Australian Banking Association

02 June 2021

Ms Sandra Roussel
Assistant Secretary, Regulatory Policy, Economic Division
Department of Prime Minister and Cabinet

By email: Deregulation@pmc.gov.au

Dear Ms Roussel

ABA submission on Regulator Performance Guide

The Australian Banking Association (**ABA**) welcomes the opportunity to comment on the regulatory performance guide proposed by the Department of Prime Minister and Cabinet (**PM&C**).

Our position

The financial system contributed $170 billion to the Australian economy in 2020 (or approximately 9 per cent of annual GDP).[1] Given the size of the sector, both in absolute terms and as a share of the economy, it is critical to ensure that regulation of the financial system does not inhibit the ability of financial firms to serve the Australian population or grow the economy.

The regulatory and compliance costs imposed on financial firms are significant, and those costs have grown noticeably since the global financial crisis. For example, the annual expenditure on reporting and compliance to APRA and ASIC increased by nearly 60 per cent between 2008 and 2016.[2]

In light of this, the ABA considers that the review of the existing Regulator Performance Guide is timely. The current framework is no longer consistently driving best practice performance or producing transparent and meaningful performance information. We are hopeful that a move towards outcomes-focused performance measures should allow for greater transparency and oversight of the relative productivity of Australian regulatory agencies.

Key recommendations

The ABA supports the Government's proposal to transition towards a more flexible and principles-based approach to regulator performance. We have developed our response with a focus on providing constructive suggestions to improve the potential scope and application of the three principles that are proposed with regard to financial regulation.

1. Continuous improvement and building trust

Regulators should aim to adopt a whole-of-system perspective, continuously improving their performance, capability and culture, to build trust and confidence in Australia's regulatory settings.

Key actions that financial regulators can undertake to achieve this include:

- coordinating closely with other regulatory bodies regarding their forward work plan;
- regularly utilising post-implementation reviews; and

[1] ABS, National Accounts, Gross Value Added, December 2020
[2] https://www.pc.gov.au/inquiries/completed/financial-system/report/financial-system-overview.docx

- conducting stakeholder surveys on an anonymous basis.

In addition, the Government can contribute to better regulation through requiring all regulators to develop a regulatory impact statement (RIS) for all measures that seek to impose mandatory obligations on business and the community, including codes and advisory instruments for which there is a reasonable expectation of widespread compliance.

2. Risk-based and data-driven

Regulators should maintain essential safeguards, using data and digital technology to manage risks proportionately to minimise regulatory burden and to support those they regulate to comply and grow.

The ABA supports risk based and data-driven regulatory policy as it is consistent with good regulatory principles. Both APRA and AUSTRAC are undertaking significant investment in new data collection systems which, if done properly, could ultimately reduce the costly burden of current reporting requirements on industry and improve the data used for decision making.

In order to ensure this program of work is well-executed and transparent, regulators should seek to develop and publish a clear data strategy each year. This strategy should clearly articulate the vision for data collection, the steps regulators are taking to implement the vision, and establish (and adhere to) timelines in which the steps will be taken.

In addition, the ABA is of the view that APRA should seek to better align its regulatory activities with the risk imposed by institutions, including by looking to overseas examples of innovation in prudential regulation.

3. Collaboration and engagement

Regulators should be transparent and responsive, implementing regulations in a modern and collaborative way.

The ABA welcomes and seeks further collaboration and engagement on regulatory changes. However, we note that good collaboration and engagement is not undertaken on a consistent basis across regulators. Often policy options do not form part of a consultation and instead only one final policy is included in the consultation. At this point, it is too late for potential implementation costs and benefits to industry to be incorporated into the policy decision making. The ABA considers that early engagement and collaboration during the policy development stage, as well as at policy finalisation is essential to achieving effective outcomes.

The ABA has provided more detail on these themes in Appendix A, as well as a commentary on financial services regulation in Appendix B. We are supportive of, and would like to stay engaged with, the Government's better regulation agenda, and look forward to working together in the future.

Kind regards

Jess Boddington
Policy Director

About the ABA

The Australian Banking Association advocates for a strong, competitive and innovative banking industry that delivers excellent and equitable outcomes for customers.

We promote and encourage policies that improve banking services for all Australians, through advocacy, research, policy expertise and thought leadership.

