6 October 2023

Basel Committee on Banking Supervision
Bank for International Settlements

Via webform at https://www.bis.org/bcbs/commentupload.htm

To the Committee

Consultation on revisions to the Core principles for effective banking supervision

COBA appreciates the opportunity to contribute to the Committee's consultation on revisions to the *Core principles for effective banking supervision* (the Core Principles).

COBA is the industry association for Australia's customer owned banks (mutual banks, credit unions and building societies). Collectively, our sector has over A$160 billion in assets and is the fifth largest holder of household deposits in Australia. Customer-owned banks account for around two thirds of the total number of domestic Australian Authorised Deposit-taking Institutions (ADIs) and deliver competition and market leading levels of customer satisfaction in the retail banking market. Our members are neither large nor internationally active banks.

Our member banks are owned by their customers. This ownership structure creates a distinct set of incentives focused on the customer rather than on distributable profits as seen in the typical listed investor-owned banks. As a result, our sector is an important counterpoint in the Australian banking market which is dominated by four large investor-owned banks. Although large in number, customer owned banks each make up a small proportion of the total banking market in Australia and typically operate business models with less complexity than larger, listed peers. Our members primarily focus on offering household deposit products, housing loans and other personal credit products, and are simple, non-internationally active banks. It is critical that regulators and supervisors take into account proportionality in their decisions, otherwise this can lead to a further strengthening of the oligarchy and group think (i.e., large investor-owned banks) of a banking system dominated by the investor-owned banks. This creates poor outcomes for consumers and financial stability.

Key points

Customer owned banks are small and non-internationally active banks with a simple business model which should be taken into account when making supervisory decisions.

Proportionality is a key concept which should be appropriately referenced and constantly reinforced in the Core Principles, to ensure that regulators appropriately supervise smaller, less complex financial institutions.

References to stress testing in the Core Principles should include considerations of proportionality to ensure that any stress tests, which can be particularly burdensome for smaller banks, are adequately tailored to the risks posed by an organisation.

Key Points (cont.)

The Core Principles should provide further clarity, flexibility and detail on the criteria for supervisors to determine a ‘balanced board’ ensuring they consider the business models and relative needs of bank boards for smaller, less complex banks as well as customer-owned banks.

More clarity is needed on the Core Principles on what constitutes a ‘sustainable business model’ and what factors supervisors should take into account when determining it.

Sufficient references to proportionality

COBA welcomes the addition of the proportionality section in the Core Principles and supports the Basel Committee’s work to include support more proportionality in banking regulation through its High-level considerations on proportionality.

The passage below reinforces how important it is that the Core Principles adequately capture the above intent:

> The Core Principles are the de facto minimum standards for the sound prudential regulation and supervision of banks and banking systems. They are universally applicable and accommodate a range of banking systems and a broad spectrum of banks. The Core Principles are used by supervisors to assess the effectiveness of their regulatory and supervisory frameworks. They are also used by the International Monetary Fund (IMF) and World Bank as part of the Financial Sector Assessment Program (FSAP) to evaluate the effectiveness of countries' banking supervisory systems and practices.

Given the Core Principles are a baseline for assessment, if the Core Principles do not reflect an intent to allow for greater proportionality, then regulators may err on the side of conservatism without proportionality due to these assessments.

The Core Principles should acknowledge the wide array of business models across the banking sector and make frequent references to the concept of proportionality across the Core Principles to reinforce this key concept. The Committee’s High-level considerations on proportionality should be more explicitly referenced and the key considerations from that document should be integrated into or at a minimum referenced in each relevant section of the Core Principles. This will ensure that the Core Principles are as permissive as possible when it comes to proportionality.

For additional clarity, the Core Principles should explicitly note that many of the approaches listed in the document are designed for large global banks with international activity. Therefore, the Core Principles should state that the application of each relevant approach should be modified to account for smaller, domestically focused banks which do not have the same risks that need to be managed.

Proportionality of Stress Tests

References to stress testing, in particular in Principle 15, do not incorporate any considerations of proportionality. This is a concern for our members, and other small organisations with simple banking business models which do not pose the same risk to domestic and international financial stability as larger institutions do and to whom the stress testing principles should be targeted. The principle should include explicit references to making stress testing proportionate relative to the specific kinds of risks posed by an organisation. For example, the principles note that “At a minimum, banks’ stress-testing programmes cover credit risk, market risk, interest rate risk in the banking book, liquidity risk, country and transfer risk, operational risk and significant risk concentrations.” As small, simple and non-internationally active banks, the above outlined risks may not all be material risks for our members.

Stress tests can impose significant financial and resource burdens on small institutions, given the resource constraints can be acute at small banks, while they do not offer material risk benefit for the financial system given the lack of systemic importance such institutions pose. Principle 15 should encourage supervisors to conduct a cost-benefit analysis prior to imposing stress tests for small, non-systemically important banks and tailor any stress testing to focus on the key risks.

Accounting for different business models in the Supervision of Boards

The Core Principles should provide further clarity, flexibility and detail in Principle 14 on the criteria for supervisors to determine a 'balanced board'. Further guidance should be provided which requires supervisors to ensure they consider the business models and relative needs of bank boards for smaller, less complex banks as well as customer-owned banks. Customer owned banks can have a different governance structure to the typical listed investor-owned bank. Supervisors should be encouraged and empowered to consider what a balanced board looks like for small resource or geographically constrained banks which do not undertake particularly complex or systemically important activities, noting that the ultimate outcome is good corporate governance.

COBA notes that the Basel Committee's own Corporate Governance principles do outline more about proportionality and flexibility when it comes to board balance noting that: "The board should have an appropriate balance of skills, diversity and expertise commensurate with the size, complexity and risk profile of the bank. Board members should be (and remain) qualified, individually and collectively, for their positions."[1]

Sustainability of Business Models

We are seeking more clarification in the Core Principles on what constitutes a 'sustainable business model' and what factors supervisors should take into account when determining it. It is not clear if this principle is seeking to address the evaluation of external risks to a business, such as climate change or economic risk or whether it refers to assessing the viability of the underlying banking model (i.e., a household focused banks vs a business focused one or a mutual ownership model vs a listed one). It is important to clarify this principle to reduce the risk of unintended supervisory actions where the supervisor begins to make judgements on the underlying business model of an organisation as a means of risk management. Regulators must also be very careful in how they consider this particular concept as a convergence to a single business model (i.e., large listed investor-owned banks) can be a poor outcome for consumers and financial stability.

Thank you for taking the time to consider our submission. Please do not hesitate to contact Mark Nguyen (mnguyen@coba.asn.au) if you have any questions about our submission.

Yours sincerely

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[1] https://www.bis.org/fsi/fsisummaries/corp_gov_principles.htm