Australian Prudential Regulation Authority

APRA

Annual Report 2010

The Australian Prudential Regulation Authority (APRA) is the prudential regulator of the Australian financial services industry.

It oversees Australia's banks, credit unions, building societies, life and general insurance companies and reinsurance companies, friendly societies and most of the superannuation industry. APRA is funded largely by the industries that it supervises. It was established on 1 July 1998.

APRA currently supervises institutions holding approximately $3.7 trillion in assets for 22 million Australian depositors, policyholders and superannuation fund members.

APRA vision, mission and values

Our vision is to be a world-class integrated prudential supervisor recognised for its leadership, professionalism and innovation.

Our core mission is to establish and enforce prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by institutions we supervise are met within a stable, efficient and competitive financial system.

We also act as a national statistical agency for the Australian financial sector and play a role in preserving the integrity of Australia's retirement incomes policy.

Our values underpin the critical role we play in protecting the financial well-being of the Australian community. High standards are required in everything we do. In our work and in our interactions with others, we value and seek to demonstrate:

Integrity

Collaboration

Professionalism

Foresight

Accountability

Our supervisory approach is forward-looking, primarily risk-based, consultative, consistent and in line with international best practice. The approach also recognises that management and boards of supervised institutions are primarily responsible for financial soundness.

Australian Prudential Regulation Authority

400 George Street (Level 26)
Sydney NSW 2000

GPO Box 9836
Sydney NSW 2001

T 02 9210 3100
F 02 9210 3102
W www.apra.gov.au

John F. Laker AO
CHAIRMAN

12 October 2010

The Hon Wayne Swan, MP
Deputy Prime Minister and Treasurer
Parliament House
CANBERRA ACT 2600

Dear Deputy Prime Minister,

In accordance with Section 59 of the *Australian Prudential Regulation Authority Act 1998*, I am pleased to submit the Australian Prudential Regulation Authority Annual Report and Financial Statements for the year ended 30 June 2010.

Yours sincerely,

John Laker

Contents

Chapter one

From the Chairman

The crisis recedes

The Australian financial system was able to draw breath in 2009/10 after the global turmoil of the previous two years. Extraordinary actions taken during that turmoil by governments and central banks, including in Australia, ensured that the worst fears about the impact of the global financial crisis did not materialise. Though unevenly across regions, the global economy began to recover at a somewhat faster rate than expected and, until the final months of 2009/10, access to global funding markets became more assured and investor confidence returned to equity markets, overseas and in Australia. The Australian economy, supported by stimulatory policy settings and the rebound in Asian export markets, continued to perform much better than most other advanced economies. Growth returned to its trend rate after only a brief slowdown, the unemployment rate retraced much of its earlier sharp increase and measures of consumer and business confidence moved back into positive territory. Not surprisingly, this favourable environment encouraged financial institutions regulated by APRA to move out of defensive mode to something closer to a 'business as usual' approach.

Not so APRA itself. When the global financial crisis erupted, APRA stepped up the intensity of its supervision markedly and it was not ready during 2009/10 to reduce that tempo. As APRA saw it, the global economic outlook remained clouded by uncertainties. The recovery in some advanced economies was not firmly rooted, the unwinding of the extraordinary public interventions was presenting serious policy challenges and banking systems in a number of economies were still undergoing repair. Global reforms to strengthen the resilience of the global financial system were not yet in place. Market sentiment, though improving, had an underlying fragility. That fragility resurfaced in the final months of the year when a spotlight on European sovereign debt problems led to a sharp decline in equity prices around the globe and heightened uncertainties, yet again, about the openness of global funding markets.

Authorised deposit-taking institutions (ADIs) have been subject to APRA's closest scrutiny during the global financial crisis. These institutions (banks, building societies and credit unions) were most exposed to the crisis through its impact on the cost and availability of wholesale funding and on global economic activity. For ADIs, these impacts waned over 2009/10 as funding conditions improved and the Australian economy regathered momentum. The Australian Government's Guarantee Scheme for Large Deposits and Wholesale Funding proved pivotal in bridging the gap before investors in global funding markets regained the confidence to lend unguaranteed, in turn enabling the larger ADIs to get a head start in meeting their 2009/10 funding needs. The guarantee was subsequently removed without unsettling effects. Average funding costs remained above the unrealistically low levels they had reached before the crisis but many ADIs were able to protect interest spreads through increasing risk margins on their lending. Notwithstanding subdued growth in overall lending volumes, the strength in core earnings and reductions in bad debt expenses as a consequence of better trading conditions gave a strong lift to ADI profitability over 2009/10. There was no repeat of the large equity raisings of the previous year but profit retention has taken ADI capital ratios to their highest levels for 15 years.

The life insurance and superannuation industries were exposed to the global financial crisis in a different way, through its impact on global and domestic equity and fixed-interest markets. The strong recovery in equity markets from earlier crisis lows, which continued until the final months of 2009/10, ameliorated a major source of pressure on the capital positions of life insurers, which a number of insurers had taken various measures to reinforce. The recovery also enabled most superannuation funds to earn positive returns for the year, after two consecutive years in the red. The general insurance industry, in contrast, has been left largely unscathed by the crisis. The industry is well capitalised and profitable, although recent results mask a deterioration in underlying profitability. Again, severe weather-related events impacted on the industry's performance in 2009/10.

Most recently, global financial markets have settled after the tremors from European sovereign debt concerns but the cloud over the global growth outlook persists, and may even have darkened a little in some major economies. For Australia, however, economic prospects remain bright, particularly as a strong terms-of-trade effect works its way through, and this augurs well for the operating environment for financial institutions. At the same time, the fallout from the global financial crisis has left households and many business sectors in Australia much more cautious, as evidenced by the slowdown in overall credit growth to its lowest rate since the early 1990s recession. If that caution were to continue, financial institutions anticipating an easy return to double-digit volume growth may be disappointed and may find, instead, that they are dissipating their energies in the pursuit of market share for its own sake, with all the risks that entails. The strategic ambitions of financial institutions as they emerge from the crisis will therefore be a major focus of APRA's attention over the coming period.

APRA's supervisory activities

As the operating environment improved over 2009/10, APRA's interactions with its regulated institutions moved from preventative to largely remedial in nature. For a number of institutions, the global financial crisis had exposed weaknesses, of varying severity, in governance arrangements, the quality of risk management, business models or capital positions. These matters received the most immediate supervisory attention. One pleasing outcome was that, over the second half of the year, the number of institutions upgraded under APRA's risk-rating system exceeded the number downgraded. APRA also worked closely with institutions that were undertaking substantial acquisitions or contemplating major strategic initiatives. APRA did not need, however, to draw on the teams of supervisors and specialist risk staff it had brought together earlier in the crisis to deal with specific industry-wide risks in the ADI and life insurance industries.

The fact that emergency crews were on standby only did not mean that APRA scaled back its focus on emerging industry-wide risks over 2009/10. On the contrary, APRA has now established a formal structure and dedicated resourcing for this 'thematic' or macroprudential work. APRA has risk registers for each of the regulated industries, in which risks are graded by their potential severity, and it assigns risk owners whose task it is to scope the appropriate mitigating actions, determine resources and timeframes and see the actions through to conclusion. Some of the higher industry-wide risks on APRA's radar currently are discussed in the next chapter of this *Report*. A macroeconomic stress-test of capital adequacy in the ADI industry conducted by APRA during 2009/10 was an essential part of this thematic work. Since the global financial crisis did not prove as demanding a real stress-test in Australia as in many other countries, APRA needed to understand what 'near death' could imply for ADIs and whether capital buffers would be sufficient. The macroeconomic stress-test, developed in conjunction with the Reserve Bank of Australia and the Reserve Bank of New Zealand, generated an economic downturn in Australia significantly worse than that experienced in the early 1990s recession and more severe than that built into recent macroeconomic stress-tests in some other countries. The results confirmed that the ADI industry has the capital resources to weather much greater adversity than it has confronted to date.

Though it has stepped up its supervisory intensity, APRA has not changed its risk-based approach or its supervisory culture through the crisis. APRA is a 'hands-on' and robust prudential regulator and its spine has been stiffened since the early years of this decade. APRA seeks an open, productive and cooperative relationship with regulated institutions built on mutual respect, and achieves this in the large majority of cases. APRA also seeks to foster effective 'partnerships' with boards of regulated institutions that can enable it to get to the nub of prudential issues quickly. APRA's supervisory strategy is to intervene early, and often but mildly, when an institution is first seen to stray. The fact that APRA has strong supervisory powers and the willingness to use them – realities that are now well understood in its regulated industries – means that it can usually be effective without deploying the more powerful tools in its armoury. So it has proven during the global financial crisis, when APRA has needed to use its formal powers on only a limited number of occasions to achieve its supervisory objectives.

Issues of supervisory culture and effectiveness are now attracting closer attention from global policymakers. This reflects the growing recognition that differences in supervisory effectiveness are one reason why some advanced countries with similar financial systems, operating under the same broad set of global regulations, were less affected than others in the crisis. In this context, APRA is being cited as an example of good supervision in practice. At their Toronto Summit in June 2010, the Leaders of the G-20 identified effective supervision of the banking system as the 'second pillar' of the current global reform agenda and called on the Financial Stability Board to develop recommendations to strengthen prudential oversight and supervision. The Board is to look at the mandate, capacity and resourcing of supervisory agencies as well as the powers that are needed to identify and address risks. APRA has joined a dialogue between supervisory agencies to share practical experiences from the crisis and provide input to the Board. Having been tested under fire more than once, APRA is confident that its risk-based approach to supervision meets the International Monetary Fund's recent tests that good supervision be 'intrusive, sceptical, proactive, comprehensive, adaptive, and conclusive'. Those words have a familiar echo to APRA!

Regulatory responses

The 'first pillar' of the global reform agenda is, of course, a strong regulatory framework that will promote a more resilient global banking system. That agenda was established by the Leaders of the G-20 in their April 2009 Declaration, *Strengthening the Financial* System, and it has been driven hard and on a tight timetable. One goal is to strengthen capital regulation by increasing the quality, quantity and international consistency of capital, discouraging excessive leverage and risk-taking and reducing procyclicality. Another goal is to strengthen liquidity regulations by introducing internationally harmonised global liquidity standards. A third goal is to implement 'tough' principles aligning remuneration in banking institutions with prudent risk management and the long-term financial soundness of these institutions.

APRA has been actively involved in the reform process, particularly through its membership of the Basel Committee on Banking Supervision, the global standard-setting body for banking regulation. The work has gained considerable momentum globally as the G-20's target to finalise capital and liquidity reforms by the end of 2010 looms. It has put APRA's policy resources under much the same pressure as its supervisory resources.

The Basel Committee's proposals to meet the G-20's first goal – strengthening capital regulation – have been released in two stages. In July 2009, a package of enhancements to the three Pillars of the Basel II Framework was announced. These included a revised market risk framework that would *inter alia* increase capital requirements for complex structured products and securitisation activities. This revised framework, subsequently adjusted, will come into effect no later than the end of 2011 but will have only a limited impact on ADIs in Australia, which largely avoided higher-risk trading activities and proprietary risk-taking.

In December 2009, the Basel Committee released a comprehensive package of proposals to raise the quality, consistency and transparency of the capital base, establish a back-up leverage ratio and introduce a framework for countercyclical capital buffers. Over subsequent months, a comprehensive quantitative impact study of these proposals was conducted, as well as assessments of their transitional and long-run impact. APRA was actively involved in the study and the high quality of information provided by participating ADIs has been acknowledged. The calibration of the package has obviously required careful judgment. Global capital requirements set too low may fail to insulate banking institutions from distress and, as a consequence, may not reduce the probability of future banking crises, the major objective of the reforms. Requirements set too high may have the perverse effect of encouraging pursuit of higher-risk activities to generate income to service the capital, or of shifting risk to the unregulated sector; they could also increase the cost of credit provision unduly.

Broad agreement on the definition of capital and the leverage ratio, and on the overall calibration of the capital reforms, has now been reached. The agreed package gives much greater weight to common equity in the capital base, raises the minimum requirements for common equity substantially and introduces stricter eligibility criteria for other forms of capital and for regulatory capital adjustments. The package also formalises two capital buffers – a conservation buffer above the regulatory minimum capital requirement that is intended to be drawn down in periods of stress, subject to restrictions on capital distributions, and a countercyclical buffer that will come into effect when excessive credit growth is leading to a build-up in systemic risk.

The tougher approach to capital quality is unlikely to have significant implications for ADIs in Australia. Before the global financial crisis, APRA had taken a more conservative approach to the definition and composition of ADI capital and this has served Australia well. APRA will therefore need to be convinced to depart from its previous 'in principle' decisions on capital simply to align with global minimum standards, where these are lower. The increase in minimum capital requirements will have an impact on a number of larger ADIs but this should be readily manageable in view of current levels of profitability and the generous transition period provided. The concept of a conservation buffer is yet to be tested in practice but it will be important that markets allow the buffer to be drawn down in times of stress; otherwise, ADIs will feel compelled to operate well above the buffer level, thereby creating a much higher *de facto* minimum. The proposed leverage ratio appears unlikely to act as a binding constraint on ADIs in Australia.

The Basel Committee's proposals to meet the G-20's second goal – strengthening liquidity regulation – were included in the comprehensive package released in December 2009. Their aim is to promote stronger liquidity buffers that provide the first line of insurance against severe liquidity stress and avoid the moral hazard that would be encouraged if banking institutions, as they did during the global financial crisis, turned immediately to their central bank instead. The proposals introduced two global regulatory standards for liquidity risk – a 30-day liquidity coverage ratio to address an acute stress scenario and a longer-term structural liquidity ratio. In contrast to the capital reforms, the proposed liquidity coverage ratio does pose problems for Australia, since the volume of high-quality liquid assets (particularly government securities) needed to meet the requirement is simply not available. Acknowledging this reality, the Basel Committee is considering refining the standard to accommodate countries in this position. This is not a concession to Australia and nor should it be. Given the use that the larger Australian banks make of offshore wholesale funding, and the intense market scrutiny that accompanies this use, APRA's prudential framework for liquidity risk management cannot be any less robust than the global standards. Alternative arrangements are under discussion with the Reserve Bank of Australia and the Basel Committee.

Policy development on the G-20's third goal – improved remuneration incentives – has been completed and the task now is to secure improvements in practice. APRA played an active role in the drafting of the Financial Stability Board's principles on sound compensation (released in April 2009) and its implementation standards (released in September 2009). APRA has given effect to these principles through extensions to its governance standards in the ADI and insurance industries, introduced from April 2010 after extensive consultation. APRA's principles-based approach allows boards of regulated institutions to design remuneration arrangements that suit their organisation's structure and risk profile, provided APRA's requirements are met. APRA does not prescribe a single or preferred set of arrangements. Methods used by institutions to adjust remuneration to risk and performance are continuing to evolve, in Australia and internationally, but APRA is seeing improvements in remuneration structures and policies. Nonetheless, gaps remain between current market practices and APRA's expectations for risk adjustment, particularly when poor risk outcomes have materialised. Consultations with industry on how these gaps can be closed will continue.

Beyond its participation in global reform initiatives, APRA's prudential policy agenda is being shaped by the global financial crisis in other ways as well. The severe contagion problems that beset a major global insurance group highlighted the need for supervisors to be able to take a group-wide view of their regulated institutions and to understand the full range of risks that arise from group membership. Acknowledging this, APRA has released a proposed prudential framework for conglomerate groups that is path-breaking in many respects, and is now subject to detailed consultation. APRA is also reviewing, and harmonising where it can, capital standards in the general and life insurance industries in the light of recent experience of pronounced equity market volatility. For life insurers in particular, the changes APRA is proposing offer scope for a significant improvement in the risk-sensitivity of the capital framework. Away from crisis responses, APRA's agenda in the coming period will also be determined by the Government's response to the Cooper Review of the superannuation industry.

APRA Members in 2009/10 – (left to right) **Mr Ross Jones, Dr John Laker** and **Mr John Trowbridge**.

