To: General Manager
Policy
Policy & Advice Division
Australian Prudential Regulation Authority

17 September 2024

RE: APRA Announcement - "A more effective capital framework for a crisis"

Dear Sir / Madam,

Thank you for the opportunity to respond to APRA's proposal that aims to address the effectiveness of regulatory capital within the banking industry in Australia. In particular, we note APRA is seeking feedback on the 'third path' of simplifying the framework by replacing AT1 with other existing forms of capital (Tier 2 and Common Equity Tier 1 (CET1)).

Our firm is a professional corporate adviser, distributor, and fund manager, specifically focused on fixed income and advising on prudential capital issues including Additional Tier 1 and Tier 2 securities. Our education on these products is broad, covering the structure and features of each investment opportunity as well as the credit quality of issuers and the banking industry as a whole. While we do invest across the spectrum of issuers, including banks, insurers, and non-bank financials, the bulk of our portfolio is within the banking industry.

In addressing your recommended questions as we respond, **we will address Question 2 first**, noting the likely impacts of the proposed approach as this will lead to a natural progression to Question 1 on design and how APRA could improve its approach to this topic.

We commence by recommending that APRA **pause and reflect on the material dangers of what is being proposed.** We cannot conceive of a single benefit to either investors, depositors, banks, or the Australian government in phasing out Additional Tier 1 securities.

We summarise below what we feel this proposal will achieve in 10 key points. Such a move, which was never contemplated in APRA's original proposals for AT1 a year ago, would:

Seed Funds Management Pty Limited | ABN 25 675 247 506 | Corporate authorised representative (No. 001308397) of its related body corporate, Seed Partnerships the holder of AFSL No. 492973.
SYDNEY | Level 32 | 225 George Street, Sydney, NSW
Email: invest@seedfm.com.au

1. Increase bank balance sheet leverage, materially heightening risk to bank credit ratings and outlooks with consequent higher costs for borrowing for banks and their customers;
2. Remove a crucial element of capital support for banks, diminishing the competitiveness of our banking industry against international rivals;
3. Lower the overall credit quality of the Australian banking industry, currently among the best globally;
4. Limit banks' options for equity support in crises, forcing them to depend excessively on shareholder dilution to boost capital;
5. Increase risks for depositors, directly contradicting APRA's core mandate;
6. Violate the Basel III global prudential capital regulations by significantly reducing Tier 1 capital for standardised banks from 6% to a minimum of 4.5% of Risk Weighted Assets;
7. Deprive investors, especially self-managed super funds, of the opportunity to benefit from franking credits associated with investments in hybrid securities;
8. Impose substantial new costs on banks and reduce funding flexibility by narrowing their choices for capital issuance.
9. Undermine a $40 billion market that has bolstered bank capital protection effectively for over 25 years;
10. Leave retail investors with fewer low-risk income investment alternatives, pushing them towards higher risk options.

In short, the implementation of this proposal would be a significant setback for Australian depositors, investors, and our banking industry and would go a long way to undermining what APRA has previously achieved in its 25 years of existence. It also represents a major over-reaction considering the strength and unique nature of our mortgage-bank-dominant industry here in Australia.

In terms of how APRA could improve the design of the proposed approach, we note one of the main considerations stated by APRA for the proposal is to bring about an improved efficiency in the potential use of AT1 in a time of crisis by ensuring that retail investors are not participating in this market.

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A very simple method of bringing about this end would be to prohibit any future ASX-listing of AT1 issues. As the minimum investment and trading amount within the wholesale market is $500,000, this prohibition would automatically rule out any direct retail involvement while still enabling sophisticated investor participation. All of the negative aspects of the proposal would be dealt with and retail investors would not be forced into riskier asset classes as professional management of hybrid securities prevail.

We strongly recommend that APRA maintain AT1 as a core part of Australian banks' capital support and progress future AT1 hybrid issues via the wholesale market in order to restrict investment to sophisticated investors. Such a move would protect the conservative nature of Australian banks, their credit standing, their depositors, and the security of their unquestionably strong nature.

Kind regards,

[redacted]

[redacted]
Director & Senior Portfolio Manager
Seed Funds Management Pty Ltd