



Discussion Paper

Basel III disclosure requirements: composition of capital and remuneration

April 2013

Disclaimer and copyright

While APRA endeavours to ensure the quality of this publication, it does not accept any responsibility for the accuracy, completeness or currency of the material included in this publication and will not be liable for any loss or damage arising out of any use of, or reliance on, this publication.

© Australian Prudential Regulation Authority (APRA)

This work is licensed under the Creative Commons Attribution 3.0 Australia Licence (CCBY 3.0).

 This licence allows you to copy, distribute and adapt this work, provided you attribute the work and do not suggest that APRA endorses you or your work. To view a full copy of the terms of this licence, visit www.creativecommons.org/licenses/by/3.0/au/.

Preamble

This discussion paper outlines the Australian Prudential Regulation Authority's (APRA's) proposals for enhanced public disclosure by authorised deposit-taking institutions (ADIs) in Australia. These proposals give effect to measures introduced by the Basel Committee on Banking Supervision (Basel Committee) to address deficiencies in publicly available information identified during the global financial crisis. The composition of capital and remuneration disclosure measures are set out in the Basel Committee's *Composition of capital disclosure requirements* (June 2012) and *Pillar 3 disclosure requirements for remuneration* (July 2011), respectively.

APRA invites written submissions on its proposals. Following consideration of submissions received, APRA will finalise *Prudential Standard APS 330 Public Disclosure*, which will come into effect on 30 June 2013.

This discussion paper is available on APRA's website at www.apra.gov.au. Written submissions on the paper should be forwarded by 16 May 2013 by email to Basel3capital@apra.gov.au and addressed to:

Neil Grummitt
General Manager, Policy Development
Policy, Research and Statistics
Australian Prudential Regulation Authority

Important disclosure notice – publication of submissions

All information in submissions will be made available to the public on the APRA website unless a respondent expressly requests that all or part of the submission is to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in confidence should provide this information marked as confidential in a separate attachment.

Submissions may be the subject of a request for access made under the *Freedom of Information Act 1982* (FOIA). APRA will determine such requests, if any, in accordance with the provisions of the FOIA. Information in the submission about any APRA regulated entity that is not in the public domain and that is identified as confidential will be protected by section 56 of the *Australian Prudential Regulation Authority Act 1998* and will therefore be exempt from production under the FOIA.

Contents

Preamble	3
Glossary	5
Executive summary	6
Chapter 1 – Disclosure requirements for composition of capital	8
Chapter 2 – Disclosure requirements for remuneration	12
Chapter 3 – Request for cost-benefit information	14

Glossary

ADI	Authorised deposit-taking institution
APRA	Australian Prudential Regulation Authority
APS 330	<i>Prudential Standard APS 330 Capital Adequacy: Public Disclosure of Prudential Information</i> , January 2013
Basel II	<i>International Convergence of Capital Measurement and Capital Standards: A Revised Framework</i> , Basel Committee, June 2006
Basel III	<i>Basel III: A global regulatory framework for more resilient banks and banking systems</i> , Basel Committee, December 2010 (revised June 2011)
Basel Committee	Basel Committee on Banking Supervision
Board	Board of directors
Capital disclosure requirements	<i>Composition of capital disclosure requirements</i> , Basel Committee, June 2012
Corporations Act	<i>Corporations Act 2001</i>
CPS 510	<i>Prudential Standard CPS 510 Governance</i>
Draft APS 330	<i>Prudential Standard APS 330 Public Disclosure</i>
PPF providers	ADIs that are providers of purchased payment facilities
Remuneration disclosure requirements	<i>Pillar 3 disclosure requirements for remuneration</i> , Basel Committee, July 2011
SCCIs	ADIs that are specialised credit card institutions

Executive summary

In December 2010, in response to the global financial crisis, the Basel Committee released a package of reforms (Basel III)¹ to raise the level and quality of regulatory capital in the global banking system. Included in this package were expanded disclosure requirements that are intended to improve the transparency of regulatory capital and to enhance market discipline. Details of these requirements were released in June 2012. Also in response to the crisis, the Basel Committee released its disclosure requirements for remuneration in July 2011. This discussion paper outlines APRA's proposed implementation of these requirements.