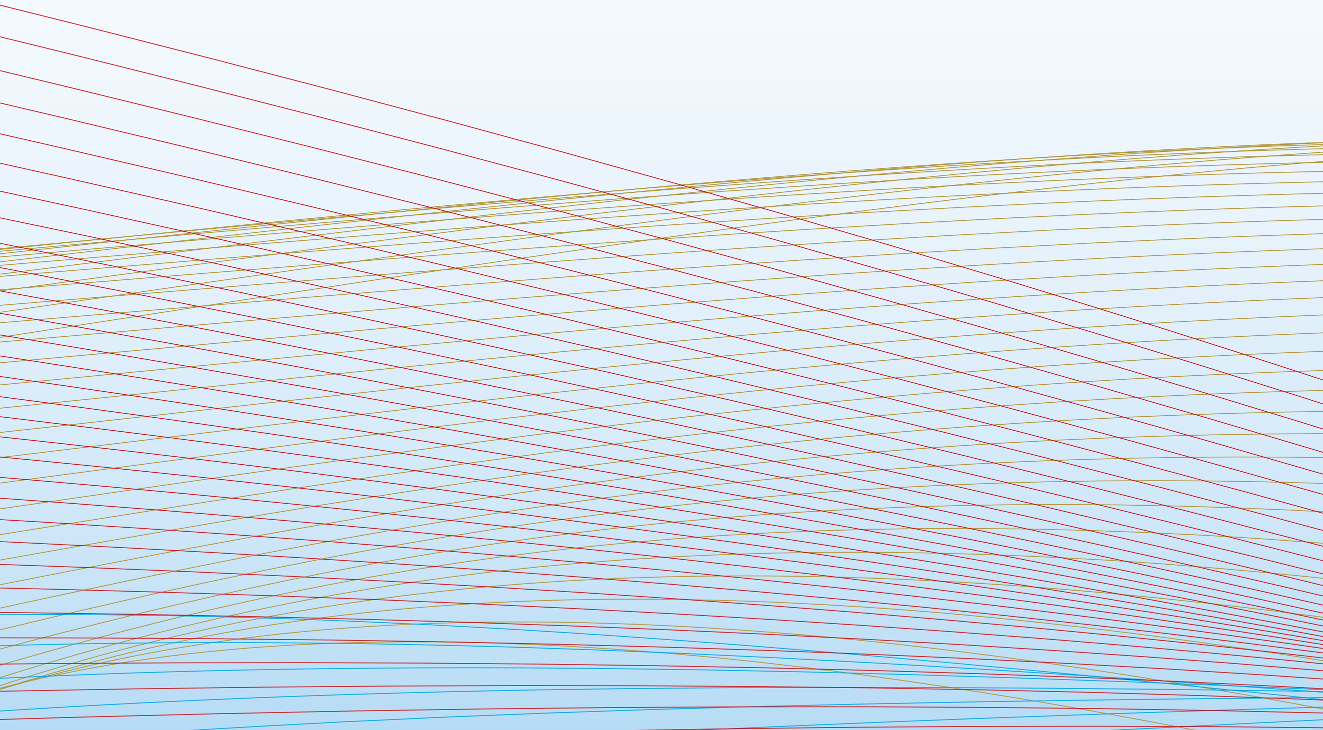
Our people

Maintaining the intensity of APRA's supervisory activities and of its prudential policy agenda through the vagaries of the global financial crisis has made significant demands on the skills, judgment and tenacity of APRA's staff. They have been tireless in response, whether in pursuit of sound prudential outcomes, their involvement in reform initiatives or their support of the various systems and functions on which a complex, integrated regulator like APRA is dependent for its efficient operation. The APRA Members greatly appreciate the outstanding commitment of each one of its now battle-hardened staff over this challenging period. APRA's ability to sustain its tempo has also been assisted by the special funding (ending after 2011/12) provided by the Government to deal with the global financial crisis and by two years of relatively low staff turnover. That latter good fortune is changing, however, as a more confident financial system once again looks at APRA as an attractive recruiting ground.

On 30 June this year, John Trowbridge's term as an APRA Member, which spanned a four-year period, came to an end. Over this period, John's actuarial and industry experience, his pragmatism and his determination to get to the heart of policy and supervisory issues put their stamp on a range of APRA's policy developments, particularly on remuneration, and on its dealings with major insurance companies. John has been replaced by Ian Laughlin, whose three-year term took effect from 1 July. Ian's appointment continues APRA's recent practice of having a third Member with considerable insurance industry experience and skills, gained in Ian's case over a long career in the life insurance industry in Australia and abroad.

John Laker

Dr John F Laker
Chairman



Chapter two

APRA's supervisory activities in 2009/10

Authorised deposit-taking institutions

Authorised deposit-taking institutions (ADIs) in Australia have emerged from the global financial crisis in a considerably stronger position than many of their overseas peers. This outcome reflects a range of factors, including the resilience of the Australian economy, the predominance of lower-risk housing lending portfolios in ADI balance sheets, minimal exposures to the complex financial instruments that precipitated large losses for offshore banks, and only limited exposures to countries and banking systems at the epicentre of the crisis. Other key factors were public policy interventions that underpinned access to funding, and investor confidence in Australia's regulatory and supervisory arrangements. ADIs were affected, nonetheless, by the pronounced impact of the crisis on the cost and availability of wholesale funding and they were unable to avoid credit losses and higher levels of provisioning, particularly in their corporate and commercial real estate portfolios. As it has turned out, a significant part of these losses arose early in the crisis from exposures that some ADIs had to certain high-profile corporations whose business models were no longer viable; additional credit cycle effects proved to be more muted than had been earlier expected because of the better economic outturn in Australia. Residential mortgage portfolios continued to perform well. Overall, credit losses were significantly lower than those experienced by banks in many offshore jurisdictions during the crisis, and experienced in Australia's early 1990s recession.

The ADI industry on the whole remains quite profitable and well capitalised. Despite solid growth in residential mortgage lending, growth in total credit in 2009/10 slowed to its lowest rate since the early 1990s recession, with business credit still very subdued after its sharp contraction once the crisis erupted. Nonetheless, profit levels for most ADIs rebounded in 2009/10 as a consequence of strong core earnings and a turning in the bad debt cycle. Although average funding costs remained well above pre-crisis levels (a situation that is likely to continue), many ADIs have been able to offset the impact through increasing risk margins on their lending. Returns on equity for the larger ADIs moved towards the mid teens. There was no repeat in 2009/10 of the substantial equity issues the previous year but, with the continuing emphasis on profit retention, capital ratios for the ADI industry as a whole are at levels last seen in the mid-1990s. The substantial industry consolidation spurred by the crisis had no further rounds over the year although the departure of smaller credit unions continued a sustained downward trend.

Liquidity and funding

APRA maintained its intense focus on the management of liquidity and funding by ADIs in 2009/10, notwithstanding the continuing improvement in access to funds and in spreads over most of this period. That improvement dates back to the unprecedented policy responses by sovereign governments and central banks to address the acute global funding pressures that emerged in the latter part of 2008. In Australia's case, those responses included the introduction of the Financial Claims Scheme covering ADI deposits up to $1 million per depositor and the Government's Guarantee Scheme for Large Deposits and Wholesale Funding announced in October 2008; they also included an increase in the flexibility of the Reserve Bank of Australia's (RBA) domestic market operations.

As global funding conditions improved over 2009 and the early part of 2010, the larger ADIs took the opportunity to bring forward their 2009/10 funding and reduced their use of the Government's wholesale funding guarantee, instead issuing more favourably costed unguaranteed debt. Reflecting the improved conditions, the Government closed the wholesale funding guarantee to new issuance after end-March 2010. At its peak, almost $150 billion of longer-term wholesale funding was raised under this guarantee. ADIs also reduced their reliance on liquidity support arrangements with the RBA. The increased availability of term funding gave ADIs the opportunity both to build up liquidity buffers (now being slowly unwound) and to lengthen the maturity profile of their funding books; ADIs have also competed intensely for retail deposits.

While the larger ADIs were able to pre-fund a sizeable portion of their 2009/10 funding needs, there remains a large volume of wholesale debt that will mature in 2010/11 and in following years. Given the use that the larger Australian banks make of offshore wholesale markets, wholesale funding is a major area of supervisory focus, especially since governments and banks offshore are accessing global funding markets on a larger scale than has been the case for some time. Over recent months, European sovereign debt concerns have jolted sentiment in global funding markets and have pushed out spreads, although spreads remain well below their crisis peaks. Australian banks have, nonetheless, continued to retain ready access to these markets.

APRA will continue to closely monitor and assess the liability structure, liquidity management and forecast funding requirements of ADIs, drawing on the detailed liquidity and funding reports it has been receiving during the crisis. APRA welcomes the increased engagement it has observed on the part of ADI boards and senior management in funding issues and contingency planning. ADIs are also increasingly recognising the importance of differentiating between stable and non-stable funding sources when monitoring their liability risk profiles; larger ADIs are now capturing this distinction in internal benchmarks that are used to guide funding decisions. This work will provide a solid preparation for implementing global reforms on the longer-run structure of funding.

Credit quality

APRA has continued its close monitoring of ADI credit quality and the adequacy of provisioning. Despite forecasts of major loan losses arising out of the global financial crisis, credit quality has proven to be significantly more robust than in the early 1990s recession. Though non-performing loan rates have risen across all lending portfolios, the overall rise has been modest and has plateaued at a level only one-quarter of that experienced in the early 1990s. The rate at which new impaired loans have emerged appears to have peaked in late 2008 but remains well above pre-crisis levels. Commercial property exposures have been the main source of impaired assets and affected ADIs have reacted by scaling back their property lending or substantially amending their underwriting practices. ADIs have also strengthened covenants and have required higher collateral in their corporate and SME lending. In contrast, non-performing loan rates in housing lending remain quite low, with only a very gradual rise in customers entering arrears.

In monitoring ADI credit quality, APRA has been collecting a range of additional information and has been reviewing ADIs' own 'watchlists', large exposures and industry concentrations. It has also continued its normal practice of on-site visits to assess credit risk issues. In the case of commercial property exposures, APRA's focus has been on whether ADIs have been taking an appropriate portfolio-level view of this form of lending and have been subjecting the exposures to rigorous stress-testing, particularly by geographic region. APRA has also stepped up its oversight of credit standards in ADI housing lending, against the backdrop of earlier signs of aggressive lending at high loan-to-valuation ratios and recent rises in mortgage interest rates. In addition, APRA has been reviewing provisioning practices (including methodologies, models and governance) and compliance with its provisioning requirements. In a number of cases, APRA required changes to be made to provisioning methodologies that led to increases in provisions.

Under the Basel II Framework, APRA has granted approval to five banks to use their internal models as the basis for calculating their regulatory capital requirements for credit risk and other key risks. During 2009/10, APRA undertook a series of validation visits to these 'advanced' banks to assess the performance of these models and whether the models needed to be recalibrated or modified in the light of experience. This validation work will be a critical part of APRA's continuing oversight of the application of the Basel II Framework in Australia.

Securitisation

The securitisation market in Australia, an important source of funding and capital management for regional banks and other ADIs before the global financial crisis, showed some welcome signs of life in 2009/10, with the support of purchases by the Australian Office of Financial Management. However, spreads are still wide by historical standards. One feature of recent securitisations is that the originating ADI has retained all, or nearly all, of the most subordinated tranche(s), where credit risks associated with the securitisation transaction are concentrated. Longstanding prudential policy, in Australia and globally, is that ADI originators can only claim regulatory capital relief on securitisations if there has been significant credit risk transfer to third parties. In reviewing recent securitisations, APRA found that some originating ADIs had been applying this policy appropriately while others had not. Against this background, APRA wrote to ADIs in August 2010 restating its policy in this area and clarifying those features of securitisations that would not be consistent with the requirements for capital relief.

Stress-testing

In line with supervisors globally, APRA has considerably elevated the importance it attaches to robust stress-testing by ADIs (and other regulated institutions) and to its own conduct of stress-testing as a supervisory tool. ADIs have been undertaking increasing and more sophisticated use of stress-testing for planning and risk management purposes and stress-testing capabilities have continued to improve. In 2009/10, APRA reviewed the self-assessments prepared by the five 'advanced' banks against guiding principles issued by the Basel Committee on Banking Supervision; this review confirmed the improvement in capabilities but also indicated areas where further development was warranted. These include the construction of scenarios that confront an institution's business model with a genuinely 'severe but plausible' downside.

For its part, APRA conducts stress-testing to better understand the vulnerabilities facing individual institutions and industries and the potential for systemic threats. When the global financial crisis first struck, APRA conducted a range of stress tests on individual ADIs to determine their resilience in the face of a sharp decline in access to, and the cost of, offshore wholesale funding and the continued absence of securitisation markets. Once the potential severity of the crisis became clearer, APRA focused on identifying potential weaknesses in the capital position of individual ADIs as well as capital adequacy and availability for the Australian banking system as a whole. APRA undertook a further series of stress-tests of ADIs based on the information it had on their lending portfolios. This involved a number of internally generated scenarios based on expected default rates, underlying profit generation, dividend payout expectations and capital availability. Where weaknesses were identified, APRA addressed these with the ADIs concerned.

APRA followed up in 2009/10 with a more comprehensive stress-test of the 20 larger ADIs, based on a specified macroeconomic scenario developed in conjunction with the RBA and the Reserve Bank of New Zealand. The scenario was built around a continued deterioration of global economic conditions, with China's growth rate assumed to fall by at least as much as other countries and the fragility of North Atlantic banks acting as a drag on recovery and contributing to wider spreads in global funding markets. This global scenario generated an economic downturn in Australia significantly worse than that experienced in the early 1990s, with a large drop in commodity prices, a sharp rise in the unemployment rate and substantial falls in housing and commercial property prices. The stress-test showed that none of the 20 ADIs would have failed under the downturn macroeconomic scenario nor would any have breached the four per cent minimum Tier 1 capital requirement of the Basel II Framework.

General insurance

Because of its conservative investment policies and the resilience of the Australian economy, the general insurance industry has not been greatly affected by the global financial crisis. The industry remained profitable and well capitalised over 2009/10, with aggregate capital at end year almost twice APRA's minimum capital requirements.

Nonetheless, profitability has come under pressure over recent years and the operating environment is now more challenging and uncertain for insurers than in the years of stronger profits earlier in the decade, when insurers benefitted from a hard premium rate market, tort law reform, the absence of severe weather events and strong investment markets. Industry profits in recent years have been significantly boosted by high levels of prior-year reserve releases that may not be sustainable, and that are masking the deterioration in underlying accident year loss ratios. This deterioration has been driven by both premium rate reductions and adverse claims experience. Strong increases in premium rates for most classes of business over 2009/10 will help to redress the trend but market competition is a limiting factor. The commercial lines market remains highly competitive and the personal lines market, which is dominated by two large general insurance groups, has seen a number of new entrants providing web-based motor and home insurance.

A large proportion of the industry's premium revenue is derived from property classes of business; as a consequence, the financial performance of the industry is heavily influenced by the number and size of natural catastrophes. Over the past couple of years, a number of large weather-related events, including the June 2007 Hunter Valley storm, the February 2009 Victorian bushfires and the March 2010 storms in Melbourne and Perth, have had a significant adverse impact on insurers' profits. The combined cost of the latter storms is expected to be almost double that of the Victorian bushfires.

Against the background of pressures on profitability, APRA's supervision of the general insurance industry continues to pay particular attention to capital management. APRA has emphasised to insurers the importance of understanding the drivers of profitability and the linkages between them so that they are well placed to withstand adversity and grow their business. For its part, APRA has been closely monitoring trends in claims experience across major classes of business to identify potential industry pressure points and areas that may warrant closer oversight. During 2009/10, APRA also conducted a survey of the stress-testing undertaken by general insurers and reported to board level or equivalent. The survey indicated that there is room for improvement in this area. In particular, many insurers only tested for stresses on individual risk factors and did not consider a combined set of stress factors that would have a material impact on their profitability or capital position. Further, the level of the stresses considered by insurers was often not sufficiently severe to reflect a genuine stress scenario. Stress-testing in the general insurance industry, as in other APRA-regulated industries, has become an area of increased supervisory focus.

