Stockbrokers and Investment Advisers Association
Serving the interests of investors

8 November 2024

By email: policydevelopment@apra.gov.au

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

Dear Sir/Madam

Second Discussion Paper – A more effective capital framework for a crisis

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 second discussion paper. The focus of this submission is to question the basis of APRA's proposed changes to its prudential framework as well as the impact that any change to Additional Tier 1 Capital (which we will refer to as hybrid securities) will have on Australian investors.

Overview

SIAA, as well as some of its member firms, provided feedback to APRA's first Discussion Paper that its concerns about hybrids were based on an incorrect understanding of the investors who actually held hybrid securities.

We made the following important points:

- The impact of the Design and Distribution Obligations (DDO) regime should allay APRA's concerns that there were large numbers of unadvised retail clients holding hybrid securities that pose a challenge to the operation of hybrids in the Australian market. Since the introduction of DDO, hybrid issuance had been restricted to wholesale clients or personally advised retail. Data from our member firms evidenced this. The number of retail clients holding pre-DDO hybrid securities was expected to fall as these products matured. Member firm data also showed 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 had fallen.

- When all categories of wholesale clients were taken into account (not just those who satisfy the product test) it was not the case that a high proportion of those holding hybrid securities were retail investors.
- Data from our member firms evidenced 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.
- Hybrids usually only made up a small percentage of their clients' individual portfolios. As a consequence of this, there was a high level of diversification in the portfolios that held hybrids. Conversion of a hybrid security was unlikely to have an outsized impact on the average client portfolio.
- Any comparison to other jurisdictions should 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.

For these reasons we disputed claims that Australia would face more acute challenges than other jurisdictions in using hybrids to support a bank resolution.

The link to our submission to the first Discussion Paper is here.

The assumptions upon which the proposal is based

Unfortunately, APRA has not taken the evidence put forward by SIAA and its members into account when formulating its response in its second Discussion Paper. APRA continues to repeat its assumptions that Australia is an outlier internationally with a material proportion (around 20% to 30%) of hybrid securities held by domestic retail investors and that as a result the use of hybrid securities in Australia is challenged due to the risk that investors don't understand their loss-absorbing nature and may not be prepared to absorb those losses potentially leading to contagion in the broader financial system, further undermining confidence in a crisis.

SIAA continues to contest the various prudential challenges APRA states in its Discussion Paper particularly those supporting its argument for:

- absorbing losses
- contagion risk
- complicating decision-making.

SIAA repeats the points it made in its previous submission.

Interestingly, at page 16 of the Second discussion Paper APRA states:

AT1 is only a small proportion of overall assets held by households, reflecting the size of the AT1 market in the broader securities market.

This comment supports the point we made in our previous submission that conversion of a hybrid security was unlikely to have an outsized impact on the average client portfolio due to the high level of diversification in the portfolios that held hybrids and that as a result concerns about investor reactions, contagion risks and broader systemic impacts were overblown.

Impact on investors

Our member firms report that 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. Investors make these investments in knowledge of the features — including the risks — of hybrids. An advantage of acquiring hybrids on issuance is that investors are not charged fees.

The bond market is not available to those unable to invest the minimum amount of $500,000, making hybrids a more accessible way to achieve income. There is almost a complete absence of corporate debt available to retail investors in Australia. The Australian corporate bond market remains undeveloped and small compared to other comparable countries and the currently regulatory settings are impacting retail investor access to quality fixed income investment opportunities – a vital asset class for Australia's ageing population.

Eliminating hybrid securities will force investors seeking income into other products that carry more risk and charge fees. By way of example, yield-seeking investors may turn to private debt funds which lack the transparency of listed investments.

The government is on record as noting that five million Australians are 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 resulting in them investing in 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 whose contact details can be found in the covering email.

Yours faithfully

Judith Fox
Chief Executive Officer