



09 April 2019

Committee Secretariat
Senate Standing Committees on Economics
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Parliament House
Canberra ACT 2600
via email: economics.sen@aph.gov.au

Dear Committee Secretariat

Banking System Reform (Separation of Banks) Bill 2019

The Australian Banking Association (**ABA**) appreciates the opportunity to provide comments on the Senate Standing Committees on Economics inquiry into the Banking System Reform (Separation of Banks) Bill 2019.

The ABA does not support this Bill and has concerns with the drastic regulatory intervention it proposes. The banking industry is undergoing substantial reform and the ABA is of the view that these reforms will achieve the objectives of the Bill in a manner that is more efficient, and less costly and disruptive to the economy and community.

This was the view of Commissioner, the Honourable Kenneth Hayne AC QC, in his Final Report of the Royal Commission into misconduct in Banking, Superannuation and Financial Services Industry (**Royal Commission**), where he stated that such form of regulatory intervention will likely be costly and disruptive, and it remained unclear that the benefits of structural separation would outweigh the costs¹.

Vertical integration and competition

The ABA has significant concerns with the proposed legislation, which is designed to forcefully separate the activities of Australian banks. Forced structural separation of Australian banks is not a new issue and was considered by several large system-wide inquiries including the Financial System Inquiry (**FSI**) and the Productivity Commission's (**PC**) inquiry into Competition in the Australian Financial System. In their report, the PC found that forced structural separation could create unsustainable market structures, that would likely lessen competition².

In their report, the PC recommended that the Australian Competition and Consumer Commission (**ACCC**) should undertake yearly market studies on the effect of vertical and horizontal integration on competition in the financial system. This view was echoed by Commissioner Hayne in his Royal Commission Final report³. The ABA supports this recommendation and we ask the Committee to support the ACCC review.

Bank integration can enhance competition and provide economies of scale that reduce the prices of products and services offered to customers. Integration allows customers the choice of having a single relationship with their financial institution and this can be tailored to meet the needs of that individual, leading to more innovative products and services. While some customers choose to have relationships with different institutions, others prefer to deal with one institution. The market should be able to offer

¹ *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, Final Report, Volume 1, February 2019, available at <https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf>, page 196.

² Productivity Commission, *Competition in the Australian Financial System*, Report No. 89, 29 June 2018, available at <https://www.pc.gov.au/inquiries/completed/financial-system/report/financial-system.pdf>, page 269.

³ *Final Report*, Volume 1, page 196.

this choice and shouldn't be hindered by such radical regulatory intervention, which is at odds with the findings of the Royal Commission, the FSI and the PC.

ABA members have different strategies in relation to the range of services they offer and the extent of vertical integration in their business. Some members are taking steps to simplify their businesses and sell or demerge some of their vertically integrated structures. Banks should retain the flexibility to determine these strategies in the future.

Stability of the Australian banking system

The ABA recognises the fundamental importance of maintaining a sound and stable financial system. Our members stand at the heart of that system and are committed to stable and competitive banking, delivering high quality services to the Australian community in a prudent and responsible manner.

This Bill's stated intent is to reduce systemic risk within the financial system through structural separation. However, the more appropriate way of managing prudential risk is through the capital and liquidity requirements that target bank activities. These Australian Prudential Regulation Authority (**APRA**) requirements require a bank to bear the cost of its risky activity as opposed to banning integration outright for all firms within the system⁴. This view was echoed by the PC, who noted that the already strong prudential settings applied to Australian banks, means that forced separation is not necessary to manage risks⁵.

Australian banks are already considered to be some of the most highly capitalised banks in the world, following the FSI recommendation that Australian banks have 'unquestionably strong' capital requirements. Being this well-capitalised means Australian banks are well prepared to withstand shocks should they arise. In addition, APRA is currently consulting on increasing the Loss Absorbing Capacity (**LAC**) of the banks they supervise. The purpose of LAC is to address the moral hazard of institutions that are considered 'too big to fail'. By strengthening the loss-absorbing and recapitalisation capacity of banks, LAC is intended to help ensure that these large and complex financial institutions can be resolved in an orderly manner if they fail, without the need for financial support from Australian taxpayers. The ABA strongly supports the introduction of an appropriate LAC regime in Australia.

In 2018, the Australian Government provided APRA with greater crisis resolution powers⁶, that allow APRA to set additional requirements on resolution planning and ensure banks and insurers are better prepared for a crisis. The reforms have also equipped APRA with an expanded set of crisis resolution powers to act decisively to facilitate the orderly resolution of a distressed bank or Credit Union.

Oversight of the prudential regulator

This Bill seeks to strengthen Parliamentary oversight of the activities of APRA as the banking regulator.

The core purpose of APRA is to promote financial stability in Australia. Confidence in the regulatory framework is contingent on independent regulators having appropriate ability to act to achieve their mandate. The reforms suggested by this Bill provide Parliament with specific powers to limit APRA's decisions and actions, hindering its effectiveness and likely having significant impacts on trust and confidence in the Australian banking system both domestically and internationally. The ABA is strongly opposed to the model of oversight proposed in the Bill.

The ABA recognises and supports the need for an oversight body to oversee the regulator and notes that the Royal Commission has recommended the creation of an oversight body to assess the

⁴ Reserve Bank of Australia, *The Regulatory Response to the Global Financial Crisis – Submission to the Financial System Inquiry*, March 2014, available at <https://www.rba.gov.au/publications/submissions/financial-sector/financial-system-inquiry-2014-03/regulatory-response-to-the-global-financial-crisis.html>.

⁵ Productivity Commission, *Competition in the Australian Financial System*, Report No. 89, 29 June 2018, available at <https://www.pc.gov.au/inquiries/completed/financial-system/report/financial-system.pdf>, page 272.

⁶ *Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Act 2018*.



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effectiveness of both APRA and ASIC and the Government and opposition have agreed to implement this recommendation⁷.

Thank you again for the opportunity to provide this submission for the Committee's consideration.

Yours sincerely

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⁷ Australian Government response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Restoring trust in Australia's financial system*, February 2019, available at <https://treasury.gov.au/sites/default/files/2019-03/FSRC-Government-Response-1.pdf>, page 35.