In its supervisory reviews of general insurers, APRA analyses the content and quality of key diagnostic reports that the Appointed Actuary prepares for the board and senior management. Insurance Liability Valuation Reports (ILVRs) are generally of a sound standard although, in some cases, the documentation around methods and assumptions could be enhanced. One key area lacking detail is the level of diversification benefit taken into account in the determination of insurance liabilities. The standard of Financial Condition Reports (FCRs) also continues to be good overall and APRA welcomes the improvements in certain areas. One such area is the greater detail about the insurer's standing in any wider group structure and the possibilities of contagion risk. Another area is the standard of commentary on asset/liability management. The recent environment of falling interest rates appears to have prompted more discussion in FCRs about the capital impacts of mismatches in asset/liability duration. Similarly, downgrades in the credit rating of some reinsurers have focussed attention on the credit risk associated with reinsurance counterparties.

Counterparty exposure

The exposure of the general insurance industry to reinsurers is a material source of counterparty risk, which APRA monitors closely. Reinsurance recoveries account for over 10 per cent of total industry assets; hence, the failure or significant downgrade of a major reinsurer would have serious implications for profitability and capital positions. The industry remains well positioned in dealing with this risk. Although there have been some downgrades in reinsurer ratings during the global financial crisis, over 90 per cent of reinsurance recoveries for the industry are due from reinsurers rated 'A' or above, and almost 50 per cent from reinsurers rated 'AA' or above. Reinsurance capacity in the Australian market appears adequate, with APRA-regulated reinsurers meeting around half of the industry's needs and the balance provided by foreign reinsurers. APRA regularly receives information on reinsurance counterparties of individual insurers through the Reinsurance Arrangement Statement (RAS) and sometimes through the FCR; however, this information is difficult to aggregate. To gain a better industry-wide understanding of the capital impacts of reinsurer downgrades, APRA is considering improvements to its data collection on reinsurance exposures, starting with a one-off collection of information.

Lender's mortgage insurers

The lenders mortgage insurer (LMI) sector in Australia, though small in absolute size, carries significant exposures to the housing market and the macroeconomic environment more generally. For that reason, APRA has always kept the sector under close scrutiny and it heightened that scrutiny during the global financial crisis as major offshore LMI companies, some of which own or reinsure Australian LMIs, came under intense pressure, particularly in the United States. Some offshore LMIs withdrew from the Australian market and reinsurance for LMI business became more difficult to obtain.

Despite the challenging global backdrop and a fall-off in premium income, LMIs operating in Australia reported an improvement in underwriting and operating performance in 2009/10 and a stronger capital base. Mortgage defaults have risen but remain relatively low. Nonetheless, in a rising mortgage rate environment, the potential for an increase in mortgage defaults to erode the capital base remains. LMIs initially responded to this risk by raising premium rates and tightening underwriting standards on certain types of new business, particularly high loan-to-valuation loans and non-standard loans, but recent evidence suggests that some of this tightening is being unwound. After a period of increases to claims provisions, some LMIs began to make releases from reserves in the second half of 2009/10.

Professional indemnity and directors and officers insurance

APRA is actively monitoring the industry's claims experience in professional indemnity and directors and officers (D&O) insurance. Litigation funders have become active in this area and the media has reported high levels of claims in these classes of business, arising out of corporate failures and from investment advisors giving poor advice. Policies in these classes are typically 'claims made'; in general, claims must be notified when the policy is in force and typically only a small proportion of notifications become claims. APRA has seen evidence of materially higher levels of claim notifications but it may take some years before the final number and costs of such claims is known. General insurers active in underwriting these classes of business in the Australian market have significant reinsurance protection (often with overseas parent companies). APRA's supervisory focus is on the strength of the reinsurance protection, the methodology for outstanding claims reserving and the approach taken to stress-testing for adverse claims outcomes.

National Claims and Policies Database

The National Claims and Policies Database (NCPD) is a database of policy and claims information relating to public and product liability insurance and professional indemnity insurance. It contains data on every policy underwritten and every open claim since 2003 from APRA-regulated general insurers. State and Territory insurers also contribute claims data on a voluntary basis. Aggregate data covering the year 2009 (including data from Lloyd's Australia for the first time) were released in June 2010.

After extensive consultation, APRA has now resolved the issue of the confidentiality protection to be applied to NCPD reports. APRA's intention had been to publish additional, more detailed reports that would enable more comprehensive analysis to be undertaken by risk factors such as industry or occupation groups and variations to product or policy coverage. However, these more detailed reports have taken some time to develop because of industry concerns about the protection of insurer confidentiality. APRA conducted one round of consultation at the end of 2008 to ascertain the industry's appetite for relaxing the confidentiality criteria, and another round in the second half of 2009 on the public interest and benefit in releasing liability insurance data and how these data would be affected by confidentiality protection.

As a result of the consultations, APRA determined that data contained within the NCPD reports are non-confidential, enabling it to publish the aggregate NCPD reports with no confidentiality masking in place. The 2009 report was the first to contain policy information without confidentiality masking; however, confidentiality protection remained in place for claims information. Policy information does not fall within the boundaries of privacy legislation since it relates to corporations and not individuals. Claims information, on the other hand, has privacy implications where the claimant is an individual rather than a corporation. APRA is currently addressing potential privacy issues relating to individual claims.

Life insurance and friendly societies

The recovery in domestic and global equity markets from crisis lows, which began in the first part of 2009 and continued over much of 2009/10, did much to ease the pressures on profitability and capital that had faced the life insurance industry (including friendly societies) earlier in the global financial crisis. Industry profitability returned to more typical levels with an improvement in fee revenues, higher investment income attributable to shareholders and continued strong growth in risk insurance premiums. Group insurance, largely through superannuation funds, now accounts for one-third of these premiums. In contrast, investment premium income, after excluding earlier one-off boosts, resumed its longer-term flat trend as superannuation business continued to be written outside life insurance companies. Over the year, life insurance assets rose moderately, due to the recovery in asset values rather than any significant increase in cash flows.

The recovery in profitability and in asset values saw the capital position of the life insurance industry return to pre-crisis levels. This development, in turn, allowed APRA to ease the intensity of its supervision, which has throughout the crisis been focussed on the capital strength of the industry and its capacity to withstand adverse financial market movements. That capacity had been subject in 2008 to detailed stress-testing by life insurers and by APRA, which identified the more vulnerable institutions requiring closer oversight. Consequent improvements in capital management and reporting have strengthened the industry's ability to absorb further shocks; most life insurers, for example, are now including stress-testing of their capital position in their Financial Condition Reports. That said, the return of equity market volatility in recent months, on European sovereign debt and global growth concerns, has moved APRA to a higher alert status.

Consolidation in the industry has continued through 2009/10. The number of life insurance licences did not change; however, a number of financial groups hold multiple licences and it is expected that these multiple licences will be rationalised in due course. The level of market concentration in life insurance (and the friendly societies sector) is now similar to that of the ADI and general insurance industries. Friendly society numbers fell to 16, half the figure seven years ago, but the declining trend in asset levels once the global financial crisis began was halted by improved investment performance on benefit funds, related mainly to funeral and education investment-linked products.

In coming years, the business models of life insurers (and other wealth management entities) may be significantly affected by responses to two major reviews. The *Inquiry into financial products and services in Australia* by the Parliamentary Joint Committee on Corporations and Financial Services (Ripoll Report) recommended *inter alia* that the Government consult on the best way to cease payments from financial product manufacturers to financial advisers, such as commissions and volume-based payments. In April 2010, the Government announced a prospective ban on commissions and volume-based payments in relation to the distribution of retail investment products, including superannuation; the payment of commissions for life insurance risk products is still under review. The report of the *Review into the governance, efficiency, structure and operation of Australia's superannuation system* (Cooper Review) includes proposals for the establishment of a new type of simple, cost-effective superannuation option that a member could choose or be defaulted into ('MySuper'). For many of the larger life insurers, the superannuation trustee within the group invests all superannuation funds through the group's life insurance company, and it is not clear whether this business model is compatible with a simple MySuper product.

Product complexity and rationalisation

Over a number of years, APRA has been in discussions with the life insurance industry about the operational and pricing risks associated with growing product complexity. The recent introduction of variable annuity products to Australia responds to a market need but adds to the level of complexity through the provision of investment guarantees and longevity benefits that are matched with complex investment hedging structures. In the United States, where these products had their genesis, the global financial crisis led to capital and operating strains for product providers. APRA welcomes market innovation but has been emphasising to life insurers that the risk management framework around complex products must be sufficiently robust to address the capital, pricing and hedging difficulties that can be created.

APRA continues to support the development of a more effective mechanism for the rationalisation of legacy products in the life insurance and superannuation industries. During 2009/10, the Government released a proposals paper that offered a specific product rationalisation mechanism involving a 'no disadvantage' test for investors. Feedback from interested parties is under review. APRA has been actively involved in this work and supports the general direction it is taking. In APRA's view, it will be important that any legislative solutions provide a resolution for life insurance products separately from that for managed investments and superannuation products.

Group risk insurance

Consolidation of the larger industry superannuation funds has led to a concentration in buying power in the purchase of group risk insurance from the life insurance industry, and price and service competition in this market has become intense. Group risk contracts are now reaching a size that is testing the capital and operational capacity of the life insurance industry, giving rise to operational risk when these contracts are won and concerns that premiums will not prove sustainable. APRA will continue to monitor developments in this market, particularly as some of the larger contracts may be re-tendered in the next 12 months. It is industry's role to find a market solution to providing group risk cover; APRA's focus will be on the capital support for, pricing disciplines in, and operational management of, these contracts.

Experience studies

APRA has continued a productive dialogue with the life insurance industry over the importance of undertaking continuing industry-based mortality and morbidity experience studies. Monitoring the changing trends in mortality and morbidity experience is an essential tool in assessing emerging risks, and the lack of quality information in this area has in the past affected the industry's ability to price and value life insurance appropriately. The industry's project to collect, analyse and publish data on experience studies has made good progress on mortality and work is now extending to morbidity statistics. APRA welcomes the initiative and the support it is receiving from industry participants.

APRA has separately commissioned a research project with the University of New South Wales on longevity issues, and this study will also assist in defining the national data sources necessary for mortality and morbidity studies.

Superannuation

As with the life insurance industry, and for the same broad reasons, 2009/10 was a period of consolidation for the superannuation industry. After two consecutive years of negative returns, a strong recovery in domestic and global equity markets over much of the year – though faltering in the latter months – led to positive returns for most superannuation funds; this, in turn, strengthened the funding position of defined benefit funds. However, many funds with significant unlisted assets continued to be affected by the marking-down of asset valuations. Over the year, merger activity saw the number of trustees with Registrable Superannuation Entity (RSE) licences fall by 26 to 251 (compared to 307 licences when the superannuation licensing regime began on 1 July 2006) and the number of registered funds under their trusteeship fall by 451 to 4,418 (6,885 on 1 July 2006).

APRA's supervision of the superannuation industry during 2009/10 has focussed on risk management practices and their refinement. Activities have covered, amongst other things, investment risk and governance, liquidity management and operational risk, including data integrity and IT system issues.

Two Government-commissioned reviews completed during the year are likely to have a significant bearing on the future shape and direction of the superannuation industry. The *Australia's Future Tax System Review* (Henry Review) included an assessment of adequacy, equity and tax issues associated with superannuation and retirement incomes policy. The Government's initial response to the Henry Review in May 2010 proposed an increase in the Superannuation Guarantee rate from nine to 12 percent over the coming decade, and further concessions on superannuation contributions. The *Review into the governance, efficiency, structure and operation of Australia's superannuation system* (Cooper Review) reported to the Government in June 2010, after extensive industry consultation. The report includes proposals to standardise and automate inter-fund data and payment transactions ('Superstream') and, as noted above, to establish a new type of simple, cost-effective superannuation option ('MySuper').

Investments

Investment issues have been a major area of attention for APRA and the industry during the global financial crisis, when domestic and global equity markets experienced significant swings and volatility. The rebound in these markets over most of 2009/10 resulted in a significant improvement in superannuation benefit balances, but equity market sentiment remains fragile. APRA's focus has not been on investment outcomes as such but on the effectiveness of risk management systems and the level of trustee understanding of the critical factors that impact on their ability to meet their obligations to fund members.

A lingering problem for some funds has been liquidity management arising from frozen investments in a number of managed investment schemes (discussed below). Another set of issues was associated with the valuation of unlisted assets, such as private equity, direct property holdings and infrastructure investments, to which some funds have significant exposures. The absence of ready benchmarks that provide a regularly updated measure of the market value of such assets can lead to outdated and inappropriate valuations and equity issues between incoming and exiting members, particularly during periods of high asset price volatility. APRA has written twice to trustees on this matter, most recently in August 2010, emphasising that trustees should have a strong governance framework for valuation of unlisted assets, should give due consideration to equity issues between members and should be mindful of the inherent valuation risks associated with investments that have multiple management layers, complex investment structures and/or underlying assets that are opaque in nature.

During the year, in consultation with the Australian Securities and Investments Commission (ASIC) and industry associations, APRA released preliminary guidance for trustees on the labelling of investment options offered by superannuation funds. APRA's aim is to improve member understanding by increasing consistency in the measurement of fund performance and by standardising descriptors of risk for investment offerings. APRA will continue to work with the industry to develop industry standards for disclosure and data collection purposes.

Liquidity

After a long period in which superannuation funds generally enjoyed ample liquidity, the global financial crisis brought home to trustees the risk that obligations to pay benefits, expenses and tax when they fall due might not always be able to be met. One particular aspect of that risk was revealed by fund exposures to investments that were or became illiquid. Since September 2008, APRA has granted relief from portability requirements under the *Superannuation Industry (Supervision) Regulations 1994* (SIS regulations) to a number of trustees with funds in frozen or suspended managed investment schemes, or in direct equity investments. The majority of funds seeking relief had investment options that were substantially invested in a single underlying asset.

Against this background, APRA has been assessing the adequacy of trustees' liquidity management practices as part of their risk management framework for fund investments. In addition to its ongoing supervisory activities, APRA provided guidance to trustees in July 2009 on its expectations in relation to liquidity management, including that trustees should be satisfied that members are being treated in an equitable fashion when determining the priority of payment. APRA also undertook a questionnaire of superannuation funds to gain a better understanding of liquidity management practices and the implementation of the 'illiquid investment' provisions of the portability requirements.

An overview of APRA's findings was published in APRA *Insight* in July 2010. The principal finding was that trustees need to strengthen their current liquidity management by taking steps to:

- manage liquidity at the investment option level (as distinct from 'a whole of fund' level);
- demonstrate a better understanding of the factors that affect their ability, and need, to redeem investments at investment option level, including 'illiquid' investments;
- undertake more comprehensive liquidity stress-testing (including crisis scenarios);
- expand their cash-flow budgeting to cover all aspects of liquidity management, not limited to periodical cash-flow;
- avoid over-reliance on the traditional positive cash-flow from contributions; and
- manage the inherent tension between offering member investment choice and the need to meet payment requests within reasonable timeframes.

Outsourcing – administration and custodian reviews

Outsourcing has been a dominant feature in the superannuation industry for many years. Outsourcing can offer the advantages of risk mitigation, cost efficiencies, obtaining expertise not otherwise within the fund and expanding the range of products and services provided. Many funds outsource their administration and custody functions. During 2009/10, APRA completed separate reviews of administrators and of custodians; though these types of institutions are not prudentially regulated by APRA, the operating standard under the *Superannuation Industry (Supervision) Act 1993* (SIS Act) dealing with outsourcing provides for APRA to have access to key service providers to superannuation funds.

The main concerns identified in the review of administrators included profitability and access to capital, concentration of a few external software/system providers, the scope for improvement in trustee oversight of administrators and governance, and data integrity. The key areas for improvement noted in the review of custodians included the adequacy of resourcing, market and investment risk controls, data integrity, and audit and assurance processes.

These various findings have been incorporated into APRA's ongoing supervisory review process. APRA is working with trustees on their operational risk systems to address the risks associated with data integrity and data management, timely and accurate processing for benefits, and unit pricing (or crediting rate) practices.

Early release of superannuation benefits

Under the SIS Regulations, APRA can approve the early release of superannuation benefits on specified compassionate grounds. These grounds are limited in the legislation and include instances where the applicant faces financial difficulties as a result of their (or a dependant's) medical condition, transport for medical attention, modifications to a home or vehicle because of a severe disability, palliative care, funeral and burial expenses, or a forced sale of an applicant's principal place of residence by their mortgagee. APRA assesses applications against the legislative criteria and a positive decision allows superannuation funds to release an amount. An applicant not satisfied with APRA's decision may request an internal review by an independent APRA delegate or an external review of process by the Commonwealth Ombudsman. The number of applications received fell in 2009/10 for the second consecutive year, after rising strongly over the previous five years.

