1 Margaret St
Sydney NSW 2000

GPO Box 4720
Sydney NSW 2001

TEL (02) 8299 9000
FAX (02) 8299 9607

Association of Building Societies and Credit Unions

21 December 2012

Mr Neil Grummitt
General Manager, Policy Development
Policy, Research and Statistics
APRA
Sydney NSW 2001

By email: Basel3capital@apra.gov.au

Dear Neil

Consultation on draft CPG 110

Thank you for providing Abacus with the opportunity to comment on APRA's draft *Prudential Practice Guide CPG 110 Internal Capital Adequacy Assessment Process and supervisory review*.

The mutual model is the proven alternative to the listed model in the Australian retail banking market. Mutual ADIs have 4.5 million customers, a strong share of the household deposits and new home loan markets and are consistent market leaders in customer satisfaction and responsible lending.

Abacus welcomes the publication of draft CPG 110. In our 31 May 2012 submission on APS 110 we noted that the lack of clarity around a number of issues in the draft standard could be addressed through the preparation of a prudential practice guide focussing on ICAAP requirements. CPG 110 will be a useful tool for our members, and the draft document provides some helpful additional context around APRA's expectations.

While we are generally supportive of the content of draft CPG 110, we have recommended the inclusion of additional information in some parts of the document to provide members with further guidance.

We also continue to have concerns about the imminent implementation of the Basel III capital requirements (including revised ICAAP reporting) given the continuing uncertainty around the availability of capital instruments for the mutual sector.

Our detailed comments on draft CPG 110 are set out below.

Capital instruments for the mutual sector

Ongoing deliberations about the nature of capital instruments available to mutual ADIs continue to present challenges. It is impossible for mutuals to provide comprehensive responses to several aspects of the new ICAAP requirements until this issue is resolved.

For example:

- Paragraph 14(b) of APS 110 requires that the ICAAP include "plans for how target levels of capital are to be met and the means available for sourcing additional capital where required." This is reinforced by paragraph 24 of the draft CPG which notes that an institution's strategy for maintaining adequate capital will take account of a range of

factors, including "the ability to access additional external capital of any form: whether Common Equity Tier 1 Capital, Additional Tier 1 Capital or Tier 2 Capital."
- Paragraph 21 of the draft CPG notes that "access to additional capital" is one of the considerations to be taken into account when setting target levels of capital.
- Paragraphs 25 through 28 of the draft CPG note that institutions are required to have trigger levels and associated actions in place to manage their capital position and protect against PCR breaches. One of the suggested options to protect an institution's capital position is "raising additional external capital."

Completing these aspects of ICAAP reporting is a challenge for mutual ADIs given the continuing uncertainty about the capital options likely to be available to them.

More broadly, having the capacity to access external capital gives mutual ADIs more flexibility to manage and grow their balance sheets, which in turn serves their members' interests. Until this issue is resolved, mutual ADIs will be limited to using retained earnings to increase their regulatory capital, placing them at a competitive disadvantage relative to other ADIs.

Abacus appreciates that the development of a Basel III-compliant capital instrument for mutual ADIs is a complex process. However, with Basel III capital obligations taking effect from 1 January, it is critical that this be resolved as soon as possible.

The need for a prompt resolution of this issue is recognised by the recently completed Senate Inquiry into the post-GFC banking sector. The inquiry report noted that while "the committee supports APRA's overall approach to Basel III," at the same time "the committee does consider that APRA could be more proactive in some areas."[1] The report goes on to recommend "that APRA addresses, without further delay, the unique issues Basel III may pose for mutual ADIs as a result of their corporate structure and that it publishes a document which sets out how these problems have been addressed."[2]

Stress testing

The ICAAP section of the revised APS 110 includes a new formalised requirement for stress testing and scenario analysis. In our previous comments on the draft standard, we noted that the requirement was very general and there was no guidance provided about the scope or extent of APRA's expectations.

The section on stress testing included in the draft CPG 110 has gone a long way towards addressing these concerns. The inclusion of suggested stress testing scenarios, along with some general context on the breadth and depth of stress testing and scenario analysis expectations provides some practical guidance.

However, the stress testing section of the CPG does not presently appear to make an allowance for the differences in size and complexity of different institutions, noting only that the testing "will be tailored to the individual regulated institution and its particular risk exposures."

Paragraph 13 of the draft CPG deals with proportionality, and notes that "the ICAAP of a regulated institution must be appropriate for its size, business mix and complexity," and that "for simpler institutions with limited product offerings and simple investment structures, simplified approaches may suffice." It would be useful if the CPG could confirm that the principle of proportionality applies to APRA's expectations in relation to stress testing.

---

[1] Senate Economic References Committee, *The post-GFC banking sector,* November 2012, p. 53.
[2] Senate Economic References Committee, *The post-GFC banking sector,* November 2012, p. 54.

Other issues

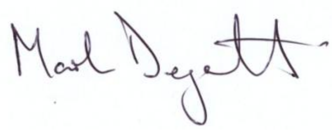
In our May 2012 submission regarding APS 110, we sought clarification around sections 14(f) and 15(a). Specifically:

- Guidance was requested about the definition and nature of "material risks" for the purposes of the new section 14(f).
- Clarification was sought about the term "financial soundness" in the new section 15(a) concerning the ICAAP summary statement.

Unfortunately, no guidance in relation to either of these issues appears to have been included in the draft CPG. Given that these are new requirements under the revised ICAAP reporting standards, some additional clarity around APRA's expectations in these two areas would be of assistance to our members, and would also help to ensure that individual supervisors applied the standard in a consistent fashion.

Please contact me on or Micah Green, Senior Policy Adviser, on to discuss any aspect of our submission.

Yours sincerely



MARK DEGOTARDI
Head of Public Affairs