Disclosure requirements for composition of capital

The proposed disclosure requirements for composition of capital are intended to apply to locally incorporated ADIs² and include a common disclosure template, capital reconciliation, a summary of the main features of regulatory capital instruments and other regulatory disclosures. They are additional to existing Basel II³ capital disclosure requirements and are intended to be referenced or included in full in published financial statements and on an ADI's website, unless APRA agrees otherwise.

Under Basel III, adjustments to regulatory capital may be phased in until 1 January 2018. However, APRA applied these adjustments in full from 1 January 2013. Accordingly, APRA is proposing that ADIs complete the post 1 January 2018 version of the disclosure template, as provided under Basel III. APRA has incorporated its approach to specified regulatory adjustments into the common disclosure template.

APRA is also proposing that an ADI prepare and disclose a full reconciliation of the elements of its regulatory capital to its published financial statements. APRA does not intend to prescribe a standard format for this reconciliation.

Finally, APRA proposes to require an ADI to complete a template describing the main features of its regulatory capital instruments and to publish in full the terms and conditions of these instruments.

APRA proposes that the disclosure requirements for the composition of capital are to become effective from an ADI's first balance sheet date occurring on or after 30 June 2013. The intention is that disclosures will be made with the same frequency as, and concurrent with, the publication of an ADI's financial statements. Thus, APRA will expect listed ADIs to disclose on a semi-annual basis and unlisted ADIs on an annual basis. The existing quarterly and other disclosure requirements of capital ratios under Basel II will continue, as required in existing *Prudential Standard APS 330 Capital Adequacy: Public Disclosure of Prudential Information* (APS 330).

APRA is also taking the opportunity to make a minor amendment to Table 11 in APS 330 for ADIs using the internal models approach for trading portfolios to reflect updated Basel Committee requirements for the treatment of market risk.

Disclosure requirements for remuneration

APRA also proposes to incorporate into an expanded APS 330 (*Prudential Standard APS 330 Public Disclosure, draft APS 330*) the Basel Committee's disclosure requirements for remuneration. These requirements are intended to apply to locally incorporated ADIs⁴ and cover the senior managers and material risk-takers who must already be included in an ADI's remuneration policy in accordance with *Prudential Standard CPS 510 Governance* (CPS 510).

APRA is proposing that, to the extent practicable, the disclosures be located either on an ADI's website or in a publicly available document. The disclosures are to be published on at least an annual basis for the first balance sheet reporting period occurring on or after 30 June 2013.

1 The revised June 2011 text is at <http://www.bis.org/publ/bcbs189.htm>

2 Other than providers of purchased payment facilities (PPF providers).

3 The comprehensive June 2006 text is at <http://www.bis.org/publ/bcbs128.htm>

4 Excluding PPF providers and specialised credit card institutions (SCCLs).

Listed locally incorporated ADIs may meet APRA's disclosure requirements for remuneration by including required information in the Remuneration Report prepared pursuant to the *Corporations Act 2001* (Corporations Act), as long as the ADIs clearly distinguish between the remuneration disclosures made under that Act and those made under APS 330.

Consultation with industry and other interested stakeholders

APRA invites written submissions on its proposals to implement the Basel III disclosure requirements for the composition of capital (including the revised table on market risk) and remuneration. APRA encourages all interested stakeholders to use this consultation opportunity to advise it of any implementation issues and to submit relevant cost–benefit information.

Chapter 1 – Disclosure requirements for composition of capital

In its June 2012 publication, *Composition of capital disclosure requirements*⁵, the Basel Committee noted the difficulties faced by market participants and supervisors during the global financial crisis in assessing the capital positions of banking institutions and making comparisons of their capital positions on a cross-jurisdictional basis. The Basel Committee also suggested that lack of clarity on the quality of capital may have contributed to uncertainty during the crisis and that interventions by national authorities may have been more effective if the capital positions of institutions were more transparent.