The incidence of schemes that promote the illegal early release of superannuation benefits has been of increasing concern to APRA, industry and government. In most cases, APRA-regulated funds are requested to roll over a member's benefit to a self-managed superannuation fund and these benefits are either cashed out by the member, in breach of the preservation standards, or fraudulently rolled over to a promoter's fund using the member's identity without their knowledge. APRA has been working with the Australian Tax Office (ATO) to determine the extent of these practices and appropriate methods to prevent or reduce their incidence. In February 2010, APRA wrote to its fund trustees providing guidance on practical steps that could be implemented by funds to reduce the incidence of illegal early release and identity fraud. APRA has also alerted its funds to the situations of fraud involving theft of identities that use forged ATO documents.

Early release of superannuation benefits

Financial year	Number of applications received	Applications approved in part or full	Amount approved for release $	Average amount released per application $
2005/06	15,027	12,754	120,842,292	9,475
2006/07	18,245	15,412	156,905,338	10,181
2007/08	20,524	14,947	173,602,110	11,615
2008/09	17,918	11,776	144,739,434	12,291
2009/10	16,331	10,539	111,121,975	10,544

Taxation–related issues

Given the important role tax plays in member benefits over time, APRA has been encouraging trustees to consider taxation-related issues appropriately. In addition to complying with the tax law obligations and reporting to the ATO as a minimum, trustees have an obligation under trust law and the SIS Act to act in members' best interests in considering appropriate structures and making available elections. Another issue is the manner in which tax is allocated to members: this should be documented and, as appropriate, disclosed. Available evidence indicates that the industry is not managing tax risks as actively as it should. APRA has suggested that collaborative industry-wide solutions might assist.

Enforcement activities

APRA prefers to work constructively with boards and management of the institutions it supervises to resolve prudential issues that may affect the interests of beneficiaries (depositors, policyholders and superannuation fund members). However, when an institution fails to meet its prudential requirements, APRA may take enforcement action to protect beneficiaries. These actions include instigating formal investigations into the affairs of a supervised institution, appointing a third party to manage an institution's affairs, imposing conditions on an institution's licence, issuing directions related to the conduct of the institution's affairs, or accepting enforceable undertakings. APRA can take criminal actions or seek to disqualify individuals from holding senior roles within supervised institutions. APRA can also take action to prevent unlicensed entities from conducting business that can only be conducted by an authorised financial institution.

The power to disqualify a person from holding a senior role in supervised institutions passed from APRA to the Federal Court following legislative amendments that came into effect on 1 July, 2008. Since the amendments, APRA has not had cause to apply to the Federal Court for a disqualification.

During 2009/10, APRA undertook 432 enforcement actions. This was an increase on the 399 actions reported the previous year, reflecting the fact that APRA had a larger number of active investigations in train during the year.

APRA used its powers under the SIS Act to freeze assets and appoint an Acting Trustee to four superannuation funds and one pooled superannuation trust, for which Trio Capital Limited was the trustee, due to concerns surrounding the valuation of assets and indications that a fraud may have occurred. APRA is working closely with ASIC in reviewing the circumstances surrounding these events.

In the general insurance industry, as part of a strengthening of APRA's powers to deal with distressed institutions, the Insurance Act 1973 was amended in 2008 to permit the appointment of a judicial manager to a general insurer. During 2009/10, a judicial manager was appointed to each of two small general insurers that have been in run-off since 2002. The Minister for Financial Services, Superannuation and Corporate Law and Minister for Human Services determined that the Financial Claims Scheme in the general insurance industry (the Policyholder Compensation Facility) be triggered in relation to one of the two general insurers to ensure that claims by eligible policyholders could be met.

APRA's enforcement actions arising from the failure of HIH Insurance were completed during 2009/10. The disqualifications of two former HIH non-executive directors were reviewed by the Administrative Appeals Tribunal (AAT) with decisions being made in favour of the applicants. In total, 24 individuals remain disqualified or undertook not to occupy senior roles in the industry because of their involvement in the collapse of HIH.

APRA also finalised its enforcement actions arising out of the improper reporting of financial reinsurance arrangements between General Reinsurance Australia Limited (part of the General Reinsurance Corporation group) and Zurich Australia Insurance Limited (ZAIL). The AAT handed down its decision in favour of APRA in relation to APRA's earlier disqualification of two individuals; the other remaining applicant withdrew an AAT application challenging APRA's disqualification. In total, nine individuals remain disqualified or undertook not to occupy senior roles in the industry because of their involvement with these financial reinsurance arrangements. In recent months, APRA released ZAIL and Zurich Financial Services Australia from enforceable undertakings they had given to APRA in May 2005.

In the banking industry, APRA accepted an enforceable undertaking from Mega International Commercial Bank Co. Ltd (Mega ICBC), in relation to the operation of its Australian branch. The enforceable undertaking was given in response to APRA's concerns that the bank had failed to meet various prudential standards and other requirements relating to the Australian branch's systems of governance, risk management and internal control. The enforceable undertaking requires the bank to complete a substantial program of remedial action to rectify shortcomings in its current operations. The program is to be reviewed by an independent expert. APRA is continuing to monitor the bank's compliance with the remedial program.

During the year, APRA considered 44 issues relating to the use of protected words under the *Banking Act 1959*. The majority of these related to the use of the word 'bank' by an unauthorised institution.

In the superannuation industry, criminal charges were laid as a result of APRA's investigation into allegations that two directors of a superannuation trustee company were victimised because they carried out their duties as trustee directors to act in the best interests of fund members. Under the SIS Act, it is a criminal offence to commit an act of victimisation against a responsible officer of a corporate trustee of an employer-sponsored superannuation fund. The former executive director has now been committed to stand trial for the alleged victimisation.

During 2009/10, APRA received 73 complaints specifically relating to the failure by employers to remit employees' voluntary post-tax employee superannuation contributions to their superannuation fund. The number of complaints received by APRA was slightly down from the previous year. APRA has no specific prudential powers in this area but its investigations resulted in the recovery of about 98 per cent of these outstanding contributions. In response to reports of suspicious requests for the early release of superannuation benefits and its own oversight, APRA commenced enquiries into a number of cases of apparent illegal access to superannuation benefits. To date, one successful criminal prosecution has been completed and APRA continues to pursue other cases.

APRA also used its powers under the SIS Act to instigate legal action on behalf of the Acting Trustee of a superannuation fund to recover assets of the fund. All the assets of the fund were vested with the Acting Trustee, including a mortgage over a property. Legal proceedings were instigated by APRA to enable the Acting Trustee to enforce its power of sale under the mortgage. APRA was successful in obtaining these orders for the Acting Trustee both at first instance and on appeal.

Enforcement actions[1]

	ADIs		Superannuation		General insurance		Life insurance		Friendly societies		Other[2]		Total	
	2009	**2010**	2009	**2010**	2009	**2010**	2009	**2010**	2009	**2010**	2009	**2010**	2009	**2010**
AAT/Federal Court review			1		5	**3**							6	**3**
Appointment of Acting Trustee			38	**5**									38	**5**
Appointment of liquidator/inspector				**5**		**7**						**3**	0	**15**
Civil litigation				**2**		**1**							0	**3**
Directions and contravention notices[3]	9	**12**	81	**91**	2	**46**					10	**15**	102	**164**
Enforceable undertaking		**1**			3								3	**1**
Follow-up delayed contributions			196	**102**									106	**102**
Investigation action		**2**	23	**5**		**11**						**30**	23	**48**
Other actions[4]	22	**28**	7	**8**							80	**31**	109	**67**
Refer to other agency/police		**2**	6	**10**	1	**5**					2	**5**	9	**22**
Removal, withdrawal or revocation of licence			2	**1**									2	**1**
Show cause letter					1	**1**						**0**	1	**1**
Total	**31**	**45**	**264**	**229**	**12**	**74**	**0**	**0**	**0**	**0**	**92**	**84**	**399**	**432**

1 Year ending 30 June.

2 Includes institutions not regulated by APRA suspected of conducting unauthorised activity.

3 Includes consents to use restricted words.

4 Includes monitoring of representative offices.

Chapter three

The prudential supervision framework

The prudential supervision framework in Australia proved to be comprehensive and effective during the global financial crisis, helping to ensure that the Australian financial system was able to weather a series of challenging conditions that had few precedents.

No prudential framework in a market economy can guarantee such an outcome. As APRA has often emphasised, it is boards – not prudential regulators – that are the crucial first line of defence against excessive risk-taking or incompetence on the part of management, and serious weaknesses in that defence were exposed in a number of major international financial institutions during the crisis. It is very much in the interests of a prudential regulator that boards are themselves strong and willing to prompt action when necessary. Against this background, APRA's prudential standards, which are both behavioural and technical in nature, promote prudent risk management and financial resilience in its regulated institutions in two main ways. One is by empowering and requiring boards to act in a manner that promotes sound stewardship. The other is by ensuring that capital resources are aligned with the risks assumed and adequate to withstand unexpected stresses.

The development of APRA's prudential framework was largely complete before the global financial crisis erupted and APRA came under no immediate pressure to address any gaps. Nonetheless, APRA had a substantial prudential policy workload in 2009/10 arising out of the global regulatory response to the crisis and APRA's own agenda to improve the coverage of risks through forward-looking and harmonised prudential standards. This workload shows no signs of abating.

The global reform agenda is aimed at restoring confidence in the liquidity and solvency of banking institutions and strengthening the capacity of the global banking system to absorb shocks from financial and economic stress. The driving force has been the Leaders of the G-20 who, over four successive Summits, have reaffirmed their commitment '...to increase the quality, quantity and international consistency of capital, to strengthen liquidity standards, to discourage excessive leverage and risk taking, and reduce procyclicality.'

To carry forward the G-20 mandate, the Basel Committee on Banking Supervision has been pursuing comprehensive reforms aimed at increasing capital and liquidity buffers held by internationally active banks, improving risk management and governance, and enhancing banks' transparency. As a member of the Basel Committee, APRA has been actively involved in these initiatives. The specific proposals released to date will strengthen bank-level or microprudential regulation but also have a macroprudential dimension in addressing the build-up of system-wide risks over the economic cycle. This dimension is germane, as well, to the responsibilities of the Reserve Bank of Australia (RBA) for financial system stability and APRA has been working closely with the RBA, also a Basel Committee member, on systemic issues.

One important element of the global regulatory response now in place is prudent principles for remuneration in banking institutions. APRA's requirements in this area, introduced through its prudential standards on governance, have been in effect since 1 April 2010; consistent with APRA's desire for harmonisation, the requirements apply to the general and life insurance industries as well.

APRA's current policy agenda includes two other major initiatives. One is an updating and, where possible, harmonisation of capital requirements for general and life insurers, which offers scope for a significant improvement in the risk-sensitivity of the capital framework for life insurers. The other is the development of a prudential framework for conglomerate groups. In superannuation, the Cooper Review into the governance, efficiency, structure and operation of the industry has recommended *inter alia* that APRA be granted standards-setting powers in superannuation. The Government's response may have implications for the prudential framework in this industry.

Response to the global financial crisis

Enhancements to the Basel II Framework

As the first stage of its comprehensive reform program, the Basel Committee announced a package of measures to enhance the three Pillars of the Basel II Framework in July 2009. These included, under Pillar 1 (minimum capital requirements), an improved coverage of risks arising from complex structured products and from securitisation as well as higher capital for market risk, resulting in part from the requirement to use data from periods of financial stress in the modelling of such risk. Under Pillar 2 (the supervisory review process), supplementary guidance was issued to address flaws in risk management practices revealed by the global financial crisis. The guidance covers institution-wide governance and risk management processes, management of risk concentrations and the capture of risk from off-balance sheet and securitisation activities. Enhancements to Pillar 3 (market discipline) strengthen disclosure requirements for these same activities. The Basel Committee set the start-date for the Pillar 1 and Pillar 3 changes at no later than the end of 2010 but expected banks and supervisors to begin implementing the Pillar 2 guidance immediately.

In December 2009, APRA released a discussion paper, accompanied by proposed amendments to relevant prudential standards and prudential practice guides, addressing these Basel II enhancements. APRA also took the opportunity to propose other amendments to its capital adequacy requirements for ADIs to clarify existing provisions and to support the implementation of the enhancements. APRA began consultations on the associated reporting requirements in May 2010.

In June 2010, the Basel Committee announced certain adjustments to its Pillar 1 proposals on market risk and a new coordinated start-date of no later than 31 December 2011. APRA has advised ADIs that it proposes to follow the Basel Committee's revised timetable for implementation and that it will consult on the adjustments. The Basel Committee has indicated that, as a result of the adjustments, market risk capital requirements will increase by an estimated average of three to four times for large internationally active banks. In contrast, the impact on ADIs in Australia, which largely avoided higher-risk trading activities, is expected to be very limited.

Strengthening banking system capital requirements

The more significant milestone in the Basel Committee's comprehensive reform program was the release of a package of proposals to strengthen global capital and liquidity requirements for internationally active banks in December 2009. The capital reforms cover a number of key areas and include proposals:

- to raise the quality, consistency and transparency of the capital base and harmonise other elements of capital;
- to improve the risk coverage of the Basel II Framework by strengthening the capital requirements for counterparty credit risk exposures arising from derivatives, repurchase transactions and securities financing activities;

- to introduce a leverage ratio as a supplementary measure to the risk-based Basel II Framework to help contain the build-up of excessive leverage in the banking system and safeguard against model risk and measurement error; and
- to introduce a series of measures to promote the build-up of capital buffers in good times that can be drawn upon in periods of stress. The Basel Committee is also promoting more forward-looking approaches to provisioning for credit losses.

Over the first half of 2010, the Basel Committee carried out a comprehensive quantitative impact study of the proposals, as well as assessments of their economic impact over the transition period and of their long-run economic benefits and costs. APRA participated actively in the study, feeding in information from a number of ADIs to ensure that the implications of the reforms for Australia were fully understood. After reviewing the various impacts, the Basel Committee announced in July 2010 that it had reached broad agreement on the overall design of the capital reforms including, in particular, the definition of capital, the treatment of counterparty risk and the leverage ratio. Broad agreement on the calibration and transition arrangements for the capital reforms was announced in September 2010. The minimum requirement for common equity (after deductions) was set at 4.5 per cent of risk-weighted assets and the minimum requirement for Tier 1 capital at six per cent. (This compares with minima of two and four per cent, respectively, that apply currently.) A capital conservation buffer was set at 2.5 per cent above these new minimum requirements; when capital levels fall within this range, banking institutions will be subject to constraints on capital distribution that increase in severity as losses mount. In addition, a countercyclical buffer up to 2.5 per cent will apply when excessive credit growth is leading to a system-wide build-up of risk. A minimum leverage ratio of three per cent based on Tier 1 capital will be tested during a parallel run period from 1 January 2013 to 1 January 2017.

The Basel Committee's intention is to present a fully calibrated, comprehensive set of proposals to the G-20 Heads of Government meeting in November and issue the proposals by the end of 2010. Implementation of the reforms in member countries will begin on 1 January 2013 and the new minimum capital requirements will be phased in by 1 January 2015; implementation of the broader package of reforms will be substantially completed by 1 January 2019. Once the Basel Committee releases its final global standards, APRA will consult extensively with industry on the application of the standards in Australia.

Strengthening banking system liquidity requirements

Running in parallel with its capital reforms are the Basel Committee's initiatives to promote stronger liquidity buffers to ensure that banking systems are more resilient to liquidity stresses. The comprehensive reform package released in December 2009 also introduced, for the first time, two internationally consistent regulatory standards for liquidity risk supervision. The first, the Liquidity Coverage Ratio, aims to promote short-term resilience by ensuring that banking institutions have sufficient high-quality liquid resources to survive an acute stress scenario lasting for one month. The second, the Net Stable Funding Ratio, aims to promote longer-term resilience by creating additional incentives for banking institutions to fund their activities with more stable sources of funding on an ongoing structural basis. The proposals also include a common set of metrics for identifying and analysing liquidity risk trends.

