Feedback on changes to authorised deposit-taking institution (ADI) reporting standards affected by implementation of the new Prudential Standard APS 220 Credit Risk Management

After a comprehensive analysis of draft standards proposed to bring the respective standards in line with the new APS 220, we find certain inconsistencies (listed further in this document), which if addressed, could help to bring greater clarity and understanding.

Guide to read:

- Excerpts from the standard used for references are added with this *"font".*
- Existing ARS 220.0 – Impaired facilities is referred as 'current ARS 220.0'.
- Proposed draft ARS 220.0 – Credit exposures and provisions is referred to as 'new draft ARS 220.0'.

1. ARS 220.0 – Consolidation level

In the current ARS 220.0 - Impaired facilities, consolidation level was explained as follows:

"Consolidated ADI group

This refers to the consolidated group of the reporting ADI at Level 2 (i.e. the consolidated banking group level) defined in accordance with the ADI Prudential Standard APS 110 Capital Adequacy.

The basis of consolidation required in this form is in accordance with the prudential consolidated ADI group. The prudential consolidated group should also be determined in accordance with Australian accounting standards, notably AASB 127 Consolidated and Separate Financial Statements with the following modifications:

1. Include the following:

- *all controlled banking entities, securities entities and other financial entities (e.g. finance companies, money market corporations, stockbrokers and leasing companies).*

2. Exclude subsidiary entities involved in the following business activities:

- *insurance businesses (including friendly societies and health funds);*
- *acting as manager, responsible entity, approved trustee, trustee or similar role in relation to funds management or the securitisation of assets;*
- *non-financial (commercial) operations; and*
- *special purpose vehicles whose assets have satisfied the clean sale requirements in APS 120)."*

These paragraphs have been deleted in the new draft ARS 220.0 leaving only the definition below, without listing the exclusions which made its consolidation level separate from AASB 127.

"consolidated ADI group means a group comprising:

(a) an ADI that is a highest parent entity; and

(b) each subsidiary (within the meaning of Accounting Standard AASB 127) of that ADI, whether the subsidiary is locally-incorporated or not, other than a subsidiary that is excluded by the instructions attached to this standard."

The change in consolidation level will be a major consideration, especially if the changes intended were only to align the standard with new APS 220.

It will also no longer be in alignment with ARS 230.0 which follows the same consolidation level and which has remined undisturbed for this part in its new draft.

2. ARS 220.0 – Doubts surrounding inclusion of market related off-balance sheet exposures.

As part of the guidance for balance outstanding, under the heading Scope, point 1, the current ARS 220.0 has three paragraphs for direct credit substitutes, commitments and market related off-balance sheet exposures respectively. Out of which the following content is no longer part of new draft ARS 220.0 while retaining the content of direct credit substitutes and commitments as it is.

"The credit equivalent amounts of market related off balance sheet transactions in the ADI Off Balance Sheet Business Form, which meet the definitions of impaired facilities. The credit equivalent amount must be calculated using the current exposure or mark-to-market method unless another method has been approved in advance by APRA. Potential credit add-ons should reflect the nature of the individual exposure involved. Derivative transaction exposures should be revalued regularly so as to maintain reasonably current assessments of the extent of credit risk attaching to those transactions."

This specific exclusion of market related off-balance sheet exposures (which are mainly derivative instruments) from the new draft ARS 220.0 casts doubt on whether the intent is to remove these from the scope of the report.

However, if new APS 220 is referred, these derivative instruments are covered as part of off-balance sheet exposures for assessment of non-performing exposures.

Hence if the intent is to exclude these from scope of new ARS 220.0, a more direct instruction will be helpful. In case this is not the intent, then retaining the paragraph for market related off balance sheet exposures will be helpful to maintain the existing scope and practice.

3. Reference to APS 220 for General reserve for credit losses (GRCL) and usage of terms 'Specific', 'General' for provisions

ARS 325.0 requires reporting of 'General provision' in Part 4 of the report. The guidance for the same has been updated as follows in the new draft ARS 325.0:

"General provision refers to the General Reserve for Credit Losses as defined in APS 111 Capital Adequacy: Measurement of Capital and APS 220 Credit Risk Management."

However General Reserve for Credit Losses (GRCL) is no longer defined in new APS 220. APS 111 also only cross references the term from APS 220.

Hence the reference to APS 220 is no longer valid and modifications may be required to define the term 'General provision' without the reference to GRCL or may be substituted with different information depending on APRA's needs.

It may also be evaluated if the terms 'specific provisions' and 'general provisions' across these standards should be replaced with 'individual provisions' and 'collective provisions' as used and defined for EFS using accounting standards as a reference.

Similar to above, the new draft for ARS 210.0 retains the term 'General reserve for credit losses' and also continues its usage in the guidance for ARF 210.6 which may have to be revised. Excepts below:

*"**General Reserve for Credit Losses** has the meaning given in Prudential Standard APS 220 Credit Quality."*

"Section B: Required stable funding

*This section captures the carrying value of assets and the amount of off-balance sheet exposures that are used as inputs for the calculation of RSF. Assets should be reported net of the associated **General Reserve for Credit Losses** that has not been included in item 1 above and specific provisions."*