To address these concerns, the Basel Committee developed a package of requirements for the disclosure of information about the capital position of banking institutions. To improve consistency and ease of use of disclosures, and to mitigate the risk of inconsistent formats undermining the objective of enhanced disclosure, the Basel Committee included two common templates for use by banks.

This chapter sets out APRA's proposed implementation of these capital disclosure requirements by ADIs. The draft of an expanded APS 330 released with this discussion paper includes details of these proposed measures.

1.1. Scope of application

Consistent with its application of the Basel III capital reforms, APRA proposes to apply the capital disclosure requirements to all locally incorporated ADIs (other than PPF providers). For some requirements, this extends the current scope of APS 330 to include ADIs using the 'standardised' Basel II approaches to measuring credit and operational risk. The requirements will apply to ADIs on a Level 2 basis or, where Level 2 is not applicable, on a Level 1 basis.

1.2. Common disclosure template

The Basel Committee's capital disclosure requirements include a common template to be used to report the components of regulatory capital. There are two versions of this template: one for the period before 1 January 2018 for use in jurisdictions that are phasing in Basel III regulatory adjustments, and one for post 1 January 2018. APRA has implemented the Basel III

approach to regulatory adjustments in full from 1 January 2013 and, accordingly, is proposing that ADIs need only complete the so-called 'post 1 January 2018 common disclosure template'. Until 1 January 2018, ADIs will be required to disclose that they are using this template because they are applying the Basel III regulatory adjustments in full from 1 January 2013. APRA has made minor amendments to the template so that it better reflects financial reporting terminology used in Australia, such as altering 'common stock' to 'ordinary shares'.

The common disclosure template envisaged disclosure of regulatory adjustments specific to national jurisdictions under the relevant 'total' row for each category of capital. APRA proposes to add additional rows below these totals to identify the regulatory adjustments that it requires. These have been highlighted in draft APS 330 and include:

- treasury shares (if not included in share capital calculated under Basel III);
- holdings of capital instruments in group members by other group members on behalf of third parties;
- offsets to dividends declared due to dividend reinvestment plans, to the extent that the dividends are used to purchase new ordinary shares issued by the ADI;
- deferred fee income;
- the capital impact of common equity, Additional Tier 1 and Tier 2 investments in financial institutions that are outside the scope of regulatory consolidation, not already reported in the template;
- the capital impact of deferred tax assets (net of deferred tax liabilities) not already reported in the template;
- capitalised expenses;
- investments in commercial (non-financial) entities deducted under APRA's capital standards;
- covered bonds in excess of asset cover in pools; and
- undercapitalisation of non-consolidated subsidiaries.

⁵ <http://www.bis.org/publ/bcbs221.htm>

In addition, APRA accepts that ADIs may wish to disclose further information on regulatory capital ratios. It therefore proposes to provide an addendum that compares capital ratios under APRA's requirements (after applying national discretions) and under Basel III rules (not applying national discretions). The addendum focuses on the numerator of the capital ratio. The Basel Committee is undertaking a substantial exercise on the denominator – the measurement of risk-weighted assets – aimed at ensuring consistent implementation of the full Basel capital framework, so as to maintain market confidence in regulatory capital ratios and provide a level playing field. APRA will consider expanding the addendum to take into account the results of the Basel Committee exercise.

Finally, APRA proposes to delete the requirements under the current APS 330 that have been superseded by the common disclosure template⁶.

1.3. Reconciliation requirements

APRA proposes to adopt the Basel Committee's common approach for banks to disclose 'a full reconciliation of all regulatory capital elements back to the balance sheet in the audited financial statements'⁷. This involves undertaking a three-step process:

Step 1: Disclose the reported balance sheet under the regulatory scope of consolidation.

The scope of consolidation for accounting purposes and for regulatory purposes is often different. This step is therefore intended to clarify the difference between the numbers used in an ADI's calculation of regulatory capital and the numbers used in its published financial statements. In addition, APRA proposes to require ADIs to disclose the list of legal entities that are included within the accounting scope of consolidation but excluded from the regulatory scope of consolidation (and vice-versa). ADIs will also need to disclose total balance sheet assets and liabilities and the principal activities of these entities.