In anticipation of the Basel Committee's liquidity reforms, APRA released a consultation package in September 2009 on its proposed enhancements to its prudential framework for ADI liquidity risk management. The key changes involved more demanding stress-testing parameters, including the addition of a severe 'market disruption' scenario; introduction of a standardised reporting framework to improve APRA's ability to assess ADIs' liquidity risk profiles under both normal and stressed conditions; and enhanced qualitative requirements consistent with the Basel Committee's revised *Principles for Sound Liquidity Risk Management and Supervision* of September 2008. Once the Basel Committee's proposals were announced, APRA advised ADIs that its approach will be developed in parallel with those proposals and APRA's next consultation paper will be held over until the proposals take final shape.

After reviewing the results of the quantitative impact study (which also covered liquidity impacts) and other assessments, the Basel Committee in July 2010 announced revisions to its Liquidity Coverage Ratio requirement and noted that its Net Stable Funding Ratio needs to be modified; revised proposals are to be released by the end of 2010. The circumstances of jurisdictions such as Australia that do not have sufficient high-quality liquid assets for inclusion in liquidity buffers were also acknowledged. APRA is working closely with the RBA and the Basel Committee and will be consulting with industry on appropriate liquidity standards in Australia that would promote a similar level of resilience as the global standards and would minimise moral hazard.

Executive remuneration

APRA finalised its prudential requirements on remuneration for ADIs and general and life insurers during 2009/10. These requirements, introduced as extensions to APRA's governance standards, address the risk that poorly structured remuneration practices may result in excessive risk-taking by individuals and undermine institutions' risk management systems.

APRA's requirements on remuneration take as their starting point the Financial Stability Board's (FSB's) *Principles for Sound Compensation Practices*, published in April 2009, and its *Principles for Sound Compensation Practices – Implementation Standards*, published in September 2009. These Principles and Implementation Standards, to which APRA was a significant contributor, were a global response to the recognition that inappropriate remuneration practices contributed to significant losses at some major international institutions and, in turn, to the severity and duration of the global financial crisis.

APRA has taken a principles-based approach on remuneration. Boards of APRA-regulated institutions are required to have an independent Remuneration Committee and a remuneration policy that aligns remuneration arrangements with the long-term financial soundness of the institution and its risk management framework. At the same time, boards are able to design remuneration arrangements that suit the structure of their own institution. The policy extends beyond senior executives to all persons who, because of their roles, have the capacity to make decisions that could materially affect the interests of depositors or policyholders, and owners. APRA's approach focuses on the incentives built into remuneration arrangements and their alignment with good stewardship of institutions; it is not APRA's role to intrude into the market and shareholder disciplines involved in determining absolute levels of remuneration. Where APRA judges that the remuneration arrangements of a regulated institution are likely to encourage excessive risk-taking, APRA has several supervisory options, including the power to impose additional capital requirements on that institution.

APRA released its final revisions to the governance standards dealing with remuneration, as well as an associated prudential practice guide, in November 2009, after two rounds of industry consultation. As part of the consultation process, APRA conducted two seminars on its remuneration proposals jointly with the Australian Institute of Company Directors, in Sydney and in Melbourne in September 2009. The revised standards came into effect on 1 April 2010.

Before the revised standards came into effect, APRA asked a number of its largest regulated institutions to assess their current remuneration practices against these standards. Some institutions were well advanced in adopting risk-adjusted remuneration practices, while others had some way to go. In following up, APRA's objective is to ensure that institutions have appropriate governance structures to deal with remuneration – another area where an informed and empowered board can be most effective – and to improve its own understanding of how institutions incorporate an adjustment for risk in their performance-based compensation schemes. APRA will be reviewing remuneration policies across peer groups to assess better practice in a range of key areas, and will provide feedback to industry on where further focus may be needed.

In March 2010, the FSB undertook its own peer review on progress in applying its *Principles* and *Implementation Standards*. Australia was one of 24 countries covered by the review and was identified as having made significant progress in this area. APRA has not adopted some of the more prescriptive limits and caps that have been recommended by the FSB, but APRA is confident that its principles-based approach will achieve the substantive outcomes sought by this global reform initiative.

Financial Claims Schemes

During 2009/10, APRA dealt with a number of implementation issues associated with the Financial Claims Schemes established in the ADI and general insurance industries in October 2008. APRA has responsibility for administering the two Schemes.

In the ADI industry, the Early Access Facility for Depositors (EAFD) provides depositors of a failed ADI with timely access to their deposit funds up to a defined limit. That limit was set at $1 million per depositor in the context of the Government guarantee arrangements and will be reviewed by the Government by October 2011. In general insurance, the Policyholder Compensation Facility (PCF) provides eligible policyholders and other claimants with access to funds to meet insurance claims, with no defined limit, in the event of the failure of a general insurer. It also provides a limited period of time within which eligible policyholders of the failed insurer remain covered against claims pending their establishment of new insurance policies with another insurer.

APRA has consulted with the ADI industry and other parties on the proposed reporting requirements needed to make the EAFD operational and on options to facilitate payout. APRA's proposals have been developed having regard to relevant international developments in deposit insurance arrangements. Following discussions with industry, a discussion paper on these issues was released in January 2010. The proposed reporting requirements relate to the need for ADIs to be able to report data to APRA at short notice on aggregated deposit balances, based on a 'single customer' view. Reporting requirements are intended to be finalised by early 2011 and will come into force after a transition period. APRA will periodically test the capacity of ADIs to provide the required deposit data as part of broader ongoing testing of the EAFD arrangements.

APRA has also consulted the general insurance industry in the development of operational arrangements for the PCF. The requirements for the PCF are different from those of the EAFD and mainly involve the development of draft documentation and guidelines for assessing the eligibility of potential claimants and determining eligible claims. They also involve the development of appropriate appeal arrangements and other operational details.

APRA's powers to respond to situations of financial distress were further strengthened during 2009/10 with the passage of legislation aimed at improving the efficiency and operation of financial sector legislation. The enhancements covered various aspects of APRA's preventative, directions and failure management powers, as well as powers relating to its role in administering the two Financial Claims Schemes.

Other harmonised prudential standards

General and life insurance capital standards

APRA is proposing to update its capital standards for general insurance and life insurance. APRA's intention is to make the capital standards more risk-sensitive, improve their alignment across regulated industries where appropriate, and consider the standards in light of international developments.

For general insurance, APRA is completing the refinements commenced in 2008. The proposed changes are relatively modest and will ensure that all material types of risks, including asset/liability mismatch, asset concentration and operational risks, are adequately addressed within the capital standards.

For life insurance, the proposed changes are more fundamental. APRA is proposing to simplify the current dual reporting requirements for solvency and capital adequacy and, by introducing the concept of a 'capital base' for life insurers, to align the capital structure for life insurers with that for general insurers and ADIs. This improved alignment of capital requirements will also facilitate adoption of APRA's proposed framework for the supervision of conglomerate groups.

APRA announced the broad scope of its review of capital standards in May 2009 and released a discussion paper in May 2010. In doing so, APRA confirmed that it is not seeking to achieve any material change in overall capital levels in the general and life insurance industries and would be carefully assessing the individual and industry impacts of the proposals. Three supplementary technical papers have since been released. APRA has also invited insurers to participate in a quantitative impact study to be completed by the end of October 2010. APRA expects to release draft capital prudential standards in the first part of 2011 and final standards later in 2011, to take effect in 2012.

Supervision of conglomerate groups

APRA's prudential framework for conglomerate groups has taken firmer shape. Conglomerate groups are groups (with APRA-regulated entities) that have material operations in more than one APRA-regulated industry and/or have one or more material unregulated businesses. The objective of this substantial initiative is to better protect the interests of depositors and insurance policyholders by limiting the risks to APRA-regulated entities (from contagion, reputation and operational risks in particular) that may arise from that entity's membership of a conglomerate group, and by ensuring that both APRA and the group itself have a broader understanding of the financial and operational soundness of the group. The global financial crisis has shown that the failure of one entity (regulated or not) within a conglomerate group may damage or even cause the failure of related entities.

APRA's proposed 'Level 3' framework for conglomerate groups is designed to complement its existing industry-based supervision of stand-alone entities (Level 1 supervision) and its supervision of single industry groups (Level 2 supervision). The framework contains proposals, built on APRA's existing capital requirements, to ensure that a conglomerate group holds adequate capital to protect the APRA-regulated entities from potential contagion and other risks within the group. The framework also contains proposals on a range of principles-based risk management standards that will apply to the parent company of the Level 3 group. The proposed framework is a flexible one intended to ensure that group structures are not unduly restricted by supervisory intervention.

A discussion paper containing APRA's proposals for the supervision of conglomerate groups was released in March 2010 and APRA has been reviewing industry feedback. In the second half of 2010, APRA will undertake a quantitative impact study to assess the impact of the proposals on potential Level 3 groups. APRA's intention is to release draft prudential and reporting standards needed to implement the Level 3 framework in the first half of 2011 and, after further consultation, to finalise the standards in the first half of 2012. Implementation of the new standards will need to be appropriately sequenced with the changes being proposed to Level 2 capital requirements in the ADI and insurance industries.

Security risk in information and information technology

In February 2010, APRA published a prudential practice guide on the management of security risk in information and information technology (IT) by APRA-regulated entities. This followed the release of a discussion paper and draft guide in May 2009. The prudential practice guide targets areas where APRA's supervisory activities continue to identify weaknesses and is designed to provide guidance to senior management, risk management and IT security specialists (management and operational). Topics addressed include the importance of an overarching framework, systematic IT asset life-cycle management, effective monitoring processes and robust IT security reporting and assurance mechanisms. Somewhat unusually, the prudential practice guide stands alone rather than in support of a prudential standard. APRA took this approach to emphasise that practice in this area is still evolving and that regulated entities need to maintain sound information security in the face of rapidly increasing threats, without relying upon an APRA prudential standard to determine minimum acceptable practice.

General insurance

Simplification of APRA reporting

During the year, APRA finalised changes to the prudential reporting framework for general insurers. These changes simplify reporting requirements by aligning them more closely with Australian equivalents to International Financial Reporting Standards (AIFRS). The benefits expected to flow from these changes are reduced reporting burdens, more effective information with which APRA can assess insurer profitability and enhanced dialogue between APRA and individual insurers on their performance. The changes followed consultation with industry and a review of responses by general insurers to a quantitative impact study undertaken by APRA. The study showed that the revised framework would lead to no material changes in the industry's capital position and limited changes at an individual insurer level.

The simplified reporting framework came into effect from 1 July 2010 through changes to a number of APRA prudential and reporting standards. General insurers are expected to report under the framework for the period ending 30 September 2010, for both quarterly and annual returns.

Lenders mortgage insurers

APRA has been reviewing its prudential standard in relation to the maximum event retention (MER) calculation for lenders mortgage insurers (LMIs). APRA's aim has been to clarify the intention of the standard and make technical modifications to improve its ease of application. In September 2008, APRA released a discussion paper that included six key proposals, as well as a draft revised prudential standard. Subsequently, it undertook a quantitative impact study to assess the impact of these proposals. Following further consultations, APRA in March 2010 released a response paper and a revised prudential standard (effective 1 May 2010) that implemented four of its key proposals; the remaining two proposals will be considered as part of APRA's broader review of the general and life insurance capital standards.

Life insurance

Enhanced supervision of life insurance companies

Amendments to the *Life Insurance Act 1995* enacted in August 2009 have given APRA power to authorise non-operating holding companies (NOHCs) of life insurance companies and to determine prudential standards for life NOHCs. APRA's intention, initially, has been to apply to life NOHCs the same governance and fit and proper standards that apply to NOHCs of ADIs and general insurers. This will better protect life insurance policyholders from risks that may exist in related companies, by ensuring that authorised NOHCs of life companies have adequate governance procedures and that persons in responsible positions are fit and proper.

In May 2009, in anticipation of legislative change, APRA released a consultation package on enhanced supervision of life companies, which included draft revised governance and fit and proper standards for life NOHCs. Final prudential standards were released in March 2010 and came into effect from 1 July 2010.

As part of this consultation process, APRA made limited amendments to the audit and actuarial requirements for life companies to clarify the requirements and align them more closely with those applying to ADIs and general insurers. In addition, APRA restructured the original prudential standard on audit and actuarial related matters into two separate prudential standards. These also came into effect from 1 July 2010.

In May 2010, APRA released guidelines on the registration of life companies and of life NOHCs. Three life NOHCs have now been authorised.

Superannuation

Review of superannuation guidance material

APRA is updating its superannuation guidance material and, where appropriate, harmonising the material with other APRA-regulated industries. The need for updated APRA guidance has arisen from changes in the structure of the industry and the increase in size and sophistication of funds since the superannuation licensing regime was introduced in 2006. New guidance material will take the format of prudential practice guides as used in the other industries.

In April 2009, APRA released for consultation two draft prudential practice guides related to reserving and conflicts of interest. This was followed in August 2009 by the release of four other draft prudential practice guides dealing with capital, risk management, adequacy of resources, and fitness and propriety. These four guides were released in final form in August 2010. The first two draft guides released will be further reviewed in the light of any Government response to the Cooper Review recommendations on these subjects.

APRA-regulated institutions

	Number			Assets ($ billion)[1]		
	30 Jun 09	30 Jun 10	% change	30 Jun 09	30 Jun 10	% change
ADIs[2]	193	**182**	-5.7	2,663.3	**2,693.2**	1.1
Banks	57	**55**	-3.5	2,587.3	**2,612.5**	1.0
Building societies	11	**11**	0.0	21.5	**23.7**	10.2
Credit unions	117	**108**	-7.7	46.0	**49.4**	7.4
Other ADIs, including SCCIs	8	**8**	0.0	8.5	**7.6**	-10.6
Representative offices of foreign banks	17	**17**	0.0			
General insurers	132	**130**	-1.5	95.2	**99.2**	4.2
Life insurers	32	**32**	0.0	212.7	**227.7**	7.0
Friendly societies	19	**16**	-15.8	6.1	**6.2**	1.6
Licensed trustees	277	**251**	-9.4			
Superannuation entities[3]	4,914	**4,458**	-9.3	613.9	**722.4**	17.7
Public offer funds	207	**196**	-5.3	477.8	**548.2**	14.7
Non-public offer funds	216	**191**	-11.6	128.7[4]	**167.3**	30.0
Small APRA funds	4,277	**3,869**	-9.5	2.0	**1.6**	-20.0
Approved deposit funds	116	**107**	-7.8	0.2	**0.1**	-50.0
Eligible rollover funds	16	**16**	0.0	5.2	**5.3**	1.9
Pooled superannuation trusts[5]	82	**79**	-3.7	69.7	**79.1**	13.5
Non-operating holding companies	17	**21**	23.5			
Total	**5,601**	**5,107**	**-8.8**	**3,591.2**	**3,748.7**	**4.4**

Notes:

1 Asset figures for end-June 2010 are based on most recent returns. Asset figures for end-June 2009 have been revised slightly from APRA's *2009 Annual Report* in line with the audited returns received during the year.

2 The ADI classification does not include representative offices of foreign banks.

3 The total does not include uncontactable funds that are in the process of being formally wound-up or transferred to the Australian Taxation Office. As at end-June 2010, there were 13 such funds, down from 15 funds as at end-June 2009.

4 Amended figure.

5 Pooled superannuation trust assets are not included in totals as these assets are already recorded in other superannuation categories.

Chapter four
APRA's supervisory capabilities

The global reform process, now nearing critical decision points, has required a substantial commitment by policy-makers and has attracted intense industry and media interest around the globe. Away from that spotlight, greater attention is being directed to the role and capabilities of prudential supervisors themselves. Recognition has grown that good financial outcomes require not just a robust and effective regulatory framework but also quality prudential supervision, to ensure that financial institutions are operating prudently and within the spirit as well as the letter of regulation. The crisis revealed significant differences in the approaches taken by countries to implement regulatory frameworks and to supervise the strength and effectiveness of risk management in financial institutions.

At its Toronto Summit in June 2010, the G-20 Leaders agreed that a new, stronger global regulatory framework must be complemented by more effective oversight and supervision. Accordingly, it tasked the Financial Stability Board, in consultation with the International Monetary Fund (IMF), to report in October 2010 on '... recommendations to strengthen oversight and supervision, specifically relating to the mandate, capacity and resourcing of supervisors and specific powers which should be adopted to proactively identify and address risks, including early intervention'. Separately, the IMF has drawn on its extensive experience with Financial Sector Assessment Programs to provide guidance on sound approaches to supervision. In a recent paper, *The Making of Good Supervision: Learning to Say, "No"*, the IMF has emphasised the importance of an active and hands-on approach to supervision, which requires prudential supervisors to have both the ability and the willingness to act to redress instances of excessive risk-taking by financial institutions. The paper also identifies six key elements of good supervision – that it is '... intensive, sceptical, proactive, comprehensive, adaptive and conclusive'.

