



TREASURY SERVICES GROUP

Submission - Review into Small and Medium-sized Banks

Council of Financial Regulators
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Introduction

Thank you for the opportunity to provide recommendations on the review of small and medium-sized banking sectors in providing competition. Treasury Services Group ("TSG") holds an Australian Financial Services Licence (315347) and an Australian Credit Licence (315347).

Background

Australia Prudential Regulatory Authority ("APRA") previously accepted TSG's ADI application under APRA's direct licensing framework.

Recommendations

1. We recommend that the Tier 1 regulatory capital requirement for the credit risk component of each loan be equal across all Authorised Deposit Institution ("ADI").

Currently, new ADIs are required to hold approximately 35% more equity (CET1 capital) than more established ADIs for the same credit risk (i.e. every loan to the same borrower with the same risk should have the same regulatory capital allocation). The current regulatory settings create a non-level playing field for new ADIs and are anti-competitive. Less-established ADIs should be subject to the same CET1 capital requirements when taking on the same level of credit risk as their more established peers (there may be an addition requirement for a concentration buffer as per recommendation 2 below).

Attachment 1 provides evidence of the current issue.

Our recommendation aligns with the regulator's mandate to balance financial stability, competition, innovation, and fairness. The current prudential standard APS 110 allows for the execution of our recommendation, as the regulator:
(i) may determine an ADI's minimum amount of capital as a dollar minimum amount;
and (ii) may change an ADI's PCR at any point in time.

2. We recommend, as required, individual ADIs include a transparent additional regulatory credit concentration capital buffer based on that ADI's business model.



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This recommendation would be consistent with frameworks used in other jurisdictions.

For example, a well-secured lender with a portfolio of low loss given default loans to unrelated borrowers would have a minimum credit concentration capital charge than an alternate ADI with credit concentration in high loan to value of first home buyers.

3. We recommend the regulator allow all ADIs to issue qualifying Tier 2 instruments. The regulator should provide standard documentation for the requirements of the issue of Tier 2 instruments for small and medium size ADI's to minimise issue costs.
4. We recommend small and medium size ADI's should be able to hold AAA securitisation paper for the dual purpose of qualifying for liquidity for regulatory purposes and credit diversification (one instrument with diversified underlying loans).
5. We recommend ADIs be able to provide their own paper for liquidity purposes into an RBA liquidity facility. It could be met on a quasi-covered bond basis with conservative key requirements such as low exposure at default (EAD) for inclusion. The facility would be aligned with APRA's minimum liquidity holding requirement.
6. We recommend the trident model for the assessing an ADI entrant is removed from the current ADI regulatory framework. We recommend replacing the trident model with a minimum \$50m capital base requirement for new ADI entrants with equality in regulatory settings.

We recommend this include a minimum annual operation capital buffer in nominal terms (not as a percentage of RWA) for all new and smaller ADIs. The operational capital buffer would be sufficient to withstand operational risk losses for small ADIs.

It would be available to unwind the ADI, including successfully;

- a) returning deposits,
- b) meeting ATO obligations,
- c) meeting employee obligations and,
- d) meeting other creditor requirements such as technology contracts.

We recommend regulator periodic regulatory reporting on the buffer to provide accountability.

7. We recommend the regulatory framework remove any requirement for new ADIs to have a lending product in the market before being given the capacity to accept deposits. Small ADIs are majority funded by deposits¹. Any excess deposits can be invested in other ADIs paper.



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8. We recommend any additional capital (CET1) buffer for governance and risk management framework should not be required of new ADIs.
9. We recommend removing a higher PCR % of RWA for new and small ADIs compared to other ADIs based on any future requirement for the returning deposits in the unforeseen event of a return of an ADI licence. The quality of the asset book and operational capabilities will determine the returning of deposits.

We recommend new and small ADIs are required to provide periodic budgets to APRA to execute an orderly and solvent exit from the banking industry including the return of deposits without the Financial Claim Scheme.

10. We recommend regulatory transparency in prudential capital requirements for all ADIs including public disclosure of all ADIs required minimum prudential capital ratios.
11. We recommend regulatory certainty in PCR requirements for new ADI entrants.

Further comments

12. We believe small and new ADIs present no risk to Australian financial stability or systematic risk. We believe that without equality in regulatory settings to enable competition, potential systemic risk exists with the current concentration of regulated entities.

Currently, regulated institutional superannuation funds provide significant funding to systematically important ADI's enhancing productivity weaknesses. Both institutional superannuation funds and systematically important ADIs have the same regulator. We believe there is an increased risk of financial instability from industry disrupters.

13. We believe RWA convergence² between the IRB framework and the standard framework seems irrelevant if the regulator sets a significantly higher prudential capital requirement for identical credit risk.
14. We believe regulators should not increase liquidity requirements for small ADIs without regard for the quality of the loan assets held by individual ADIs.
15. We believe that any new ADI adhering to regulatory standards should be able to offer any products offered by current ADIs.



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16. We believe regulators should be required to publicly publish regulatory impact statements for all material regulatory changes that impact ADIs.

Thank you for the opportunity to provide a submission.

Kind regard



Footnotes

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Attachment 1

We provide below an example of the current inequality in CET1 treatment to new ADIs for an identical loan with same risk as current ADIs. The following table and chart assume a borrower has adequate debt servicing and secured with a principal place of residence.

Loan size (standard loan)	\$500,000		
Security value	\$1,000,000.00		
LVR	50%		
	Example 1 - New ADIs	Example 2 - Major ADI's	Example 3 - Minimum
	CET1 Equity	CET1 Equity	CET1 Equity
PCR	18%	12.2%	Minimum PCR - IRB / D-SIB
Loan Credit RWA estimate %*	20% RWA	20% RWA * 72.5% Capital floor	20% RWA * 72.5% Capital floor
Estimate Loan Credit Component RWA*	\$100,000	\$72,500	\$72,500
Liquidity Holding Credit RWA - MLH vs LCR/ SFR**	15% MLH / 20% RWA	9% MLH (estimate LCR) / 20% RWA	9% MLH (Estimate LCR) / 20% RWA
Estimate Liquidity Component RWA**	\$15,000	\$9,000	\$9,000
Total Credit - APS 112 / APS 113 - RWA	\$115,000	\$81,500	\$81,500
Total Credit CET1 - APS 112 / APS 113	\$20,700	\$9,943	\$8,761
Operational RWA Estimate (APS 110 / APS 115)	\$11,500	\$8,150	\$8,150
Operational CET1 Estimate (APS 110 / APS 115)	\$2,070	\$1,068	\$876
Market risk APS 116 - 3% Total RWA (major ADI average)	n/a	not applicable for loan analysis	not applicable for loan analysis
CET1 - IRRM APS 117 - Assumed 4.5% RWA	Non significant FI	\$3,668	\$3,668
Other RWA (APS 120)	Minimal for comparison	Minimal for comparison	Minimal for comparison
Counterparty APS 180	Minimal for comparison	Minimal for comparison	Minimal for comparison
Total CET1 Equity (ex CCB & CCyB)	\$22,770	\$14,678	\$13,305
CCB at 2.50% / 3.75% IRB ADI	\$3,163	\$3,362	\$3,362
CCyB 1% of RWA	\$1,265	\$897	\$897
Domestic systemically important banks buffer - assume 1%	n/a	\$897	n/a
Estimated Total CET1 ***	\$27,198	\$19,833	\$17,563
Notes			
* The loan credit component for AIRB is conservatively estimated			
** The liquidity credit component for AIRB is conservatively estimated			
*** Total capital would include future Tier 2 requirements			



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