Step 2: Expand the lines of the balance sheet under the regulatory scope of consolidation to display all of the components that are used in the composition of capital disclosure template.

As outlined by the Basel Committee, many of the elements used in the calculation of regulatory capital cannot be readily identified from the face of the balance sheet. Under this step, APRA proposes that ADIs expand the rows of the regulatory-scope balance sheet such that all of the components used in the composition of capital disclosure template are displayed separately.

ADIs will only be required to expand elements of the balance sheet to the extent necessary to reach the components used in the disclosure requirements for the composition of capital.

Step 3: Map each of the components that are disclosed in Step 2 to the common disclosure template.

When reporting the common disclosure template, ADIs will be required to use the reference numbers/ letters from Step 2 to show the source of each input. Specifically, under this step ADIs will need to illustrate how components have been used to calculate items in the common disclosure template.

APRA does not intend to prescribe a standard format for this reconciliation.

In addition, APRA proposes to delete the existing Table 1: Scope of application in Attachment A of APS 330 as the Basel III reconciliation requirements will in part duplicate that information. However, APRA is retaining the qualitative information required under (a) and (c) of Table 1, viz:

- the name of the top corporate entity in the Level 2 group; and
- any restrictions, or other major impediments, on the transfer of funds or regulatory capital within the group.

This information will need to be disclosed as part of the reconciliation requirements.

⁶ That is, the capital structure parts of Tables 2 and 15 in Attachments A and B, respectively.

⁷ Refer to paragraph 91 of the *Composition of capital disclosure requirements*, June 2012.

1.4. Main features template

ADIs approved to use the 'advanced' Basel II approaches to measuring credit and operational risk for capital adequacy purposes are already required to disclose summary information on the terms and conditions of the main features of all capital instruments⁸. The Basel Committee has found that this requirement has not been met in a consistent manner across jurisdictions. It concluded that the lack of consistency in both the level of detail provided and the format of disclosure made analysis and monitoring of this information difficult. To ensure that the main features of regulatory capital instruments are disclosed in a consistent and comparable way, the Basel Committee has introduced a 'main features template'. This template represents the minimum level of summary disclosure that banks are required to report in respect of each regulatory capital instrument issued.

APRA proposes to adopt the Basel Committee's main features template without amendment. The template is set out in Attachment B to draft APS 330.

1.4.1. Disclosure of the full terms and conditions of capital instruments

APRA is proposing that, in addition to completing the main features template, ADIs be required to make the full terms and conditions of their regulatory capital instruments available on their website. This will allow market participants to investigate the specific features of individual capital instruments.

The full terms and conditions of capital instruments and the main features template will need to be updated whenever a new capital instrument is issued and included in regulatory capital, whenever an instrument is redeemed, converted or written off, or where there is a material change in its nature. APRA is proposing that this be done within seven calendar days of the event.

1.5. Other disclosure requirements

APRA also proposes to adopt the following Basel Committee requirements:

Non-regulatory ratios: APRA proposes that any ADI using non-Basel III terminology to describe regulatory capital ratios (e.g. 'Equity Tier 1', 'core Tier 1' or 'Tangible Common Equity' ratios) be required to accompany such usage with a comprehensive explanation of how these ratios are calculated.

Disclosure policy: APS 330 requires an advanced ADI to have a formal policy relating to its prudential disclosures approved by the Board of directors (Board) that addresses the ADI's approach to determining the content of its prudential disclosures and the internal controls over the disclosure process.

As the expanded capital disclosure requirements will apply to all locally incorporated ADIs, other than PPF providers, APRA also proposes to require all such ADIs to have a formal disclosures policy approved by the Board.

Market risk: APRA is taking the opportunity to update APS 330 to amend the table on market risk (Table 11) in the January 2013 version of APS 330. This will fully align the table with the Basel Committee's February 2011 document, *Revisions to the Basel II market risk framework*⁹. The proposed changes apply to ADIs using the internal models approach for trading portfolios and are highlighted in Table 14 in Attachment D to draft APS 330.

⁸ Refer to Table 2(a) in the January 2013 version of APS 330.

