



13 November 2023

By email: policydevelopment@apra.gov.au

General Manager
Policy and Advice Division
Australian Prudential Regulation Authority
Level 12 1 Martin Place
SYDNEY NSW 2000

Dear Sir/Madam

DISCUSSION PAPER- ENHANCING BANK RESILIENCE: ADDITIONAL TIER 1 CAPITAL IN AUSTRALIA

The Stockbrokers and Investment Advisers Association (SIAA) is the professional body for the stockbroking and investment advice industry. Our members are Market Participants and Advisory firms that provide securities and investment advice, execution services and equity capital-raising for Australian investors, both retail and wholesale, and for businesses. Practitioner Members are suitably qualified professionals who are employed in the securities and derivatives industry.

The history of the stockbroking profession in Australia can be found [here](#).

SIAA members represent the full range of advice providers from online providers providing execution-only services to full-service stockbroking. These services are provided to both retail and wholesale clients.

SIAA welcomes the opportunity to provide feedback on APRA's discussion paper on enhancing bank resilience: Additional Tier 1 Capital in Australia (Discussion Paper). The focus of this submission is the impact that any change to Additional Tier 1 Capital (which we will refer to as hybrid securities) would have on Australian investors which is in answer to Question 2 of the Discussion Paper. We also provide information on the Australian investment context.

Executive summary

- The impact of the Design and Distribution Obligations (DDO) regime should allay APRA's concerns that there are large numbers of unadvised retail clients holding hybrid securities that pose a challenge to the operation of hybrids in the Australian market.
- When all categories of wholesale clients are taken into account (not just those who satisfy the product test) it is not the case that a high proportion of those holding hybrid securities are retail investors.
- Data from our member firms evidences the high levels of ownership of hybrids amongst investors defined as wholesale under all definitions of the Corporations Act 2001, not just

the product test.

- We are concerned about the impact that proposed changes would have on Australian investors, particularly changes that prevent certain investors from acquiring hybrid securities either on issuance or on market.
- Investors shut out of hybrids who are seeking income, particularly those in retirement, which number will increase over coming years, will be forced into other products that carry more risk and charge fees.

Overview

We agree with the Discussion Paper that when weighing up potential options and determining whether the benefits to be gained from policy changes outweigh the costs, a range of trade-offs will need to be considered and it will be important to understand and clearly assess the benefits for financial resilience against the impacts on banks, investors and the broader financial system.

The Australian context

The Discussion Paper states that the challenges in using hybrids to absorb losses are more acute in Australia due to several reasons including *strong investor expectations that distributions will continue to be made in stress, given the lack of crisis experience*. This statement assumes a lack of understanding on the part of Australian hybrid investors of the features of hybrid securities. We don't agree with this assumption. Investor expectations are the result of investor education. Our members point to the increased amount of education and information provided to investors on the features and risks of hybrids. They also point to the role that the DDO regime has had on the distribution of hybrids with the result that hybrids can only be issued to retail investors who have received advice on the product. We make additional comments on the impact that DDO has had on the financial services industry and the knowledge and understanding of Australian hybrid investors later in this submission.

Australian investor base

We do not agree that the investor base of hybrids in Australia would necessarily make the use of hybrids to resolve a bank crisis more challenging. The Discussion Paper states that retail investors are a prominent part of the Australian hybrid market and in support of this, points to the fact that around 50% of investors in hybrids listed on the ASX hold less than \$500,000, thus placing them in the category of retail as opposed to wholesale clients.

This approach overlooks the fact that the requirement to invest an amount of \$500,000 is only one measure of whether a client is defined as wholesale or retail. The test that is most frequently applied by our members to categorise a client as wholesale is the 'high-net-worth' test that is based on the asset or income threshold.¹ Data from our member firms evidences the high levels of ownership of

¹ Section 761G (7) of the Corporations Act 2001 provides that except when advice relates to superannuation or general insurance, if the financial product or service is not provided for use in connection with a business and the person acquiring the financial product or service provides a certificate from a qualified accountant, obtained within the prior 6 months, that they have:

hybrids amongst investors defined as wholesale under all definitions in the Corporations Act, not just the product test.²

Investors do not automatically become wholesale clients by virtue of their wealth or income; they must actively request this classification by obtaining a certificate from an accountant which must be renewed every two years. While our members rely on the asset or income threshold test as an objective measure they also take into account the sophistication and financial knowledge of the client. Licensees understand that a client's asset level is not always a reliable indicator of financial knowledge or sophistication. Therefore, investors who include hybrids in their portfolio are aware of the features of hybrid securities, which does not align with APRA's statement that this understanding is lacking.

