AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY
1 Martin Place (Level 12), Sydney, NSW 2000
GPO Box 9836, Sydney, NSW 2001

T 02 9210 3000 | W www.apra.gov.au

11 December 2019

TO: ALL AUTHORISED DEPOSIT-TAKING INSTITUTIONS

RELEASE OF FINAL PRUDENTIAL STANDARD APS 115 CAPITAL ADEQUACY: STANDARDISED MEASUREMENT APPROACH TO OPERATIONAL RISK

RELEASE OF DRAFT REPORTING STANDARD ARS 115.0 FOR COMMENT

In June this year, APRA released a response to submissions paper on its proposed revisions to the capital framework for authorised deposit-taking institutions (ADIs), which included APRA's response to submissions on revised operational risk requirements. Today, APRA is releasing the final operational risk requirements for ADIs which are contained in *Prudential Standard APS 115 Capital Adequacy: Standardised Measurement Approach to Operational Risk* (APS 115).

Six submissions commented on the operational risk proposals set out in the June response to submissions paper and draft APS 115, with respondents supportive of APRA's proposed approach to the determination of capital to be held for operational risk purposes. There were only two issues that generated material comment from industry as reflected in respondents' submissions.

Commencement date and interaction with existing requirements

While submissions expressed differing views on the proposed commencement date of 1 January 2021 for the new APS 115, the majority either supported or did not object to the proposed date. One submission also stated that it was unclear as to how ADIs are expected to use and manage existing internal models, including Advanced Measurement Approaches (AMA), until the new APS 115 takes effect, and AMA models after 1 January 2021.

APRA's June response to submissions paper specifically dealt with the commencement date of APS 115 noting that APRA considers an earlier implementation date for ADIs using an AMA will be advantageous, as the more onerous model maintenance requirements in the existing APS 115 will be replaced with the Standardised Measurement Approach (SMA) requirements. Ultimately, this is expected to provide ADIs with greater clarity in calculating their operational risk capital requirements.

Interaction with APRA's proposed new operational risk standard

A number of submissions commented on APRA's intention to issue a new prudential standard covering qualitative operational risk matters. Submissions argued that the absence of information on the content of the future standard creates uncertainty for ADIs given it is not clear how a qualitative standard will interact with APS 115 and the implementation of that standard.

APRA's qualitative operational risk requirements are still undergoing development and, while the final draft content is yet to be settled, the new standard will not have implications for when and how ADIs implement and comply with the new APS 115.

Adjustments to capital

Under paragraph 16 of the existing APS 115, APRA may require an ADI to reduce its level of operational risk or increase its capital if APRA considers the ADI's operational risk regulatory capital is not commensurate with the ADI's operational risk profile. While the draft APS 115 released in June this year did not specifically include this provision, it did provide for APRA to be able to adjust or exclude specific provisions in the Prudential Standard, which could be applied for this purpose where necessary. To avoid uncertainty, APRA has reinserted the wording of the original provision dealing with this matter in the final APS 115 released today. This provides clarity on the circumstances where APRA could require an ADI to reduce its operational risk or hold additional capital.

Draft Reporting Standard ARS 115.0 Capital Adequacy: Standardised Measurement Approach to Operational Risk (ARS 115.0)

Today, APRA is also releasing the draft ARS 115.0 for comment.

ARS 115.0 has been designed to be aligned with relevant accounting standards. In most cases, entities will only be required to enter information for the current period, the system will automatically retrieve historic data points and include them in the form. Adjustment fields have been included to take account of events such as divestments and mergers.

ADIs will be required to submit the required data for historical periods in the first collection. This data will be used solely for calculating the first period's capital requirement.

The proposed implementation of ARS 115.0 is expected to coincide with the start of APRA's new data collection solution (DCS), which replaces Direct to APRA (D2A), APRA's current data collection tool. As such, APRA intends that entities will submit ARS 115.0 data in the new DCS and expects that ADIs will be able to submit data via manual entry, upload of XBRL or Microsoft Excel files. More information on the DCS is available on the APRA website at: https://www.apra.gov.au/apra-replacing-d2a.

Confidentiality and publication of data

Data collected by APRA under a reporting standard is protected information under section 56 of the *Australian Prudential Regulation Authority Act 1998* (APRA Act). APRA may disclose protected information in certain circumstances, including where APRA has determined the information to be non-confidential under section 57 of the APRA Act. APRA intends to determine ARS 115.0 data to be non-confidential for the purposes of section 56 of the APRA Act and, accordingly, seeks feedback on this proposal.

ARS 115.0 will commence on 1 January 2021 for AMA ADIs and on 1 January 2022 for all other ADIs.

The proposed reporting standard, reporting forms and instructions are available on the APRA website. APRA welcomes feedback on the proposed collection, including the instructions in the draft reporting standard, the proposed implementation timeline and the treatment of ARS 115.0 data as non-confidential.

Written submissions on draft ARS 115.0 should be sent to DataAnalytics@apra.gov.au by 21 February 2020 and addressed to:

Senior Manager, Data Strategy and Frameworks
Data Analytics and Insights
Australian Prudential Regulation Authority

Yours sincerely,

John Lonsdale
Deputy Chair

Attachment A — Regulatory costs

This Attachment sets out the steps taken in finalising the operational risk requirements for ADIs, including details of compliance cost estimates for the implementation of the requirements.

