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DISCUSSION PAPER – IMPLEMENTING BASEL III LIQUIDITY REFORMS IN AUSTRALIA

The Association of Superannuation Funds of Australia (ASFA) would like to provide comments on APRA's proposals to implement the Basel III liquidity reforms in Australia, as outlined in the Discussion Paper released on 16 November 2011 and draft Prudential Standard APS 210 Liquidity (APS 210). ASFA's comments are limited to the impact of the proposed liquidity reforms for banks on investment returns for the superannuation industry.

About ASFA

ASFA is a non-profit, non-political national organisation whose mission is to advance effective retirement outcomes for members of superannuation funds through research and advocacy. We focus on the issues that affect the entire superannuation industry. Our membership, which includes corporate, public sector, industry and retail superannuation funds as well service providers some of whom deal with self managed superannuation funds (SMSFs), has over 90% of the approximately 12 million Australians with superannuation as members. ASFA members manage or advise on the bulk of the $1.3 trillion in superannuation assets as at September 2011. ASFA is the only organisation that represents all types of superannuation funds and associated service providers.

Implications for the superannuation industry of the Basel III reforms

ASFA considers that there are two main issues stemming from the proposed liquidity reforms that impact superannuation funds. These relate to the implications of the proposed requirements for the interest rates offered to superannuation funds and the availability to banks of deposits from superannuation funds. These issues are discussed below.

(i) Potential unlevel playing field between SMSFs and APRA-regulated funds

In addition to capital requirements, the Basel III reforms include a Net Stable Funding Ratio (NSFR) requirement, which aims to promote more medium and long term funding of the bank's assets to decrease the risks associated with short-term funding mismatches, and a Liquidity Coverage Ratio (LCR) requirement, which aims to ensure banks maintain an adequate level of high quality liquid assets. Both the NSFR and LCR requirements will pose particular challenges for Australian banks, but ASFA contends that they will also have implications for the superannuation industry.

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The first issue arises from the fact that Self Managed Superannuation Funds (SMSFs) are classified as Retail depositors, whereas APRA-regulated funds are included in the definition of a Financial Institution (FI). For the purposes of Basel III, Retail deposits are considered gold standard when it comes to the quality of bank funding. They are regarded as highly liquid and considered more reliable and stable sources of funding, which importantly reduces banks' dependency on potentially volatile funding markets. On the other hand, Basel III treats deposits from FIs as falling in the "high run off" category (i.e. least liquid assets under the 30-day LCR requirements) and considered to be a much less stable source of funding for banks. Indeed, deposits from FIs held for less than 1 year count 0% towards a bank's Available Stable Funding (ASF) under the NSFR requirements. This is regardless of the type of FI holding the deposit and its typical holding pattern.

The issue for the superannuation industry is that, this difference in classification has the potential to create an unlevel playing field between SMSFs and APRA-regulated funds because the LCR and NSFR requirements in the Basel III reforms place a much higher value on funding sourced from Retail customers than from FIs. This means that (somewhat perversely) SMSFs can potentially access greater interest rates on their bank deposits than very large superannuation funds. This is despite APRA regulated superannuation funds typically having very stable patterns of holdings of deposits in banks. Superannuation funds (both APRA-regulated and SMSFs) invest for the long term.

We note that APRA has set out specific conditions whereby Retail treatment can be applied to deposits placed with a bank via a financial intermediary such as a super fund (paragraph 30 of APS 210). However, one of the conditions that must be satisfied for this Retail treatment to be allowed includes the intermediary (i.e. the superannuation fund) relinquishing all legal rights regarding the placement, withdrawal or movements of the monies, which is likely to be problematic for trustees of super funds.

ASFA suggests that, given that there is relatively little volatility in bank accounts and deposits by superannuation funds, deposits by APRA-regulated funds and SMSFs should be treated in an equivalent manner without any requirement for APRA-regulated funds to relinquish all legal rights in regard to placement, withdrawal or movements of monies.

(ii) Impact on the ability of banks to increase their funding from super funds

The second issue is the broader impact of the Basel III reforms on superannuation funds. In Australia, a comparatively large section of savings are funnelled into superannuation funds, from which only a portion makes its way into either long term bank debt or bank deposits. We recognise that APRA is keenly aware of the importance of changing the status quo: "We also see banks becoming more proactive in sourcing superannuation funding. For many years bankers have complained that superannuation trustees invest insufficiently in bank paper. Banks are now moving to offer attractive term deposit rates on superannuation investment platforms. We expect that in the next few years, banks will become more adept at sourcing term funding from super funds". (APRA's Basel III Implementation Rationale and Impacts, 23 November 2011)

The issue is that, whilst there is general recognition that greater funding from superannuation funds would be beneficial, the Basel III reforms will result in banks having to reduce their interest rates, which means superannuation funds may not necessarily receive desired returns on their deposits. This in turn would hamper the ability of banks to greatly increase their sourcing of funding from super funds due to the reduced attractiveness of their rates.

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Recommendation

To address the issues outlined above, ASFA considers that APRA-regulated funds should be classified as Retail depositors. This would ensure that there is a level playing field between SMSFs and APRA-regulated funds. Also, this would increase the attractiveness of interest rates offered to all superannuation depositors, which would improve banks' capacity to source term funding from superannuation funds. This would assist banks to more easily satisfy their liquidity requirements by increasing the potential pool of highly liquid and reliable funding sourced from Retail depositors.

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We trust that the information contained in this submission is of value. We would be pleased to meet with you to discuss our submission.

If you have any queries or comments, please feel free to contact Jon Echevarria, Senior Policy Adviser on 02 8079 0859 or by email jechevarria@superannuation.asn.au.

Yours sincerely,

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