APRA's risk-based approach to supervision, which had been developed and honed before the global financial crisis, would broadly satisfy the IMF's key elements. Nonetheless, continuous improvement is a priority. Under APRA's approach, supervisory activity – such as on-site reviews, data analysis and regular interactions with boards and management – is directed at risk issues of highest priority. More attention and supervisory resources are focussed on those regulated institutions that have higher risk profiles or identified risk management weaknesses, or that present potential systemic risk.

APRA's supervisory approach is not 'one-size-fits-all' but a multifaceted one that has regard to the particular characteristics of each regulated institution. However, the approach has some key and consistent underlying themes:

- it seeks a detailed understanding of the strengths, weaknesses and major risks facing regulated institutions through a rigorous program of off-site and on-site analysis and strategic discussions with boards and senior management;
- it is forward-looking by nature, not to 'predict' future downturns but to ensure that regulated institutions have taken prudent steps to protect themselves from future losses, especially in boom times;
- it takes a probing and questioning approach that requires regulated institutions to constantly demonstrate, and not just assert, that they are financially sound and prudently managed;

- it takes a broad view of the main activities of large banking and insurance groups so that risks to regulated institutions emerging from outside APRA's immediate reach, such as from offshore activities or from unregulated members of the group, can be identified early;
- it seeks to adapt to changing circumstances and stay in tune with better industry practice; and
- it requires supervisory staff to pursue outstanding prudential issues to their satisfactory resolution. In any given year, APRA may issue more than 1,000 recommendations or supervisory 'requirements' to its regulated institutions, each of which is tracked and followed through to ensure that the risk issues identified are addressed appropriately.

As noted throughout this *Report*, APRA has maintained a heightened degree of supervisory intensity since the global financial crisis began in August 2007. APRA's risk-based approach has not, however, compromised the provision of a 'baseline' level of supervisory oversight for all regulated institutions that ensures APRA's risk assessments and supervisory action plans remain current and appropriate.

Supervisory approach

The essential building-blocks of APRA's risk-based approach to supervision are set out in the *APRA Supervision Blueprint*, which APRA published in January 2010. The Blueprint provides an overarching set of principles that aligns all of APRA's supervision methodologies, processes and supporting systems and tools. It also provides the strategic direction for the evolution of APRA's supervisory processes and their adaptation to financial innovation and market changes.

One of the main building-blocks of APRA's approach is a forward-looking supervisory action plan for each regulated institution. The plan addresses the key risks facing the institution and any broader industry issues, ensuring that potential risks are investigated by APRA and remedial action taken when a threat to beneficiaries' interests is identified. The plan, tailored to each institution, spells out the desired supervisory outcomes and the activities to be completed over the next one to three years. Since supervisory resources are limited, activities are prioritised to ensure the most important issues are dealt with. A more formal planning process designed to keep supervisory action plans up-to-date and in line with changing risk assessments was bedded-down in 2009/10. Peer group analysis is undertaken for the plans of particular groups of regulated institutions. For selected larger institutions, the APRA Members are involved in the peer review process.

A second main building-block is a structured decision-making process to ensure that the risk judgments that underpin supervisory action plans are rigorous and consistent and that supervisory interventions are targeted and timely. The Probability and Impact Rating System (PAIRS) is APRA's risk assessment model, used to gauge the risk profile of regulated institutions and identify emerging risks across industries. Based on the outcomes of supervisory activities, PAIRS ratings are updated to reflect APRA's latest assessment of an institution's risk profile and its ability to manage its risks. The Supervisory Oversight and Response System (SOARS) guides supervisors in responding to identified risks. Under SOARS, a response grid is imposed on the PAIRS ratings for an institution to determine APRA's supervisory stance. In this way, the risk assessment process is a primary input to the relative frequency and intensity of APRA's supervisory actions. There are four SOARS supervision stances, which range from routine supervision for Normal institutions to supervisory intervention of increasing vigour for Oversight, Mandated Improvement and Restructure institutions.

During the global financial crisis, APRA has increased the frequency of its reviews of PAIRS ratings to ensure that they remain appropriate to the changing risk outlook and provide realistic triggers for more intense supervisory interactions where necessary. The ratings for many regulated institutions have been revisited on a number of occasions. Internal benchmarking sessions have also been conducted to promote consistent PAIRS assessment and ratings practices across APRA supervisors, identify key risk areas and discuss the appropriate responses to these risks in supervisory action plans.

At end-June 2010, around 58 per cent of risk-rated institutions were in the Normal stance, 39 per cent in Oversight, two per cent in Mandated Improvement and one per cent in Restructure. Over the past three years, the proportion of institutions in Oversight has risen and the proportion in Normal has fallen as institutions have confronted the fallout from the global financial crisis.

APRA is conducting research on the next generation of PAIRS arising from a review of the PAIRS model by the Australian Mathematical Sciences Institute in 2008/09. This review, together with user feedback, proved very valuable in identifying areas for potential improvement in the PAIRS model as a central risk assessment tool that is responsive to changing circumstances.

To strengthen the risk judgments that are vital inputs into PAIRS ratings, APRA commenced work during 2009/10 to improve the quality and functionality of prudential data provided to its supervisors for risk analysis. This work will deliver more detailed financial data in a form that is amenable to further analysis; it will also enable the production of *ad hoc* reports of emerging risk issues and further 'drill-down' into specific risk concerns. This work is being done in conjunction with an improved financial analysis training program to enhance the skills of supervisors in identifying and assessing risk issues.

A third building-block of APRA's approach is its 'thematic' or industry-wide analysis of risks. An Industry Analysis Team of industry specialists is responsible for the preparation and updating of industry risk 'registers' for each of the APRA-regulated industries. These registers identify the main emerging risks and supervisory issues for each industry, the implications for regulated institutions and the key areas or triggers where specific supervisory action may be required. The registers draw on research into and analysis of industry developments as well as information provided by frontline supervisors, specialist risk teams and other subject-matter experts. For each of the high risks identified, risk owners are assigned to recommend and coordinate an appropriate APRA response; these risk owners are supported by small working groups drawn from across APRA to ensure that the recommendations are robust, balanced and present a 'one APRA' view. The registers are available to all APRA supervisors and provide essential input into supervisory action plans. During 2009/10, the Industry Analysis Team was also responsible for conducting a major macroeconomic stress-test of capital adequacy in the ADI industry (see Chapter 2).

APRA's staffing

APRA's heightened level of activity during the global financial crisis, across its supervisory, policy and corporate areas, has unavoidably required increases in its staffing resources. APRA has secured those increases, thanks largely to the four-year special funding provided by the Government to deal with the crisis. APRA's recruitment efforts also benefitted from relatively low turnover rates, for the second year running, and from its strong commitment to its graduate program at a time when many financial institutions were cutting back heavily on graduate hires. At end-June 2010, total permanent staffing was 619, in line with the higher staffing target. The addition of fixed-term and casual employees brought staffing levels to around 642 on a full-time equivalent basis. Of this total, around 14 per cent have come from predecessor agencies and around the same percentage from APRA's graduate program; the remainder have come from external recruitment.

More recently, there are signs that the financial industry is expanding its hiring programs and is, once again, seeking to woo APRA staff.

The strong emphasis in APRA's recruitment program on bringing financial sector skills and experience into the organisation has been an important factor in APRA's ability to respond to the global financial crisis. Staff most directly involved in that response have been a valuable mix of long-serving supervisors and newer recruits who brought with them an average of nine years of relevant industry or professional experience. This mix considerably enhanced APRA's antennae and its ability to pursue prompt but practical solutions to emerging prudential problems.

In many respects, prudential supervision is more art than science and it is difficult to recruit ready-made supervisors from either the public or private sector. Hence, APRA has always invested heavily in its training and development programs to support the skills formation of its staff. In benchmark surveys, APRA consistently ranks around the 90th percentile of organisations in terms of training expenditures; over 80 per cent of staff training is targeted at the development of core supervisory skills. During 2009/10, the priority has been further developing prudential supervision and leadership capabilities. On the former, key initiatives have included a new curriculum for prudential supervisors, associated training programs, both face-to-face and online, and structured evaluation processes. On the latter, a new leadership program has been successfully implemented within APRA to enhance leadership capabilities.

APRA's training activities in 2009/10

Training by type (%)	
Internal technical training	47
External training	21
APRA seminars	17
Management training	10
Desktop training	5
Studies support	
Employees undertaking formal post-graduate studies	136
Key training metrics	
Training spend per employee	$3,350
Training spend as a per cent of base salary (%)	3
Per cent of staff provided with training (%)	100
Training sessions per employee	12
Training days per employee	5.5
Number of internal classroom courses offered	387

Other initiatives to improve staff development and retention include improvements to career progression and mobility programs, overseas secondments to regulatory agencies or global standard-setting bodies, domestic secondments to other regulators and agencies, and enhanced recognition and rewarding of performance. APRA is also well aware of the importance of workplace flexibility as a key to attracting and retaining valued staff, and continues to be a recognised leader in this area.

APRA's statistical capabilities

APRA is the central repository of statistical information on the Australian financial system and it collects financial statistics from a wide range of financial institutions, both regulated and unregulated. APRA's statistical collections provide supervisors with access to relevant, timely and accurate data on APRA-regulated institutions and are a vital input into supervisory action plans.

APRA also collects data on behalf of the Reserve Bank of Australia and the Australian Bureau of Statistics, and about 80 per cent of data collected are shared with other agencies. The statistics APRA publishes inform many decision-makers in the Australian financial system, including policy-makers, other regulators, market analysts, researchers and senior management of financial institutions. APRA follows international standards aimed at ensuring that users can have confidence in the integrity of the data and that statistics are made available on an impartial basis. Ultimately, APRA's statistical data contribute to a more stable, competitive and efficient financial system.

For regulated institutions, APRA targets a rate of 95 per cent for submission of returns by the statutory due dates, and the remainder to be submitted within the following week. Over 99 per cent of APRA returns are now submitted on time or within one week of the due date. In 2009/10, 94 per cent of all errors uncovered through APRA's data quality assurance work on quarterly forms were resolved within two weeks of the due date.

APRA produces a suite of 13 statistical publications that provide regular updates on the financial performance of APRA-regulated industries. In 2009/10, APRA brought forward the regular release date of seven of the 13 publications to improve their timeliness.

In June 2010, APRA released the initial edition of the *Annual Friendly Society Bulletin*, its first statistical publication dedicated to friendly societies. The publication follows the introduction of updated reporting requirements for life insurers and friendly societies from 1 January 2008 and was developed in consultation with the friendly society industry. After considering the views of life insurers and friendly societies, APRA made a determination that data contained within specific quarterly and annual returns lodged by life insurers and friendly societies are non-confidential. This enabled APRA to include individual friendly society data in the new publication in line with APRA's other industry publications. A new *Half Yearly Life Insurance Bulletin* was released in July 2010.

During the year, and as discussed earlier in this *Report*, APRA also determined that data contained in the National Claims and Policies Database (NCPD) was non-confidential. APRA's report covering the year 2009, released in June 2010, contained for the first time level 2 reports from the NCPD, policy information with no confidentiality masking and data from Lloyd's Australia. Following increased public interest, APRA also released, for the first time, data on First Home Saver Accounts in December 2009.

One priority for APRA's statistics unit in 2009/10 was establishing the collection of data on insurance business placed with unauthorised foreign insurers (UFIs). The need for this collection arose from amendments to the *Insurance Act 1973*, effective from 1 July 2008, that require all insurers operating in the Australian general insurance market to be authorised and supervised by APRA, or to only write business in Australia subject to certain exemptions. In December 2009, new regulations introduced a new reporting regime for Australian Financial Services (AFS) licensees that deal in general insurance products. Under this reporting regime, general insurance intermediaries are required to provide aggregate data on all insurance contracts with APRA-authorised general insurers, Lloyd's underwriters and UFIs. ASIC appointed APRA as its agent to collect data under this regime. The first data collection covering the six months to June 2010 was due in August 2010. The UFI data collection will assist the Government to assess the operation of the limited exemption regime and enable a better understanding of the intermediation of general insurance products in the Australian market.

Another priority over 2009/10 was the finalisation of changes to the prudential reporting framework for general insurers (see Chapter 3). These changes simplify reporting requirements by aligning them more closely with Australian equivalents to International Financial Reporting Standards. During the year, APRA also received the first returns of data under new reporting standards that apply to general insurance groups. These reporting standards, which took effect from September 2009, complete APRA's prudential framework for supervising general insurers that operate as part of a corporate group. APRA is now better positioned to monitor the financial health of insurance groups that are domiciled in Australia.

In November 2009, following the establishment of the Cooper Review into the superannuation system (see Chapter 2), APRA announced the deferral of its proposed update to its superannuation statistical collections and publications. APRA will review the time-frame for an enhanced collection after the Government responds to the Cooper Review.

During 2009/10, APRA continued its active involvement in the development of the Government's Standard Business Reporting (SBR) program, along with 12 other Australian, State and Territory government agencies. This whole-of-government initiative seeks to eliminate duplication and reduce reporting burdens by streamlining and automating reporting between businesses and government agencies. SBR went live on 1 July 2010 for a range of reports to government and APRA plans to roll out its SBR forms by 1 July 2011. APRA is currently finalising the taxonomies for all forms in its electronic data collection system, Direct to APRA (D2A). The Chairman of APRA is on the SBR Board and the Chief Information Officer is a member of the SBR Steering Group.

APRA's statistics unit fulfilled around 500 requests for customised statistics over the past year. These statistics give more detailed insight into particular aspects of the financial system than APRA's regular publications. The statistics, which have been in particular demand during the global financial crisis, are provided to external users such as other government agencies, financial institutions, market analysts, researchers and universities. Customised statistics are also provided to international agencies such as the Organisation for Economic Co-operation and Development (OECD), the IMF and the Bank for International Settlements, to facilitate comparisons of various aspects of the Australian financial system with those of other countries.

APRA's research capabilities

A small research unit supports APRA's work by identifying emerging prudential issues that benefit from rigorous theoretical and applied analysis. The unit publishes working papers on the APRA website and papers in APRA's *Insight* publication and in reputable journals, and presents research results at conferences.

In 2009/10, the unit directed much of its efforts to supporting APRA's prudential policy agenda. The unit contributed to the development of APRA's proposals on remuneration and also undertook research on transfer pricing for liquidity risk as background to APRA's proposals to enhance liquidity risk management by ADIs.

During the year, the unit continued its research activities on superannuation topics. APRA produced two working papers on superannuation fund investment performance and presented papers at the Superannuation Colloquium of the University of New South Wales (UNSW) in July 2009 as well as the International Centre for Pensions Management conference in October 2009. This latter presentation was also published in the *Rotman International Journal of Pension Management*. APRA also produced two working papers on superannuation outsourcing, which were released in July 2010 and presented at the 2010 UNSW Superannuation Colloquium.

APRA continues to support university research relevant to prudential regulation. In 2010, Professor Doug Foster from the Australian National University was a visiting researcher in the unit, engaged in developing an outline for future research topics in superannuation. APRA continued its support for a four-year Australian Research Council (ARC) Linkage Grant project on longevity risk with researchers from UNSW. This project is now through its first full year and has a team of academics, PhD students and Honours students engaged in several streams of research. During the year, this group produced research papers on longevity risk modelling, reverse mortgages and annuities. APRA also partners with the Capital Markets Cooperative Research Centre to co-sponsor four PhD students (since 2008).

Chapter five

Cooperation and liaison

Cooperation between regulatory agencies has emerged as an important focus of attention in the aftermath of the global financial crisis. Cooperation has both a domestic dimension, encompassing the prudential regulator, central bank, finance ministry and other agencies within a country, and an international dimension. A number of countries, particularly the United States and in Europe, have reformed or are reforming their domestic regulatory structures to strengthen supervisory oversight and better assess and manage systemic risks. Internationally, efforts to reinforce regulatory cooperation have centred on the development of supervisory colleges and crisis management groups for major complex cross-border financial institutions, and on global reforms aimed at materially raising the resilience of banking systems. APRA participates in a number of supervisory colleges. However, APRA's main international engagement since the crisis began, and especially during 2009/10, has related to its involvement in global reform initiatives.