⁹ <http://www.bis.org/publ/bcbs193.htm>

1.6. Implementation date, frequency and timing

APRA is proposing that an ADI's capital disclosures under Attachment A to APS 330 and the reconciliation requirements be determined as at its first balance sheet date on or after 30 June 2013. Subsequent disclosures would be made semi-annually for listed ADIs and annually for unlisted ADIs, in accordance with requirements for the publication of financial statements under the Corporations Act.

Subject to minor adjustments, APRA proposes that disclosures made under the current APS 330 will continue with the same frequency under the new measures. That is, disclosures under Attachment C in draft APS 330 (formerly Table 16, 17 and 18) will continue to be made as at the end of each quarterly period in relation to the balance sheet date, together with the disclosures required for the previous quarter.

Under Attachment D to draft APS 330, an ADI with approval to use the IRB/AMA approaches to credit and operational risk will continue to make the qualitative risk exposure and assessment disclosures on an annual basis, coinciding with its balance sheet date. The quantitative risk exposure and assessment disclosures must be made on a semi-annual basis and published together with the disclosures made for the previous semi-annual period.

APRA also proposes that the full terms and conditions of regulatory capital instruments and a main features template for each instrument under Attachment B to draft APS 330 be disclosed from 30 June 2013.

1.7. Location and archiving of capital disclosures

APS 330 currently requires an ADI to provide ready access to its prudential disclosures in a clearly identifiable location on its website, or as otherwise agreed with APRA if the ADI has no website. To align with the Basel Committee's disclosure requirements, APRA is proposing that an ADI's financial statements must include the new capital disclosures under Attachment A (including the reconciliation report) and Attachment B to draft APS 330 in full or provide a direct link to the completed disclosures on its web site. In either case, APRA also proposes that all disclosures relating to regulatory capital will be included in a Regulatory Disclosures section of an ADI's website. In cases where disclosure requirements have been met through publicly available regulatory reports, the Regulatory Disclosures section of an ADI's website should provide specific links to these reports. An ADI that has no website will continue to require approval by APRA for an alternative means of publication.

Finally, the Basel Committee's capital disclosure requirements require banks to archive previous templates on their websites for a 'suitable retention period' determined by national authorities. APRA proposes that an ADI will need to retain previous disclosure documents for at least the previous 12 months, on its website, or as otherwise agreed with APRA.

Chapter 2 – Disclosure requirements for remuneration

On 1 July 2011, the Basel Committee issued disclosure requirements for remuneration in its document, *Pillar 3 Disclosure Requirements for Remuneration*¹⁰. These remuneration disclosures took account of the Financial Stability Board's *Principles for Sound Compensation Practices* (2 April 2009)¹¹.

The requirements include qualitative disclosures in relation to remuneration policy and processes and also quantitative disclosures, including aggregate information in relation to the remuneration of an ADI's senior management and other material risk-takers. The objective of these disclosures is to support effective market discipline and allow market participants to assess the quality of an ADI's remuneration practices.

In a letter to ADIs on 7 October 2011¹², APRA proposed to consult with industry on the Basel Committee's remuneration disclosure requirements as part of ADI Pillar 3 reporting requirements. At the same time, APRA encouraged all locally-incorporated ADIs to commence reporting on their remuneration practices in a manner consistent with the Basel Committee's document as soon as practicable.

This chapter sets out APRA's proposed implementation of its disclosure requirements for remuneration in an expanded APS 330. Detailed proposals are set out in Attachment E to draft APS 330.

2.1. Scope of application

APRA proposes to apply the Pillar 3 disclosure requirements for remuneration to all locally incorporated ADIs, except PPFs and SCCIs. Foreign ADIs are excluded from the proposed remuneration disclosure requirements on the basis that their parent entities will make these disclosures through requirements imposed by their home supervisors.

2.2. Interaction with remuneration disclosures required under the Corporations Act

APRA is mindful that listed ADIs must already meet remuneration disclosure requirements under the Corporations Act. Under those requirements, the annual directors' report of a listed company is to include a separate Remuneration Report covering qualitative and quantitative information for 'key management personnel'¹³, being 'those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity'. In other words, remuneration disclosure under the Corporations Act is focused on management positions.

