



10 January 2019

TO: ALL LOCALLY INCORPORATED AUTHORISED DEPOSIT-TAKING INSTITUTIONS (ADIs)

**PRUDENTIAL STANDARD APS 910 FINANCIAL CLAIMS SCHEME (APS 910)
REQUIREMENTS AND OPERATIONAL PREPAREDNESS**

This letter sets out APRA's observations and recommendations on the ADI industry's Financial Claims Scheme (FCS) operational preparedness.

The FCS is an important component of APRA's resolution framework and, as a safety net, it plays a major role in maintaining financial system stability. While it is APRA's role to administer the FCS, each locally incorporated ADI is required to be adequately prepared should it be declared under the FCS.

Following the 2013 release of *Prudential Standard APS 910 – Financial Claims Scheme (APS 910)*, APRA has, in recent years, conducted a range of activities designed to assess and facilitate improvement in ADIs' FCS operational preparedness levels. These activities comprised prudential reviews, an FCS readiness survey and benchmarking exercises to review APS 910 audit reports and CEO attestations.

Several high-level observations from these activities include:

- **FCS frameworks, governance and risk management** could be strengthened significantly. Generally, Board and senior management have low levels of awareness and limited oversight of requirements in this area. The integration of FCS requirements with relevant risk management frameworks and crisis-related plans is key.
- **FCS testing** is often treated as a compliance exercise rather than a genuine examination of preparedness. It is consistently identified as an area of weakness with most ADIs failing to test as required, under APRA's FCS testing schedule¹. In addition, testing results are often not presented to the Board and senior management, and issues are not appropriately monitored and remediated.
- **FCS data integrity** is critical to administering the FCS. ADIs are not adequately analysing FCS reports and testing results with respect to data integrity and variance levels. Of particular concern are the high levels of FCS exceptions – amounts that are not able to be paid to account holders immediately – that require manual processing.

Attachment A sets out more detailed observations and recommendations to assist ADIs to improve their FCS operational preparedness levels.

¹ As notified to ADIs in September/October 2016 and contained in FCS technical FAQ for ADIs 13.2 <https://www.apra.gov.au/frequently-asked-questions-faqs-financial-claims-scheme-fcs-adis>

Next steps

APRA asks that each ADI self-assess against the themes and observations outlined in Attachment A of this letter and prepare a detailed action plan (incorporating timeframes) to strengthen FCS readiness in accordance with APS 910 requirements and APRA's expectations.

ADIs are to submit the self-assessment and action plan to their responsible supervisor no later than 31 May 2019.

APRA will follow up on any specific issues directly with individual ADIs and will continue to conduct targeted prudential reviews focused on FCS preparedness. APRA will also analyse the *Reporting Standard ARS 910.0 Financial Claims Scheme Data Collection (ARS 910)* data submitted by ADIs in February 2019.

Questions about this letter should be directed to your supervisory team.

Yours sincerely,

Brandon Khoo
Executive General Manager
Diversified Institutions Division

Mark Adams
Executive General Manager
Specialised Institutions Division

Attachment A – Key themes and observations

1. FCS framework

Governance and risk management

Under APS 910, the Board and senior management of an ADI are ultimately responsible for ensuring appropriate policies and procedures are in place for the integrity of the operations, internal controls and information pertaining to the FCS. APRA has observed across a number of ADIs, low levels of management and Board awareness of both FCS requirements and the ADI's ongoing FCS operational preparedness. Delegation of FCS functions is common, however, without appropriate visibility and formal sign-off procedures, the reliability of the annual CEO attestation is questionable.

To facilitate effective governance, an appropriate risk management framework should be in place for FCS issues. This includes mechanisms for recording and reporting FCS issues as well as oversight across all three lines of defence. APRA notes a large proportion of ADIs do not track issues identified through FCS testing and a similar number do not have remediation plans in place to address them. Further, some ADIs do not engage risk functions or internal audit to review FCS components (including testing), nor do they report items/issues to senior management and/or Board committees.

- 1.1. ADIs should review FCS governance procedures to improve Board and senior management awareness and oversight (accountability and responsibility) as well as including FCS related components in an appropriate risk management framework.

Plans and outsourcing

Maintaining appropriate plans and procedures and the operational knowledge of staff, as well as addressing key person risk, become increasingly important with the passage of time. A number of ADIs have FCS-related policies and manuals that are out-of-date, are insufficiently embedded, are not operational in nature, do not contain FCS communications and/or are not integrated with existing BCP, retail run or recovery/resolution documentation. In addition, operational knowledge across organisations is dangerously narrow and plans are not generally updated to reflect the results of testing.

Many ADIs are heavily reliant on a number of key outsourcing arrangements to meet ongoing FCS requirements such as those related to data, systems, website and internet banking hosting and other communication channels such as call centres and statement or document management solutions. In the event that an ADI is declared under the FCS, these service providers are critical to the success of an FCS payout. Notwithstanding this, APRA notes very few ADIs have considered the continuity or extension of services in the lead up to, and during, an FCS declaration and the contractual implications.