Our members report that hybrids usually only make up a small percentage of their clients' individual portfolios. As a consequence of this, there is a high level of diversification in the portfolios that hold hybrids. Conversion of a hybrid security is not therefore likely to have an outsized impact on the average client portfolio. This is another reason why our members dispute claims that Australia would face more acute challenges than other jurisdictions in using hybrids to support a bank resolution.

Any comparison to other jurisdictions must take into account Australia's very high levels of share ownership and our developed superannuation system. According to the *ASX Investor Study 2023*, 51% of Australian adults, or 10.2 million people, hold investments outside their primary residence and superannuation. Of these, 7.7 million people hold investments through a stock exchange. An estimated 1.2 million investors have started investing since 2020.

The study found that of the investments currently owned, either personally, in a company structure, through a family trust or in an SMSF, while 58% directly held Australian shares, only 5% held hybrid securities. This contrasts with 20% who held ETF's, 16% who held international shares, 10% who held LICs and 8% who held unlisted managed funds. Interestingly, while 30% of High Value Investors (defined as the top 10% of investors by wealth and trading value) held hybrids, only 4% of non High Value Investors held those products.

The impact that DDO has had on the financial services industry.

Our members consider that DDO has been a 'game changer' in the provision of financial products. ASIC has been very active in surveillance and enforcement of DDO and has issued 81 interim stop orders, including orders relating to product distribution.

While DDO only applies to products offered to retail clients, a product that is aimed at both retail and wholesale clients must comply with the DDO regime. The introduction of DDO moves the focus to whether the product is appropriate for the investor.

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- net assets of at least \$2.5 million; or
 - a gross income for each of the past 2 financial years of at least \$250,000;
- the product or service will be provided to a wholesale client.

² Except when advice relates to superannuation or general insurance, a person is a wholesale client under section 761G of the Corporations Act 2001 if the price for the provision of the financial product, or the value of the financial product to which the financial service relates, equals or exceeds \$500,000.

Since the introduction of DDO, hybrid issuance has been restricted to wholesale clients or personally advised retail. The consequence of this regulatory approach should be to limit holdings of hybrid securities to the following investor classes:

- retail clients who have received personal advice on the product
- wholesale clients
- retail clients who have purchased hybrid products on market.

Data from our member firms evidences this.

Our member firms report that the vast majority of their clients who hold hybrids are either wholesale clients or retail clients who receive personal advice. Unadvised retail clients holding hybrids have either acquired hybrid securities on market or acquired the product prior to DDO. The number of retail clients holding pre-DDO hybrid securities are expected to fall as these products mature.

Member firm data also shows a significant fall in the number of retail clients acquiring hybrid securities after the introduction of DDO. Even the number of retail clients acquiring hybrid securities on market has fallen.

We consider that the impact of DDO should allay APRA's concerns that there are large numbers of unadvised retail clients holding hybrid securities that pose a challenge to the operation of hybrids in the Australian market. When all categories of wholesale clients are taken into account, (not just those who satisfy the product test) it is no longer the case that a high proportion of those holding hybrid securities are retail investors. And those retail investors who have acquired hybrid products after the introduction of DDO are either advised or acquired them on market.

Question 2 of the Discussion Paper –The impact on investors of changes to hybrid securities

Any options that improve the effectiveness of hybrid securities need to be assessed in light of the potential trade-offs and impacts.

We are concerned about the impact that proposed changes would have on Australian investors, particularly changes that prevent certain investors from acquiring hybrid securities either on issuance or on market.

The bond market is not available to those unable to invest the minimum amount of \$500,000. Investors who seek income, particularly those in retirement, are prepared to take credit risk by moving down the capital structures of financially strong and well managed institutions and acquire hybrids for the income stream. They do so in knowledge of the features — including the risks — of hybrids.

Investors who acquire hybrids on issuance are not charged fees.

Limiting hybrids to investors who qualify as a wholesale investor under the product test (ie minimum investment of \$500,000) will create a problem. By way of example, to hold a parcel of \$500,000

worth of one hybrid security in a diversified portfolio, would require an investor to have a portfolio of at least \$20 million. Accordingly, introducing such a limitation would prevent most investors from acquiring the product.

Investors shut out of hybrids will be forced into other products that carry more risk and charge fees. By way of example, yield seeking investors may also turn to private debt funds which lack the transparency of listed investments.

The government is on record as noting that with five million Australians either retiring or approaching retirement. We are of the view that it would imprudent policy to shut an increasing cohort of investors seeking income out of hybrids into products that carry more risk and charge fees.

Conclusion

If you require additional information or wish to discuss this matter in greater detail, please do not hesitate to contact SIAA's policy manager, Michelle Huckel, at michelle.huckel@stockbrokers.org.au.

Kind regards

A handwritten signature in black ink, appearing to be 'JF' with a stylized flourish and the letters 'Gx' below it.

Judith Fox
Chief Executive Officer