Under CPS 510, an ADI's remuneration policy is broader in scope and encompasses senior managers, material risk-takers and risk and management personnel. The remuneration disclosure requirements reflect this, with the exception that the aggregate quantitative disclosures apply only to the first two categories. This would mean that, at a minimum, an ADI's quantitative disclosures should cover¹⁴:

- an executive director;
- a senior manager, being a person (other than a director) who:
 - makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the regulated institution;
 - has the capacity to affect significantly the regulated institution's financial standing;
 - may materially affect the whole, or a substantial part, of the business of the regulated institution or its financial standing through their responsibility for:
 - (i) enforcing policies and implementing strategies approved by the Board of the regulated institution;

¹⁰ <http://www.bis.org/publ/bcbs197.htm>

¹¹ http://www.financialstabilityboard.org/publications/r_0904b.pdf

¹² <http://www.apra.gov.au/adi/Publications/Documents/Letter-to-industry-Remuneration-Disclosures-071011.pdf>

¹³ As defined by reference to Accounting Standard AASB 124 *Related Party Disclosures*.

¹⁴ Refer to subparagraphs 48(a) and (c) of CPS 510.

- (ii) the development and implementation of systems used to identify, assess, manage or monitor risks in relation to the business of the regulated institution; or
- (iii) monitoring the appropriateness, adequacy and effectiveness of risk management systems;
- a person who performs activities for a subsidiary of the regulated institution where those activities could materially affect the whole, or a substantial part, of the business of the regulated institution or its financial standing, either directly or indirectly (but not for a subsidiary that holds a registrable superannuation entity licence under the *Superannuation Industry (Supervision) Act 1993*); and
- all other persons for whom a significant portion of total remuneration is based on performance and whose activities, individually or collectively, may affect the financial soundness of the regulated institution.

APRA is proposing that it be open to a listed ADI to incorporate the APS 330 remuneration disclosure requirements into its Remuneration Report, provided that the disclosures made in relation to 'key management personnel' under the Corporations Act are clearly distinguished from the disclosures made under APS 330 for 'senior managers' and 'material risk-takers'.

2.3. Implementation date, frequency, timing and location

APRA proposes that an ADI be required to meet the disclosure requirements for remuneration from its first balance sheet date occurring on or after 30 June 2013 and for each subsequent year. APRA is also proposing that an ADI should disclose its previous year's quantitative information on remuneration, beginning from its second published report of this information.

APRA is proposing that remuneration disclosures be published concurrent with:

- for a listed ADI, the publication of its audited financial statements; or
- for an unlisted ADI, the lodgement of its financial statements under the Corporations Act.

APRA is proposing that, to the extent practicable, ADIs disclose the information required on their website or in a publicly available document. In line with the Basel Committee's requirements, APRA is also proposing to permit ADIs to refer to a different website or document:

- if an equivalent disclosure has already been made under an accounting or listing requirement relating to the same time period; or
- to indicate where additional information may be found.

In these situations, ADIs must ensure that the site or document is publicly accessible.

Chapter 3 – Request for cost-benefit analysis information

To improve the quality of regulation, the Australian Government requires all proposals to undergo a preliminary assessment to establish whether it is likely that there will be business compliance costs. In order to perform a comprehensive cost-benefit analysis, APRA welcomes information from interested parties.

As part of the consultation process, APRA also requests respondents to provide an assessment of the compliance impact of the proposed changes. Given that APRA's proposed requirements may impose some compliance and implementation costs, respondents may also indicate whether there are any other disclosure requirements that should be improved or removed to reduce compliance costs.

Respondents are requested to use the Business Cost Calculator (BCC) to estimate costs to ensure that the data supplied to APRA can be aggregated and used in an industry-wide assessment. APRA would appreciate being provided with the input to the BCC as well as the final result. The BCC can be accessed at www.finance.gov.au/obpr/bcc/index.html.



Telephone
1300 55 88 49

Email
info@apra.gov.au

Website
www.apra.gov.au

Mail
GPO Box 9836
in all capital cities
(except Hobart and Darwin)