- 1.2. ADIs should review and update operational FCS plans and integrate them with other relevant crisis related plans where appropriate. The plans should cover the systems, people, and processes necessary to deliver the FCS, both on an ongoing basis and in the event of an FCS declaration. Furthermore, the plans should form part of the training and testing program in relation to the FCS.
- 1.3. Each ADI should identify all key service providers it would rely upon in the event of an FCS declaration and ensure associated contractual arrangements are appropriate to meet APS 910 requirements. This includes the option to extend agreements in an FCS declaration for the ongoing provision of services.

2. FCS testing

ADIs are required to regularly review and test various aspects of operational readiness in accordance with APRA's FCS testing schedule. Testing has been consistently identified as a significant area of weakness with only limited testing of systems and processes conducted by ADIs. APRA's testing schedule specifies the timing and extent of testing required to be performed for each of the key domains of the FCS. For example, it is expected the Single Customer View (SCV) is run at least twice a year, which includes reconciling the SCV back to source systems.

APRA notes a number of ADIs are only generating the SCV on an annual basis, and reconciling it back to source systems and the general ledger either annually or not at all. Similarly, a significant proportion of ADIs had not tested the capture of alternative ADI account data, the generation of payment instruction information or the ability to generate and transmit FCS reports in adherence with APRA's testing requirements or at all.

A number of ADIs were also identified as not presenting FCS testing results to senior management or the Board.

2.1. ADIs should ensure internal FCS testing occurs, at a minimum, in line with APRA's testing schedule. Test results – including shortcomings with FCS-related systems, processes and reporting as well as respective causes – should be documented, along with remediation plans and timeframes. Test results, remediation plans and progress should be reported to senior management or the Board on a timely basis.

3. Data integrity

Analysis and investigation of discrepancies

In general, ADIs are failing to adequately analyse and sense-check FCS reports and testing results to determine whether the results are in line with expectations. Many ADIs have not evaluated or set tolerance levels around data integrity and variances. Furthermore, efforts to continuously improve data integrity are often hampered by failures in other business areas of the ADI, which results in no net improvements from period to period.

3.1. ADIs should thoroughly investigate and analyse FCS reporting and testing results against clearly defined tolerance levels. Timely reconciliations and checks should be performed with the generation of each report with tracking of issues, and a remediation plan linked to the risk management framework.

Exceptions

FCS exceptions are a particularly concerning component of data integrity. FCS exceptions are amounts that are not able to be paid immediately (for example due to account status or insufficient/incorrect information on file), and require manual processing. For a number of ADIs, FCS exceptions constitute an unacceptably high proportion of total FCS entitlements in terms of either account holder number or dollar value. Evaluation of exceptions is not common practice and almost 20 per cent of the ADIs that have recorded exceptions have not taken any remedial action.

3.2. ADIs should work to reduce exception numbers and values to acceptable levels that are within the tolerance set by the ADI.

4. Reporting

Under APS 910, an ADI's systems must be able to be updated to reflect account holder balances post FCS payments. APRA has found some ADIs do not meet this requirement, which could hamper the ability to provide account holders with information on FCS payment transaction details and remaining balances.

4.1. ADIs must take steps to ensure systems have the capability to be updated to reflect account holder balances post FCS payments.

5. FCS communications

Awareness

A deposit insurance system such as the FCS is more likely to provide financial stability if the public is aware of it. A number of ADIs' websites lack easily accessible information on the FCS and the protection it offers. Despite a 2016 APRA request, over 10 per cent of ADIs do not provide a link to the FCS website and over 30 per cent do not show the FCS FAQs. In the future, APRA anticipates considering options to increase overall FCS public awareness levels and expects industry to play a greater role in achieving this.

5.1. ADIs should examine the FCS information currently contained on their website and in PDS documents to ensure it is accurate, up-to-date and easily accessible. ADIs could also consider the positive benefits that FCS protection offers account holders and help to facilitate this messaging.

Communications capacity and contingency arrangements

Under APS 910, an ADI must be able to communicate with account holders and other customers via its existing website, telephone and internet capabilities in the event it becomes a declared ADI. The purpose is to convey FCS-related information as specified by APRA, respond to FCS-related customer enquiries and record information from account holders relevant to preparation of the FCS payment. APRA has found that 25 per cent of ADIs have not assessed the FCS communications capacity (resourcing and infrastructure) they require.

5.2. ADIs should critically assess capacity for FCS communications (including the alternate ADI account data capture mechanism), conduct testing (including communication infrastructure and resource testing) on an ongoing basis (in line with APRA's testing schedule), and ensure FCS-related communication plans and other documents are appropriately updated and integrated into the broader planning framework.