Australia

The underlying principle of Australia's 'twin peaks' regulatory model is a clear separation of functions between prudential regulation and 'conduct of business' regulation. APRA performs the first of these functions while the Australian Securities and Investments Commission (ASIC) has responsibility for the Corporations Law, disclosure and market conduct of Australian companies and financial services providers, and consumer protection in the financial system. The other main agency involved in the oversight of the Australian financial system is the Reserve Bank of Australia (RBA), which has responsibility for monetary policy, stability of the financial system and the safety and efficiency of the payments system. All three agencies are independent statutory authorities.

Cooperation between these three agencies and the Australian Treasury proved very effective through the global financial crisis. The Council of Financial Regulators is the umbrella body for such cooperation. The Council, which is non-statutory, operates as a forum for coordination and information-exchange between its members on financial policy and regulatory issues. The Council meets quarterly but can meet on an *ad hoc* basis when relevant issues arise. Its main roles are to ensure that there are appropriate arrangements between the Council members for coordinating their responses to potential threats to financial system stability, and to advise the Government on the adequacy of Australia's financial system architecture. Over 2009/10, the Council continued to review conditions in global funding markets and monitor experience with the Government Guarantee Scheme for Large Deposits and Wholesale Funding. Acting on Council advice, the Government withdrew the Guarantee Scheme for new issues from 31 March 2010. The Council began an examination of various aspects of the Financial Claims Scheme for ADIs, including the future level of the cap, as input to the Government's review of the parameters of the Scheme due by October 2011. Agencies also shared views on the implications for the Australian financial system of major global reform initiatives and coordinated advice to the Government for its participation in G-20 deliberations.

Over the year, the Council devoted considerable attention to crisis management arrangements, drawing on lessons learned from the global financial crisis. The Council refined its policies and procedures for managing financial distress in an ADI, developed proposals to enhance APRA's crisis management capacity and conducted a domestic crisis simulation exercise to test coordination arrangements between the agencies. The Council also worked closely with the New Zealand Treasury and Reserve Bank of New Zealand on trans-Tasman crisis managements arrangements.

Other matters discussed by the Council included over-the-counter (OTC) derivatives markets developments, APRA's prudential requirements for remuneration, the collection of ADI lending and funding data, and APRA's macroeconomic stress-test of the ADI industry.

APRA also meets regularly with individual members of the Council. APRA's relationship with the RBA is particularly close, through the formal channel of the RBA/APRA Coordination Committee and at times daily communications between officers of the two agencies. In the more settled global market conditions over most of 2009/10, discussions in the RBA/APRA Coordination Committee moved away from immediate market developments and the condition of financial institutions to broader issues of global reform and the implications for Australia. Other topics discussed were crisis management arrangements within Australia, including 'open resolution' procedures and related close-out netting issues; preparations for and conduct of the crisis simulation exercise; and the implementation of the Financial Claims Scheme for ADIs. Other operational issues covered included APRA's proposals for conglomerate supervision, data-sharing and statistical matters, and arrangements for staff exchanges. Market developments as a result of sovereign debt concerns in Europe became more prominent in discussions as the year ended.

The relationship between APRA and ASIC is maintained through three primary contact points. *Ad hoc* high-level discussions are held between the APRA Members and the ASIC Commissioners on emerging issues of mutual concern. Regular liaison meetings focus on policy issues or operational supervision matters concerning industries and institutions regulated by both agencies. These meetings are also a forum for discussion on practical supervision outcomes due to changes to legislative and administrative procedures. Finally, joint legal and enforcement liaison meetings are held as required to discuss broad enforcement-related issues as well as to coordinate specific legal actions related to jointly regulated institutions. During 2009/10, issues under discussion between the two agencies, in addition to joint enforcement actions (see Chapter 2), included the risk management aspects of over-the-counter (OTC) derivatives activities, crisis management issues and arrangements for the collection of data from insurance brokers. In addition, the Memorandum of Understanding (MoU) between APRA and ASIC, signed in June 2004, was updated to reflect the expanded regulatory responsibilities of both agencies.

The APRA Members and ASIC Commissioners also met jointly with the Finance Industry Council of Australia (FICA), an umbrella body for a number of finance industry associations, to discuss significant regulatory and industry issues. This dialogue conforms with the Government's 2007 *Statement of Expectations of APRA*, which encouraged APRA and ASIC to explore mechanisms for joint consultation with industry. FICA comprises the Australian Bankers' Association (ABA), Abacus – Australian Mutuals, Australian Finance Conference (AFC), Australian Financial Markets Association (AFMA), Investment and Financial Services Association (now the Financial Services Council) and the Insurance Council of Australia.

During the year, APRA, ASIC and the RBA established a joint working group aimed at fostering improvements in the over-the-counter (OTC) derivatives markets in Australia and contributing to the development of new standards and practices internationally. This is in line with the stronger global regulatory focus on the infrastructure supporting the markets most dislocated during the global financial crisis, particularly markets for the more structured or complex financial products. The working group is considering initiatives that would enhance market transparency and risk management, expand the use of automated infrastructure and, where appropriate, widen the use of central counterparties.

APRA and the Treasury continued their close liaison during the year on legislative initiatives, particularly those related to strengthening APRA's crisis management powers. Other significant areas of coordination included proposals for life insurance and superannuation product rationalisation, the collection of data from insurance brokers and superannuation reform issues (including the Cooper Review). Senior APRA and Treasury officials also held regular liaison meetings at which a major topic was global regulatory reform, including the work of the G-20 and the Basel Committee.

APRA and the Australian Transaction Reports and Analysis Centre (AUSTRAC) coordinate their activities through the AUSTRAC/APRA Coordination Committee, which is used to update each agency on relevant regulatory developments and to share experiences from supervisory activities. Referrals on regulatory matters and exchanges of information between the agencies are conducted using protocols established to meet relevant legislative requirements. There is also regular communication at the working level on visit schedules to jointly regulated institutions, with the aim of minimising duplication.

Under its MoU on superannuation matters, APRA and the Australian Taxation Office (ATO) liaised on a range of superannuation administration and policy issues over 2009/10, including ATO rulings, determinations and interpretative decisions on the application of superannuation legislation for self-managed superannuation funds, illegal early access to superannuation benefits, instalment warrants, the development of variable annuity longevity products and the public register of superannuation funds maintained by the ATO. The regular interaction (including data interchange on superannuation matters) between APRA and ATO staff is augmented by operational and technical liaison meetings as well as *ad hoc* meetings on specific issues as required. APRA continues to participate in the ATO's Superannuation Consultative Committee and the superannuation technical subcommittee of the National Tax Liaison Group.

APRA cooperates closely with the Private Health Insurance Administration Council (PHIAC), which has responsibility for supervising providers of health insurance. Over the year, APRA provided support to PHIAC in relation to its supervisory functions, covering a range of subject matters including prudential standards, group supervision and policy on actuarial involvement in insurance activities. PHIAC accessed APRA's training and assistance to develop its crisis management plan and enforcement functions. The two agencies regularly exchange information on jointly supervised institutions and discuss common industry issues; a review of the MoU is also underway.

APRA liaises regularly with State regulatory bodies that administer compulsory third-party (CTP) motor vehicle insurance (the Motor Accidents Authority of New South Wales and the Motor Accident Insurance Commission of Queensland). Over the year, discussions with these bodies covered the financial condition of CTP insurance providers, recent developments in the prudential supervision of general insurers, and the pricing and competition reviews being undertaken by these two bodies. APRA also liaises with workers' compensation state authorities on prudential matters such as capital requirements for general insurers. During the year, APRA concluded a MoU with Workcover Tasmania.

APRA has continued its liaison with the Financial Reporting Council and the two Boards the Council oversees: the Australian Accounting Standards Board (AASB) and the Australian Auditing and Assurance Standards Board (AuASB). APRA Member John Trowbridge was a member of the Council for a two-year period ending on 30 June 2010 and has been succeeded by APRA Member Ian Laughlin. APRA also contributed to the AASB's work on reporting by superannuation funds and to the development of AuASB's guidance for auditors of life insurers.

APRA is a permanent member of the Banking and Finance Sector Group (BFSG, previously the Banking and Finance Infrastructure Assurance Advisory Group) and currently provides the Deputy Chair. Established under the Government's Trusted Information Sharing Network, BFSG aims to strengthen the financial system's ability to respond to an industry-wide operational disruption by providing a framework for sharing security-related information that affects critical infrastructure. Membership comprises representatives from major financial institutions, financial markets participants, industry associations and State and Australian Government agencies. BFSG's main areas of focus during 2009/10 were strengthening the resilience of the sector and further streamlining business and government coordination in disasters. In the context of concerns about outbreaks of swine flu abroad and in parts of Australia, BFSG conducted multiple audio conferences between its members, representatives of other sectors, the Department of Health and Ageing and other government departments to share information and discuss response plans. In 2009/10, BFSG also established a 24-hour emergency hotline for any other sector or government agency to establish contact with banking representatives should existing contact arrangements fail. This facility complements arrangements already implemented by the Insurance Council of Australia for insurance-related matters. BFSG continues to support the Federal Government in electronic security initiatives through participation in the ESecurity Information Exchange meetings.

In addition to its meetings with FICA, APRA liaises directly with a number of industry organisations including the ABA, Abacus - Australian Mutuals, the AFC, the Financial Services Council, the Insurance Council of Australia, the Association of Superannuation Funds of Australia (ASFA), the Corporate Superannuation Association (CSA) and the Australian Institute of Superannuation Trustees (AIST). APRA also liaises with professional associations and institutes such as those for accountants, actuaries, administrators, auditors, company directors, compliance professionals, financial planners, managers and trustees. APRA's regional offices also have wide-ranging liaison programs with regional offices of ASIC, industry bodies and professional associations.

The actuarial profession plays an important role in financial management and prudent risk management in the general insurance, life insurance and superannuation industries, both through statutory Appointed Actuary roles and through providing advice on financial and risk management issues to boards and management of institutions. APRA has regular and extensive dialogue on matters of mutual interest with the Institute of Actuaries of Australia (IAAust) and the profession generally. In addition to regular meetings with representatives of the relevant practice committees of the IAAust and with its Executive, APRA has established more formal dialogue with life insurance Appointed Actuaries as a group. APRA's own actuarial staff are actively involved in various committees and taskforces of the IAAust.

International liaison

APRA's international liaison activities take two main forms. The first are its traditional direct links with overseas regulatory agencies associated with the supervision of specific financial institutions. The second, which has stepped up in intensity since APRA joined the Basel Committee on Banking Supervision, is its participation in international groups and fora that have carriage of global reform initiatives.

Direct links with overseas regulatory agencies provide important input into APRA's risk assessment of regulated institutions that also operate in other jurisdictions and of foreign financial institutions for which APRA is 'host' supervisor. In response to the global financial crisis, supervisory colleges of relevant supervisors and central banks have been formed for the largest cross-border banks and insurance companies, and APRA participates in several of these colleges. APRA also has established its own colleges for a number of large, internationally active financial institutions headquartered in Australia. Following the signing of a MoU with the prudential regulator in Malta during the year, APRA now has formal bilateral information-sharing arrangements with 20 overseas regulators. Several other information-sharing arrangements are under discussion, including arrangements to facilitate the activities of supervisory colleges. APRA has also been involved in work by the International Association of Insurance Supervisors (IAIS) to put in place a multilateral MoU template and vetting mechanism. APRA is one of 10 jurisdictions to have been approved as a signatory to the multilateral MoU; a further 18 jurisdictions have submitted applications for accession. APRA also has provided staff resources to assist the IAIS in the validation of applications.

APRA attaches considerable importance to the need for effective coordination between Australia and New Zealand in supervising financial institutions with substantial operations in both countries, and in promoting financial stability. In this context, APRA maintains a close working relationship with the Reserve Bank of New Zealand (RBNZ). There is regular liaison between APRA and the RBNZ on matters relating to the supervision of the major Australian banks, including regular information exchange and coordination of supervisory measures where appropriate. APRA and the RBNZ also worked together in coordinating trans-Tasman aspects of APRA's macroeconomic stress-test of the Australian banking system. In addition, APRA has provided advice and assistance to the RBNZ on matters relating to the supervision of insurance, as the RBNZ begins to extend its responsibilities to the prudential supervision of insurance companies in New Zealand. More generally, APRA and the RBNZ maintain a regular liaison on prudential policy issues and second staff between the two agencies from time to time.

A particular focus during 2009/10 – and one that will continue into the current year and beyond – is enhanced coordination between APRA and the RBNZ in detecting emerging stress in trans-Tasman banks and responding in ways that maintain financial system stability in both countries. APRA is working within the Trans-Tasman Council on Banking Supervision (which comprises APRA, the RBA, the RBNZ and the Treasuries of Australia and New Zealand) to develop a more formalised and structured approach to the detection of, and response to, trans-Tasman financial distress.

APRA's participation in the global reforms being pursued by the Leaders of the G-20 is mainly through its involvement in global standards-setting bodies and in other fora. These include:

- Basel Committee on Banking Supervision. In March 2009, Australia was invited to become a member of the Basel Committee on Banking Supervision. Following a request from the Leaders of the G-20, membership of the Basel Committee was subsequently expanded to include all G-20 countries. APRA and the RBA are both now members and attended their first meeting in July 2009; the APRA Chairman represents Australia on prudential supervision matters. APRA is also represented on the Basel Committee's three key sub-committees. The Policy Development Group identifies and reviews emerging prudential issues and develops policies to promote strong prudential standards. Its primary focus over the past year has been the development of major reforms to capital and liquidity requirements for internationally active banks. The Standards Implementation Group shares information and promotes consistency in implementation of the Basel II Framework and of Basel Committee guidance and standards more generally. The Accounting Task Force engages with global accounting and auditing standard-setters on international financial reporting and auditing standards and assesses their impact on prudential regulation. In the past year, it has been closely involved in proposals from the International Accounting Standards Board (IASB) to move from the current incurred loss approach to an expected loss approach for provisioning. It has also been working on a range of issues relating to risk disclosures and valuation in response to the recommendations of the Financial Stability Board.

APRA is also an active participant in a number of other sub-committees and working groups of the Basel Committee. APRA is represented on three groups dealing with key aspects of the reforms to global capital and liquidity requirements – the Top-down Calibration Group, which has been assessing the overall calibration of the reforms, the Definition of Capital Sub-group and the Working Group on Liquidity. APRA also participates in two sub-groups of the Standards Implementation Group. The Validation sub-group (SIGV) explores issues related primarily to the validation of rating systems that serve as inputs into the internal ratings-based approaches to credit risk, while the Operational Risk sub-group (SIGOR) investigates issues related primarily to the implementation of the advanced measurement approaches for operational risk. During 2009/10, SIGOR developed a series of issues papers clarifying supervisory expectations of practices identified in a loss data collection exercise the previous year, and expects to publish the consolidated document before the end of 2010.

Towards the end of the year, APRA also joined the Basel Committee's Cross-Border Resolution Group, a Group established in recognition of the complexity of cross-border crisis resolution and the growing importance of cross-border banking operations in many countries. In March 2010, the Basel Committee published for consultation a set of principles aimed at promoting and strengthening the operation of supervisory colleges, and the Group will be undertaking further work in this area.

A senior officer of APRA took up a secondment to the Basel Committee Secretariat in the latter part of 2009.

- International Association of Insurance Supervisors (IAIS). The main objective of the IAIS is to contribute to improved supervision of the insurance industry at the domestic and international level for the protection of policyholders. This objective aligns directly with APRA's supervisory objectives and APRA has had a significant involvement with the IAIS since its formation in 1994. APRA has had continued representation on the IAIS Executive and Technical Committees as well as being an active participant on various sub-committees.

  In response to the global financial crisis, the IAIS formed two new high-level committees to ensure that the deliberations of the G20 and the FSB are fully recognised in supervisory standards in insurance. These committees, in which APRA is participating, are the Financial Stability Committee and a taskforce to establish a framework for effective supervision of internationally active insurance groups and their group-wide risks. APRA has also continued its involvement in the Accounting, Insurance Contracts, Solvency and Actuarial Issues, Insurance Groups and Reinsurance sub-committees.