Appendix A: Thematic considerations

The ABA supports the Government's proposal to transition towards a more flexible and principles-based approach to regulator performance. We have developed our response with a focus on providing constructive suggestions to improve the potential scope and application of the three principles that are proposed.

1. Continuous improvement and building trust

Regulators adopt a whole-of-system perspective, continuously improving their performance, capability and culture, to build trust and confidence in Australia's regulatory settings.

Whole of system perspective

The ABA looks forward to regulators incorporating principle 1 into their performance measures. An example of current good regulatory practice demonstrating principle 1 is APRA's annual publication of policy priorities. This enables banks to efficiently plan their investment in policy development through efficient allocation of operational and policy resources.

Recommendation 1

The ABA considers that regulatory practice could be further improved in two ways:

Better coordination across financial regulators of planned regulation; and

Government should publish a combined financial regulator plan for next 24 months.

There is limited coordination or tracking of financial regulation across regulators, and this is increasing the cost of regulation to banks. As noted earlier, the banking sector is facing a rapidly increasing regulatory implementation program in the next 12 months, which is causing severe resourcing issues and increases potential operational risks to banks.

Further, an uncoordinated approach is not cost effective for regulated entities or regulators. This approach to regulation is increasing risks of high-cost systems being developed that are not suitable to undertake all regulatory expectations in the future. In addition, it increases the risk of additional costs in the form of inconsistent format and reporting requirements (i.e., different data collection systems requiring different formats rather trying to align across the industry), duplication of data requests, and potential duplication in data collection investment by regulated entities.

The ABA strongly recommends that Government consider implementing a similar approach to the UK Regulatory Initiatives Grid[3]. The UK Regulatory Initiatives Grid sets out the planned regulatory initiatives for the next 24 months and is published twice a year and is a product of the Financial Services Regulatory Initiatives Forum. The Forum is made up of the key financial regulators with the Treasury having observer status. The ABA considers that a minimum of 24-month period is needed given banks plan implementation projects at least two years in advance.

Regular post-implementation reviews

Recommendation 2:

Regulators should be regularly utilising post-implementation reviews as a way to continually improve their performance.

Planning regulatory initiatives 24 months in advance would provide an opportunity for regulators to allocate resources for regular post-implementation review (PIR) of the effectiveness of existing regulation. The ABA considers that regular reviewing existing regulation is an important component of continuous improvement. At present, few PIR are scheduled as part of the regular programme of work for financial regulators.

[3] https://www.fca.org.uk/publications/corporate-documents/regulatory-initiatives-grid

As noted earlier, the financial industry is highly regulated and is constantly changing in response to technological developments. However, the existing stock of regulation is not regularly reviewed to ensure its ongoing effectiveness. As a result, regulation continually increases without any potentially unnecessary regulation being removed. Also, important lessons regarding the effectiveness of regulation are not learnt by Government if regular reviews are not undertaken.

Annual surveys of stakeholders

Recommendation 3:

Regulators should conduct stakeholder surveys on an anonymous basis.

The ABA considers that the annual survey of stakeholders undertaken by its regulators is another good example of how regulators demonstrate continuous improvement and building trust. The annual survey allows stakeholders to provide annual feedback on how the regulator has met its performance measures.

However, stakeholders cannot provide the feedback anonymously. This severely limits the potential frankness of the feedback. In many cases, a financial regulator has unilateral power to impose severe restrictions on its business so many stakeholders may be reluctant to provide frank and fearless feedback. Given this, the ABA suggests that in future stakeholder surveys, there should be an option for regulated entities to provide feedback anonymously.

Transparent implementation of regulatory best practice

Recommendation 4:

The Government should require all regulators to:

- implement the Australian Government Guide to Regulatory Impact Analysis (the Guide), and
- develop a regulatory impact statement (RIS) for all measures that seek to impose mandatory obligations on business and the community, including codes and advisory instruments for which there is a reasonable expectation of widespread compliance.

Currently, the implementation of the RIS is not consistent across financial regulators. The Office of Best Practice Regulation provides oversight of the implementation of RIS across Government, but it does not have a sufficient remit or resources to enforce the guidelines. Further, scrutiny of RIS by the Office Best Practice Regulation can be limited if the regulator provides assurance that its internal policy development meets RIS requirements. As a result, the incentives for regulators to continuously improve in regulatory practice is also limited.

