set of proposals to respond to overseas banking crises. We acknowledge that these crises may contain important lessons for Australian regulators, but we urge APRA to take proportionate responses and recognise the uniqueness of the strong Australian financial system.

Our view is that the current proposal as it stands creates a significant negative impact on our sector in a 'business as usual' scenario in order to mitigate a much rarer, more severe and systemic scenario. We also note that the US regional bank issues arose while banks were holding government securities i.e. the same High Quality Liquid Assets (HQLA) which these reforms are pushing mutual ADIs towards. While we acknowledge that APRA is a 'tail risk' regulator, it is critical that these policy trade-offs are fully explored given the continued concerns around banking competition and diversity in Australia.

APRA mandate and statement of expectations

We are concerned about the adequate consideration of competition and impact on consumers of this proposal. While APRA has particular prudential regulation objectives in mind with this proposal, APRA needs to further consider other elements in its mandate and the recently updated statement of expectations.

APRA's mandate is to "balance the objectives of financial safety, efficiency and competition, contestability and competitive neutrality and, in balancing these objectives, promote financial system stability in Australia". The absence of a full discussion paper has not provided any evidence on how APRA has considered competition in this proposal.¹

We are concerned about whether this proposal aligns with APRA's statement of expectations, which notes that APRA should "minimise the costs and burdens of regulatory requirements for regulated entities, including by applying proportionate requirements, considering different businesses models, and taking a principles-based approach to regulation, ultimately to benefit consumers".

Key points

Removing bank securities from the liquidity regime will reduce many mutuals' ability to sustainably operate and grow. We expect that this will reduce banking competition and diversity in Australia.

Independent analysis shows that these changes will reduce sector profits in excess of \$100m as mutual ADIs are forced to move into lower yielding securities and are subject to higher funding costs.

APRA needs to balance its prudential objectives with competition and consumer considerations, particularly in the current environment where there are fewer non-major banks and increasing consolidation. We are concerned that the current proposal to mitigate APRA's identified risks has the potential to introduce far greater risks to the banking sector and banking competition.

To respond to these changes, each mutual ADI will need to decide on whether to offset reduced profits by increasing loan rates, decreasing deposit rates, increasing fees, increasing returns on other liquid assets and reducing costs (for example, reducing branch numbers).

While we provide some potential solutions to mitigate these impacts, COBA requests that APRA consider additional analysis and workshops on the potential mitigants to these impacts with

¹ APRA discussion papers have previously included information on how it has balanced each element of its mandate.

MLH ADIs, including considering these changes as part of its wider liquidity review. This includes considering the role of industry support schemes such as CUFSS.

COBA holds significant concerns that removing bank securities from the liquidity regime (Proposal 3) will reduce mutual ADIs' ability to grow and serve their customers.

It is critical that the MLH regime remains a fit for purpose and a viable long-term regime for smaller banks rather than a stepping stone to the more complex Liquidity Coverage Ratio (LCR) regime. The same applies to the standardised capital framework. This will involve balancing the risk management expectations with the capabilities of smaller banks in a way that adequately manages prudential risks.

Our member and wider stakeholder engagement over the last few months finds this proposal is a significant and meaningful change to the regime. APRA should reconsider the current timelines for finalising this policy (proposed 1H 2024) and consider bringing this proposal into its more comprehensive review of Prudential Standard APS 210 Liquidity for a more holistic approach to liquidity requirements for smaller banks. This would allow for a 'modernisation' of the MLH liquidity regime rather than a series of piecemeal changes. Such a review would also be able to reflect the significant changes in the mutual ADI sector over the last decade or so.

Ultimately, this particular change, alongside the proposed APS 117 and any future APS 210 changes will result in fundamental changes in how treasury functions are managed for smaller banks and the mutual ADI sector. It is therefore critical that APRA gets the settings right.

We expect that there will be significant and broad ranging impacts on the sector, including:

- narrowing of funding options and subsequent increase in the cost of funding for mutual ADIs
- reduced revenue from liquidity portfolios, leading to potentially adverse business decisions
- increased complexity in liquidity management
- offsetting increase in interest rate risk and IRR management impacts.

We provide more information and specific comments on these impacts in **Appendix A**.

Quantitative Impact Assessment

COBA has commissioned a quantitative impact assessment (**Appendix B**) based on publicly available data and common assumptions. This proposal, if implemented, will have differing impacts across different mutual ADIs. As mentioned, we represent a diverse range of mutual ADIs — all connected with a common 'people first' purpose. Our members include larger mutual ADIs who may move to the more complex LCR regime at some point in the future, medium-sized mutual ADIs with self-securitisation and treasury functions and the smallest mutual ADIs.

This proposed change will reduce the income of many mutual ADIs, reduce the sector's funding sources and increase funding costs for all mutuals. The impact assessment estimates a decrease in sector profits in excess of \$100 million once fully implemented. Actual impacts will vary based upon individual ADIs' current cash, government bond and ADI security holdings, how they adjust their buffers because of these changes as well as other factors. Ultimately, this analysis highlights that the potential impact is significant and the need for further analysis and consideration.

Given the customer-owned nature of mutual ADIs, lower profits will directly impact the sector's ability to serve customers, innovate and grow. The result could see mutual ADIs offering less competitive mortgage or deposit rates and products, charging higher or new fees for services, lower investment in innovation, customer service and product development, and less branches.

Adequate consideration of potential mitigants

Our view is that more time will provide APRA and industry a better opportunity to examine the design, calibration and impacts of potential mitigants to address the trade-offs for APRA's objectives, competition and consumer impact. Given we expect APRA's proposal to have significant impacts, this may also be the case for any potential mitigants. Therefore, adequate consideration of potential mitigants is essential. Our view is that more structured industry workshops to engage on these potential solutions are necessary.

Noting the need for further workshopping, we note that potential solutions could include:

- recalibration of the 9% MLH ratio
- rules on the composition of MLH liquidity assets (particularly on LCR ADI/MLH ADI exposures)
- limits, weightings or haircuts on particular types of liquid assets
- expansion of assets that could be included in MLH liquidity.

While APRA has proposed a transitional arrangement, we note that this is a time-limited measure that delays but does not substantially reduce the impact and should not be the only mitigant provided.

COBA also provides further information on APRA's proposals in **Appendix C**. In particular that APRA should recognise that emergency liquidity assistance sources for smaller mutual ADIs include industry support schemes such as CUFSS and that this should be factored into the liquidity regime.

Thank you for taking the time to consider our submission. Given the significance and breadth of consequences of this proposal, we would appreciate ongoing engagement with APRA to ensure that our industry's concerns are understood, and any possible solutions are adequately considered.

If you wish to discuss any aspect of this submission, please contact [REDACTED], Policy Manager (a [REDACTED]).

Yours sincerely

[REDACTED]

[REDACTED]
Chief Executive Officer

Appendices – please treat these as confidential.

- **Appendix A – Removing bank securities from MLH**
- **Appendix B – Quantitative Impact Assessment**
- **Appendix C – Other proposals**