AUSTRALIAN ASSOCIATION OF PERMANENT BUILDING SOCIETIES
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2 May 2001

Mr Brian Gray
Executive General Manager
Policy, Research & Consulting
Australian Prudential Regulation Authority
GPO Box 9836
SYDNEY NSW 2001

Dear Mr Gray

REVISED PROPOSALS ON CAPITAL ADEQUACY

The member institutions of AAPBS have had the opportunity to examine the Basel proposals and to consider how they will affect their operations. I have to confirm there is grave concern by all boards and management as to the impact on future operations.

The member institutions we represent are not internationally operating banks for which the Basel proposals have clearly been drafted. Our institutions are the antithesis. We are domestic Australian community banks providing housing finance and retail financial services to some two million account holders. Our institutions are predominately head-quartered in regional Australia providing vigorous competition to the four large Australian banks (which are internationally operating) and contesting markets with other competitors which include foreign internationally operating banks.

Community banking in Australia is a very important competitive force which is welcomed by consumer organisations and political and community leaders in Australia. Our view is that if the Basel proposals were applied these parties would be concerned for ongoing competition in basic retail financial services.

The Association is supportive of the principle of refining the Accord to recognise the capital that should be held against various specific risks. It recognises that the previous Accord took an approach in allocating capital on the basis of risk weighted assets only and that the capital required was to support credit risk and also all other risks faced by building societies, including operational risk.

We especially note the Basel Committee principle that any further changes should not increase the overall level of minimum capital required (because the changes merely constitute a more precise measurement of the various risks). This has particular importance in relation to the Australian building society and regional banking sectors, as capital has been more than adequate to cover the risks faced. We are very firmly of the opinion, for both efficiency and fairness considerations, that any additional allocation of capital for operational risk should lead to an at least equal offset in capital held in respect of risk weighted assets.

It is a concern that the proposal put forward for internationally operating banks does not take into account any substantial reduction in the capital to be held against risk weighted assets for our type of institution. The proposals as drafted will substantially increase the minimum capital we need to hold as a result of the proposed capital to be held against operational risk. This is clearly contrary to the stated intention of the reform.

Our industry is also very concerned that no change has been proposed to the risk weight of housing loans. While this has been linked with the allocation of capital for operational risk in discussions, it is also evident that the current 50% risk weight requires more capital to be held against this asset than experience warrants. Member institutions are providing APRA with individual specific details in support of this position.

Of particular concern is the major competitive inequalities that will result when banks use the Internal Ratings Approach to credit risk, which will recognise for them the very low credit risk of Australian housing loans. This will allow a substantial difference (in their favour) in the capital held against very similar credit risk assets. This is particularly so in Australia where housing loans are homogeneous across Australia. This outcome is contrary to any espoused philosophy for a best practice supervisory regime, namely that similar risks should have similar regulatory responses.

In respect to the disclosure requirements in the Market Discipline area, these are appropriate requirements for internationally operating banks raising funds from the wider market. Our industry however has a concern with the amount of disclosure and its relevance to members of small and mutual societies and community banks that are not involved in the wider market. Lenders to these types of organisations mostly require specific information rather than rely on general purpose reports. We consider that the cost of disclosure would grossly outweigh the benefit (if any) to the vast majority of relevant readers of our reports. We would support an abridged version to be produced for the information of counterparties and others on request, without the necessity of inclusion in annual reports.

Our sector of the Australian banking and finance market looks forward to a sensible and satisfactory outcome to our concerns. We hope APRA’s submission to the Basel Committee will effectively alert them to the perverse consequences of the accord being applied to institutions of our size and risk profile in Australia.

Failing some change of approach by Basel our businesses would welcome discussion on other avenues to achieve a simple outcome that does not penalise regional, community banks and building societies conducting a simple and relatively risk averse banking business. If this necessitates Australia not applying the proposed Basel Accord to non internationally operating banks, we would strongly support such an approach and would be pleased to cooperate in such a development.

Yours sincerely

Signed:

J.V. LARKEY
EXECUTIVE CHAIRMAN