Greater oversight by OBPR and the future FRAA could also provide greater incentive for regulators to implement capability review recommendations and findings. For example, the industry is awaiting APRA's update on how it is implementing June 2019 APRA Capability Review Report competition recommendation and how it will be improving its competition assessment[4].

In 2019, the APRA Capability Review, chaired by Graeme Samuel, final report recommendation 3.7 stated that:

> *To support its consideration of competition, APRA should:*
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> - *create a competition champion within APRA, preferably at Member level. Their role should be to ensure that issues of competition are embedded effectively across all areas of APRA;*
> - *ensure that there is sufficient tension in the internal debate and analysis of competition. It should test how policies are developed and applied by supervisors. This could be done in the Quality Assurance function and reported to the competition champion; and*

[4] https://treasury.gov.au/sites/default/files/2019-07/190715_APRA%20Capability%20Review.pdf

- *report regularly on competition developments in its external accountability assessment (see recommendation 6.4).*

In addition, the report made the following commentary on the current standard of competition assessment undertaken by APRA at page xxii:

> *"…there should be greater recognition of the nature of any trade-off and the strategic importance of facilitating competition for the incumbent institutions. APRA can do more, including publishing a clearer interpretation of its mandate, establishing a strategic position on competition and being held to account. It should create a competition champion in the organisation and embed a regular assessment of competition into its quality assurance process."*

2. Risk-based and data-driven

Regulators maintain essential safeguards, using data and digital technology to manage risks proportionately to minimise regulatory burden and to support those they regulate to comply and grow.

Proportionality of risk-based regulation

Recommendation 5:

APRA should seek to better align its regulatory activities with the risk posed by institutions according to their size and market significance, including by looking to overseas examples of innovation in prudential regulation.

The ABA would also welcome regulators better aligning regulation with the risk posed by the regulated entities. It is important that regulators such as APRA maintain essential safeguards to financial stability. However, the risk of a regulated entity to financial sustainability varies according to the size and market significance of the bank. For example, the largest banks are likely to pose greater risks to financial stability in the event of failure compared to smaller non-major banks. That said, all banks have the same regulatory requirements imposed as APRA applies a "one-size fits all" approach to regulation citing simplification as the objective. This is not aligning regulatory risk with the regulatory burden.

The ABA suggests that APRA could achieve a better trade off between mitigating regulatory risk and imposing regulatory burden if it considered the UK's latest thinking and the USA's approach to prudential regulation.

The UK Prudential Regulation Authority is considering developing a simpler prudential framework for banks that are considered by the PRA to neither systemically important nor internationally active[5]. The objective of this framework would be to:

> *"…maintain the resilience of those firms and of the UK financial sector while using simplified prudential regulation, thereby enabling a dynamic and diverse banking sector in the UK. Any changes to simplify prudential regulation for smaller firms should be balanced against the risk those changes may create barriers to growth, which could discourage or prevent smaller firms from becoming large enough to provide effective competitive challenge to larger firms. The intention is to develop a strong and simple framework that is fully consistent with the Basel Core Principles for Effective Banking Supervision, but simpler than the Basel standards that apply to large and internationally active banks."*

The US Federal Reserve follows a risk-focused approach by scaling its supervisory work to the size and complexity of an institution. In supervising financial institutions, it takes a risk-focused approach to supervision as it is more efficient and results in more rigorous oversight of firms that pose increased risk to the financial system.

The Federal Reserve does this by having differing intensity of regulation according to asset size. For community banks (less than USD$10 billion in assets) and Regional Banks (with less than USD$100 billion in assets), the Federal Reserve follows a risk-focused approach that aims to target examination

[5] https://www.bankofengland.co.uk/prudential-regulation/publication/2021/april/strong-and-simple-framework-banks

resources to higher-risk areas of each bank's operations and to ensure that banks maintain risk-management capabilities appropriate to their size and complexity[6]. Alternatively, large financial institutions including US firms (with assets of USD$100 billion or more) and foreign banking organisations with combined US assets of USD$100 billion or more have more intensive set of regulatory supervision and requirements[7].

Data-driven regulation

Recommendation 6:

Regulators should seek to develop and publish a clear data strategy each year. This strategy should clearly articulate the vision for data collection, the steps regulators are taking to implement the vision, and establish (and adhere to) timelines in which the steps will be taken.