The February 2018 discussion paper outlined three options for proposed revisions to the capital framework for ADIs, including operational risk capital requirements. These proposed changes include the associated reporting requirements. The options were:

Table 1. Summary of options

Options	Approach
Option 1: Increase minimum CET1 capital ratios	Increase the minimum CET1 capital ratio for each ADI under APRA's current capital adequacy framework.
Option 2: Implement Basel III reforms	Modify the current capital adequacy framework through implementing the Basel III reforms relating to credit risk, operational risk, market risk, credit valuation risk and interest rate risk in the banking book (IRRBB).
Option 3: Implement Basel III reforms, adjusted for Australian conditions	Modify the current capital adequacy framework through implementing the Basel III reforms, adjusted to accommodate Australia-specific factors.

Assessment of regulatory costs

As part of its public consultation, APRA sought information from stakeholders on the compliance impacts of the proposed changes to the capital framework for ADIs, including associated substantive costs. Respondents were asked to use the Australian Government's Regulatory Burden Measurement Tool (RBMT) to assess regulatory costs.

While none of the submissions provided regulatory costs estimates using the RBMT, APRA received detailed cost impacts from one ADI as part of the submissions process.

Option 1: Increase minimum CET1 capital ratios

Under this option, APRA would raise the minimum CET1 capital ratio applying to an ADI. A portion of this proposed increase would be attributable to the operational risk capital charge. This option would not involve adjustments to the existing operational risk requirements. Hence, no costs would be incurred by ADIs.

Table 2. Average annual regulatory costs

Sector	Business	Community organisations	Individuals	Total change in costs
Total change in cost by sector ($ million)	0	0	0	0

Option 2: Implement Basel III reforms

Under this option, APRA would amend the current capital framework to implement the Basel Committee's Basel III reforms relating to credit risk, operational risk, market risk, CVA risk and IRRBB, applying these revisions to all ADIs as relevant (i.e. whether they are standardised or IRB ADIs).

In terms of operational risk, APRA would replace its existing operational risks – *Prudential Standard APS 114 Capital Adequacy: Standardised Approach to Operational Risk* which applies to all standardised ADIs (approximately 100 ADIs) and *Prudential Standard APS 115 Capital Adequacy: Advanced Measurement Approaches to Operational Risk* which applies to five ADIs. Under this option, the existing approaches to operational risk would be replaced with a new Standardised Measurement Approach set out in a new *Prudential Standard APS 115 Capital Adequacy: Standardised Measurement Approach to Operational Risk* (new APS 115).

Table 3. Average annual regulatory costs

Sector	Business	Community organisations	Individuals	Total change in costs
Total change in cost by sector ($ million)	1.77	0	0	1.77

Option 3: Implement Basel III reforms, adjusted for Australian conditions

Under this option, APRA more generally is proposing to apply a simplified framework to ADIs who meet certain criteria – but typically it will mean small ADIs would only have to apply a simple capital add-on to risk-weighted assets for operational risk purposes. This would leave approximately 17 ADIs who would need to apply the new operational risk prudential requirements set out in the new APS 115. This would substantially reduce the overall complexity of operational risk requirements for capital purposes as the existing modelling approaches allowed under APS 115 would be removed and all ADIs would need to apply a approach to operational risk – either the simple capital add-on to risk-weighted assets or the Standardised Measurement Approach for determining the capital to be held against operational risk. Overall costs of this option are expected to be limited with a low cost impact on an industry-wide basis and for individual ADIs.

Table 4. Average annual regulatory costs

Sector	Business	Community organisations	Individuals	Total change in costs
Total change in cost by sector ($ million)	1.09	0	0	1.09

Conclusion

Option 1 results in no additional compliance costs as it essentially maintains the status quo. This option is not considered feasible by APRA as it would mean that APRA's capital framework would not align with the international Basel capital standards that the Australian Government has agreed to implement.

Option 2 results in a complete overhaul of the operational risk capital requirements for ADIs. It removes the existing option that allows ADIs to use their own models to estimate capital for operational risk purposes and replaces it with a simplified approach known as the Standardised Measurement Approach (SMA).

Option 3 adopts the same basis for operational risk capital requirements for ADIs as Option 2, but adjusts this approach to reflect Australian conditions. Under this approach, APRA would exercise its national discretion to not implement the loss component of the Basel framework and instead set operational risk requirements equal to a business indicator component for ADIs.

While all three options are assessed as having low net compliance and regulatory costs, only Option 3 meets the criteria for implementing the international Basel capital standard for the assessment of capital for operational risk purposes, while at the same time recognising Australian conditions.

Table 5. Summary of net benefits of each option

	Option 1	Option 2	Option 3
Compliance cost	No change	Low cost	Low cost
Meets minimum international regulatory requirements	Does not meet this criterion	Meets this criterion	Meets this criterion
Considers local conditions	Does not meet this criterion	Does not meet this criterion	Meets this criterion
Overall	Low net cost	Low net cost	Low net cost

Implementation and review

APRA will release the final operational risk capital requirements before the end of 2019, with effect from 1 January 2021 for those ADIs currently subject to existing APS 115 and from 1 January 2022 for all other ADIs. In addition, APRA has commenced consultation on a new reporting standard ARS 115.0, which will collect data from ADIs reflecting the prudential requirements set out in APS 115.

APRA's prudential framework is regularly reviewed, including consideration of whether the requirements continue to reflect good practice, remain consistent with international standards and remain relevant and effective in facilitating sound risk management practices.