The ABA supports risk based and data-driven regulatory policy as it is consistent with good regulatory principles. Both APRA and AUSTRAC are undertaking significant investment in new data collection systems which, if done properly, could ultimately reduce the costly burden of current reporting requirements on industry and improve the data used for decision making.

Using data to support regulatory decisions will result in better outcomes for regulators and the Australian community and economy. To assist regulators with their data needs, the banking industry needs a clear and detailed forward looking plan. Recently the Bank of England undertook a multi-year planning project, involving extensive stakeholder consultation, and resulting in a detailed data transformation strategy.[8] This clearly signals to industry the Bank's data approach and outlines the reasoning for the strategy. In comparison, in the Australian setting, guidance on a regulatory data strategy it is limited and usually buried within discussion of other regulatory priorities.[9] Industry is concerned that significant resources have been, and are being, invested into developing data infrastructure which will soon be superseded by new requirements.

Further, temporary and unplanned data collections are implemented on a frequent basis, resulting in industry needing to resource these collections to the detriment of resourcing longer term data projects. New data collections are required of banks with short notice and very tight turnarounds. This is done without providing relief for current reporting requirements and results in onerous workloads. More importantly, these data requests are implemented without the timeframes in which ADIs are able to recruit and train staff to meet the requirements.

3. Collaboration and engagement

Regulators are transparent and responsive, implementing regulations in a modern and collaborative way.

Recommendation 7:

Regulators should consult with key stakeholders on significant regulatory changes in a transparent and timely manner. Genuine consultation periods should be an absolute minimum of four weeks.

The ABA welcomes and seeks further collaboration and engagement on regulatory changes. A good example of collaboration and engagement is the ABA's work with APRA during the COVID-19 pandemic. APRA closely engaged with the ABA to develop regulatory options in fast time frames which enabled banks to act quickly to support their customers and the economy. The COVID-19 loan deferrals facilitated by APRA's agile changes to the regulation, is widely credited as a key contributor to the remarkable post-COVID economic recovery.

The ABA also considers AUSTRAC's increased policy engagement with banks as another improvement in regulatory engagement. AUSTRAC is holding regular workshops with banks and seeking input on

[6] https://www.federalreserve.gov/supervisionreg/community-and-regional-financial-institutions.htm
[7] https://www.federalreserve.gov/supervisionreg/large-financial-institutions.htm
[8] https://www.bankofengland.co.uk/paper/2021/transforming-data-collection-from-the-uk-financial-sector-a-plan-for-2021-and-beyond
[9] https://www.apra.gov.au/sites/default/files/2021-01/Information%20Paper%20-%20Supervision%20Priorities%202021.pdf

early drafts to work through potential policy issues ahead of the finalisation of AUSTRAC guidance on the Phase 1.5 Rules.

However, good collaboration and engagement is not undertaken on a consistent basis across regulators. Often policy options do not form part of a consultation and instead only one final policy is included in the consultation. At this point, it is too late for potential implementation costs and benefits to industry to be incorporated into the policy decision making. The ABA considers that early engagement and collaboration during the policy development stage, as well as at policy finalisation is essential to achieving effective outcomes.

Appendix B: Comment on financial sector regulation

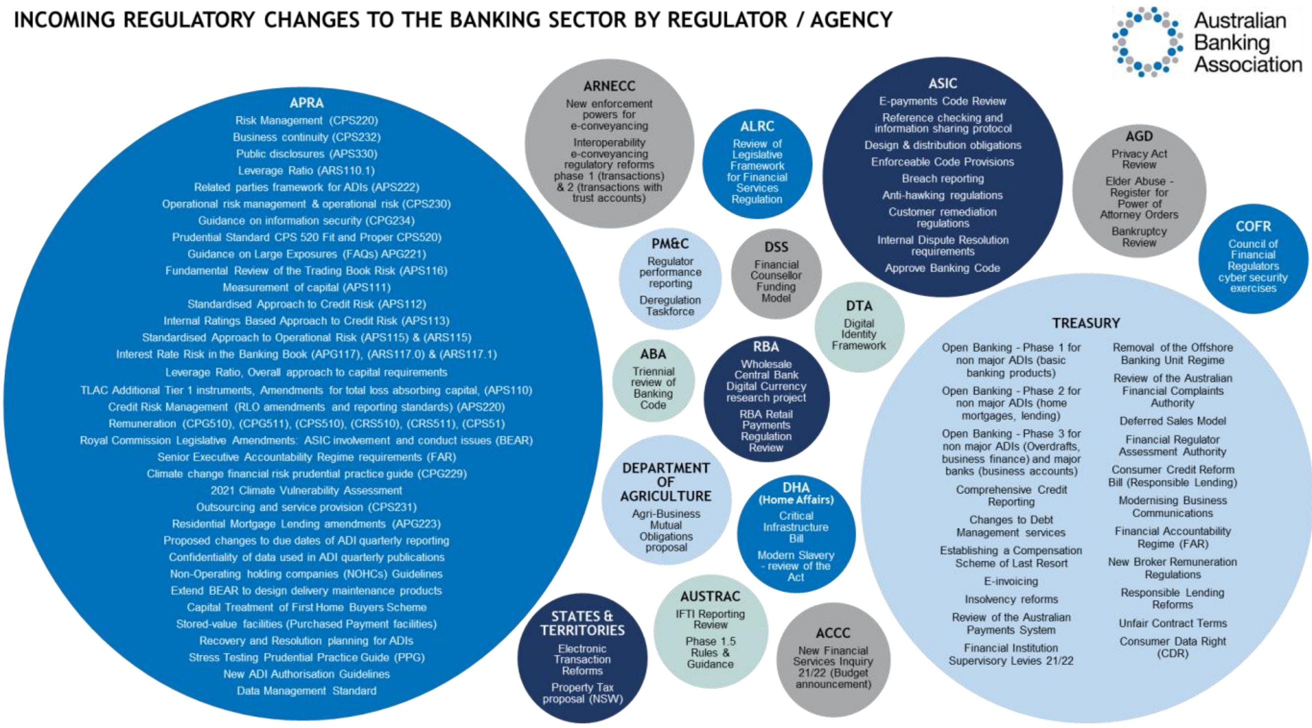
The ABA supports a strong, stable and resilient financial system. The Australian financial system employs nearly 480,000 people (3.7 per cent of the workforce) and accounts for a larger proportion of the total value added in the economy than the financial systems of most other advanced economies.[10]

Given the size of the sector, both in absolute terms and as a share of the economy, it is critical to ensure that regulation of the financial system does not inhibit the ability of financial firms to serve the Australian population or grow the economy.

The costs of financial regulation are high and increasing

In 2018, the Productivity Commission found that the cost of this regulation to banks and other suppliers of financial services is significant, and that the costs have grown noticeably since the global financial crisis. Based on figures provided to the Commission by banks, the annual expenditure on reporting and compliance to ASIC and APRA has increased by nearly 60 per cent between 2008 and 2016.[11]

We note that the regulatory costs imposed on financial firms is likely to reach a record high in 2021, with the number of mandatory compliance projects essentially doubling. This is a result of the regulators deferring a large proportion of their policy agenda early last year due to the pandemic. For an illustration of incoming regulatory projects, please see the chart below.



In this context, the ABA is concerned that there is limited discipline on the regulators to demonstrate that the regulation that is imposed on financial firms is proportionate to the risks present and does not inhibit innovation or growth. This is particularly relevant given that both ASIC and APRA are seeking additional funding for their activities in 2021-22.

The ABA considers that the review of the existing Regulator Performance Guide is timely. We are hopeful that a move towards outcomes-focused performance measures should allow for greater transparency and oversight of the relative productivity and performance of Australian regulatory agencies.

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[10] ABS, Labour Force Australia, Employed persons by industry division of main job, February 2021 and OECD, Value added by activity, https://data.oecd.org/natincome/value-added-by-activity.htm, accessed 28th May, 2021

[11] https://www.pc.gov.au/inquiries/completed/financial-system/report/financial-system-overview.docx

FRAA should bring much-needed oversight to the regulators

The ABA is supportive of the Government's intention to implement recommendation 6.14 of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. This recommendation was to establish an independent assessment authority to review the effectiveness of APRA and ASIC, and to report on its findings to the Minister.

We understand that legislation to implement the Financial Regulator Assessment Authority (**FRAA**) will introduced into Parliament by the middle of 2021. The ABA considers that it would be appropriate for the FRAA, once established, to utilise the final Regulator Performance Guide in developing its assessment framework.