  Over 2009/10, the main priorities for the IAIS have been continuing its work to extend to insurance groups its risk-based solvency framework for solo insurers, liaison with the IASB on insurance liability valuation and reporting, and enhancing the IAIS standards and guidance on the supervision of insurance groups.

APRA sees significant benefits in being closely involved with the IAIS, similar to those from its involvement with the Basel Committee. These include the opportunity to engage in policy formulation at the international level to ensure that the interests of the Australian market are properly represented and recognised; to learn of supervisory developments in other jurisdictions that could can enhance APRA's supervision; and to increase communication and interaction with overseas supervisors that will stand APRA in good stead when there is an issue that requires international supervisory cooperation to progress.

An APRA officer is currently seconded to the IAIS secretariat.

- Joint Forum. APRA and ASIC represent Australia on the Joint Forum, a body working under the umbrella of the Basel Committee, the IAIS and the International Organisation of Securities Commissioners (IOSCO).

  The work of the Joint Forum encompasses issues relating to financial conglomerates and other issues that are common across the banking, insurance and securities sectors. During 2009/10, the Joint Forum released a major report on the differentiated nature and scope of regulation, which had been requested by the FSB, as well as a report on the benefits and risks of the use of special purpose entities. The Joint Forum is currently considering a number of significant work-streams relevant to financial regulation and supervision in Australia, including a review of its *Principles for the Supervision of Financial Conglomerates*, in which APRA will be actively participating.

- International Organisation of Pension Supervisors (IOPS). IOPS is an independent body representing agencies involved in the supervision of private pension arrangements. It was formed in 2004 to become the global standards-setter for the pensions industry, to promote international cooperation on pension supervisory issues, and to provide a global forum for policy dialogue and exchange of information on these matters. IOPS now has around 60 members and observers representing more than 50 countries at different levels of economic development and with a variety of pension and supervisory systems.

  APRA is on the foundation board of IOPS and is a member of the Technical Committee. In late 2009, the APRA Deputy Chair was re-elected President of IOPS for a second two-year term. APRA contributed to a third series of working papers that were published by IOPS in 2009, as well as to supervisory guidelines relating to the use of intervention, enforcement and sanctions powers, released in November 2009. APRA is currently participating in the development of a 'toolkit' on risk-based supervision of pension funds, a paper on supervision of defined contribution funds, and a joint OECD/IOPS good practices paper on risk management.

- OECD Insurance and Private Pensions Committee (IPPC). APRA is represented on the IPPC, which focuses on liberalisation of insurance markets, governance and regulatory frameworks in insurance and private pensions, and the collection and publication of cross-country statistics in insurance and pensions. The APRA Deputy Chair is Vice-Chairman of the IPPC Working Party on Private Pensions (WPPP). During 2009/10, the IPPC and WPPP directed their efforts to analysing and considering appropriate policy and regulatory responses to the impact of the global financial crisis on insurance companies and private pension funds, and on accession reviews of a number of countries seeking to join the OECD.
- International Association of Deposit Insurers (IADI). In 2009/10, APRA joined IADI, an international body with responsibility for promoting principles and guidance in the design and administration of deposit insurance and guarantee arrangements. Membership of IADI complements APRA's role as the agency responsible for the administration of Australia's Financial Claims Schemes in the ADI and general insurance industries. In particular, APRA's membership of IADI will assist it to keep abreast of international developments in deposit insurance and guarantee schemes and to factor these developments into the design and implementation of the Schemes as appropriate. Membership will also assist APRA to contribute to international thinking on deposit insurance and guarantee issues in the aftermath of the global financial crisis.
- International Credit Union Regulators Network (ICURN). ICURN is an independent network of regulators of financial cooperatives. Its objective is to share information on topics critical to sound financial regulation; it also initiates research on financial cooperatives and their oversight, identifies best practice and issues recommendations to its members to improve regulations, safety and soundness. ICURN is governed by a steering committee of representatives from six regions around the world. APRA is currently represented on the steering committee covering the Asia-Pacific region.
- International Actuarial Association (IAA). The IAA is dedicated to research, education and development of the actuarial profession and national actuarial associations. It oversees development of guidance notes relating to areas of international actuarial practice; those of most relevance to APRA relate to the measurement of liabilities for insurance contracts and IAA involvement in an International Accounting Standards Board insurance accounting project, enterprise risk management, and the development and management of internal models (the paper is close to finalisation). Over the year, the direct involvement of senior APRA staff in IAA activities has been modest as APRA has focussed its international involvement on matters of more direct prudential relevance. Going forward, APRA staff will continue to have some indirect involvement through the IAAust.

APRA meets annually with integrated supervisory agencies from a number of countries to discuss issues arising out of the integrated supervisory model. At the 12th such conference in June 2010, the main topic was the lessons learned from the global financial crisis, particularly the need for robust supervisory responses to emerging risks.

Together with the RBA, APRA is a member of the Working Group on Banking Supervision of the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP), which brings together central banks, monetary authorities and banking supervisors within the region. The Working Group provides a forum to discuss regional financial and prudential developments. In 2009/10, the Working Group focussed primarily on the implications of global capital and liquidity reforms for countries in the region. EMEAP facilitates a number of training initiatives to which APRA provides speakers from time to time.

Technical assistance

APRA continues to support improved institutional capacity among its Asian and Pacific regulatory counterparts through a series of tailored technical assistance programs, principally funded by AusAID. These programs seek to assist regulators to improve standards of prudential supervision, as part of a broader whole-of-government effort to strengthen public sector governance in the Asian and Pacific regions. The importance of APRA's contribution of technical and other assistance is recognised in the Government's 2007 *Statement of Expectations of APRA*.

In the Pacific, APRA administers two distinct but complementary projects under the auspices of the Government's multilateral Pacific Sector Linkages Program (PSLP). The Pacific On-Site Prudential Supervision Project provides for APRA supervisors to travel to Pacific countries for two weeks at a time to conduct training programs with on-site review teams comprised of local and other visiting Pacific prudential regulators. During 2009/10, APRA supervisors undertook three on-site training programs in Papua New Guinea and one each in Fiji and the Solomon Islands. The Pacific Prudential Regulator Internship Project places staff from Pacific prudential regulators within APRA's frontline supervisory divisions for a period of up to four months to learn about prudential supervision techniques. Resource pressures arising from the global financial crisis saw this project placed on hold during the past two years but it is to be resumed in September 2010, initially with a participant from the Financial Supervisory Commission of the Cook Islands and from the Bank of Papua New Guinea to be hosted, respectively, in APRA offices in Brisbane and Melbourne. Taken together, the two projects make a worthwhile contribution to deepening capacity and strengthening prudential supervision across the Pacific region.

In Asia, APRA's offshore engagement is primarily focussed on, but not limited to, technical assistance activities with Indonesia. APRA has been engaged with BAPEPAM-LK, Indonesia's integrated regulator of securities markets and non-bank financial institutions, for the past five years. Building upon the successful introduction of a new risk-rating model (adapted from APRA's PAIRS framework) by BAPEPAM-LK's Pension Fund Bureau in 2008, APRA is now assisting the Bureau to refine procedures around the benchmarking of risk-rating scores; it is also assisting BAPEPAM-LK's Insurance Bureau to develop a risk-rating model. APRA's capacity-building engagement with Bank Indonesia continued in 2009/10 with two Bank Indonesia interns, one placed within a frontline supervisory division and the other within the operational risk team in the supervisory support division for a period of around six months. This was part of a longer-term engagement between APRA and Bank Indonesia that began in 2006. In total, APRA hosted 10 interns from Indonesia during the past year and also received visits by a number of senior officers from Indonesian regulatory agencies.

APRA's assistance to BAPEPAM-LK and Bank Indonesia are multi-year initiatives funded under the auspices of the Government Partnership Fund (GPF) as part of the Australia-Indonesia Programme for Reconstruction and Development. By improving economic governance and public sector management, the GPF program aims to contribute to a healthy financial sector, which is an essential prerequisite to economic development and the efficient flows of resources within and between economies. The current phase of the GPF program concludes at the end of 2010 and APRA expects to be an applicant in a new funding round later this year.

The Association of Financial Supervisors of Pacific Countries facilitates cooperation between regulators in the region. APRA represents Australia as an observer at Association meetings and supports its training activities through sponsoring speakers on topical issues at the Association's annual meeting and workshop, and by providing administrative support for training initiatives when conducted in Australia.

APRA is also a member of:

- the Asian Forum of Insurance Supervisors;
- the South-East Asia New Zealand and Australia (SEANZA) Forum of Banking Supervisors;
- the Financial Regulators Training Initiative (FRTI) of the Banking Supervisors' Advisory Group of Asia-Pacific Economic Cooperation (APEC), coordinated through the Asian Development Bank; and
- the Australian APEC Study Centre Advisory Group.

APRA also participates as an observer in the South-East Asian Central Banks (SEACEN) Conference of Directors of Supervision.

APRA continues to support the international broadening of knowledge on prudential supervision by providing expert speakers to various institutes, including the Financial Stability Institute (of the Bank for International Settlements), the APEC Study Centre at RMIT University and the SEACEN Institute. During 2009/10, APRA provided 10 speakers to conferences organised by the Financial Stability Institute, which are often co-hosted with other regional bodies, and 11 speakers to programs organised by the APEC Study Centre funded through AusAID. APRA values these opportunities to develop the skills of its staff, as both participants and speakers in these programs. APRA also provided expert assistance to two IMF-funded missions, the first in Mauritius and the second a Financial Stability Assessment Program for the United States.

During the year, APRA hosted approximately 100 international delegations from regulatory agencies, central banks, multilateral organisations, industry bodies and private sector organisations. Almost two-thirds of the delegations were from developing countries and over a fifth from China. Areas of interest were wide-ranging and included APRA's functions and operations, prudential policy development, risk-based supervision, the stability of global financial markets and Australia's responses to the crisis, and superannuation prudential policy and supervisory practice. In addition, APRA hosted several visits by individual financial institutions to discuss the requirements for establishing operations in Australia.

Chapter six

APRA's costs and performance

Financial performance

APRA's expenditure is devoted to implementing and enhancing the prudential supervision framework in Australia and to APRA's ongoing supervisory and enforcement activities. Its income comes mostly from annual levies on supervised institutions.

APRA's expenditure

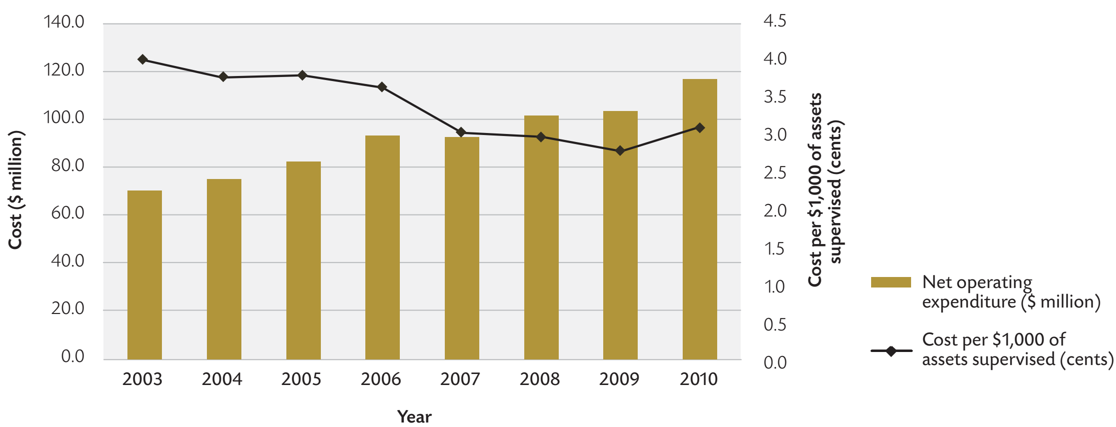
APRA's total operating expenditure in 2009/10 was $116.3 million. This included costs of $2.9 million for the Government's Standard Business Reporting program and costs of $1.3 million covered by additional revenue sources. Excluding these two amounts, operating expenditure was $112.2 million, compared with the budget of $117.6 million.

APRA's operating expenditure has risen over the past three years as a consequence of the build-up in supervisory numbers and capacity during the global financial crisis. However, relative to the value of assets supervised by APRA, costs have remained around three cents per $1,000 of assets supervised.

APRA's income

APRA is funded primarily from levies collected from supervised institutions, with a contribution from interest earnings, fees for services and miscellaneous cost offsets. Included in revenue in 2009/10 was $18.5 million of a Special Appropriation from the Government to deal with the global financial crisis. This was part of a total appropriation for this purpose of $45.5 million over four years, provided in the 2008/09 Additional Estimates.

APRA's costs



Levies are raised according to the *Financial Institutions Supervisory Levies Collection Act 1998* and six other Acts applying to the regulated industries. Prior to the beginning of each financial year, and after consultation with the main industry representative groups, the Minister announces the levy determinations for each industry. The levy rate is applied on assets, subject to a minimum and maximum amount per institution, except for non-operating holding companies that are levied at a flat rate. The levies collected by APRA also cover some costs of ASIC and the ATO. Levies are based on the costs incurred for each industry. In addition, levies are collected to cover the costs of the National Claims and Policies Database, with a rate applied to the gross earned premiums of general insurance entities that contribute to it. The total levies collected by APRA for all three agencies in 2009/10 were $124.9 million, which included $2.6 million of under-collection for the prior year, compared with the plan of $121.5 million.

APRA's total revenue in 2009/10 was $126.9 million. After adjusting for funding for the Standard Business Reporting program and additional revenue from the recovery of direct costs, net revenue was $123.4 million, compared with the budget of $120.3 million.

Reserves

APRA had an operating surplus from ordinary activities of $10.7 million in 2009/10. As a consequence, total reserves increased to $32.1 million. Included in this amount is a $6.0 million Contingency Enforcement Fund that is available to be used for large unexpected investigation and enforcement activities. Part of APRA's total reserves will be used to fund APRA's expenditures in 2010/11.

Business planning

In July 2009, APRA launched its 2009-12 Strategic Plan, which consolidates progress under its first strategic plan (2006-09) and looks beyond the challenging environment created by the global financial crisis. The new Plan does not involve any major change in APRA's strategic direction but gives priority to considering the lessons from the crisis and ensuring that these lessons are incorporated into APRA's supervisory and other processes. The Plan is reviewed each year in light of developments in APRA's operating environment.

The Plan identifies six strategic objectives and the initiatives APRA will undertake to meet them. The objectives are to:

- sharpen APRA's risk-based approach to supervision by ensuring its supervisory processes are sufficiently flexible and responsive in challenging economic circumstances;

- enhance and support the capabilities of APRA's people to ensure that it maintains high standards in all areas and remains an attractive employer for people whose skills are also in demand in the finance sector;
- enhance APRA's document and data management capabilities by continuing to invest in new and existing solutions to ensure that appropriate technologies, processes and training are in place;
- improve the resilience and effectiveness of APRA's infrastructure to support its supervisory and regulatory activities;
- strengthen the resilience of the prudential framework in response to global reform initiatives and APRA's own reform agenda; and
- strengthen APRA's engagement with stakeholders through actively communicating APRA's position and priorities.

The Strategic Plan forms the basis for annual divisional business plans and relevant objectives are also incorporated into individual performance plans. Overall performance against the Plan is reviewed on a quarterly and annual basis by the Executive Group.

Supervisory performance

APRA publishes information from two different sources to provide broad quantitative indicators of its supervisory performance.

Firstly, APRA has developed 'transition matrices' to track the migration of institutions between the four SOARS supervision stances (see Chapter 4). As an institution moves out of a Normal stance, routine supervision is likely to give way to greater use of APRA's more specialised intervention and enforcement powers. Institutions in Oversight are not expected to fail but there are aspects of their risk position that may create vulnerabilities in extremely adverse circumstances and that require more extensive examination by APRA. APRA does not expect institutions to be permanently classified in Mandated Improvement. Institutions in Restructure are those in which APRA has lost confidence that financial promises to beneficiaries will be met in the absence of vigorous intervention, or which have long ceased to be viable operating businesses and are being assisted to exit the industry in an orderly fashion.

Over the past three years, more than half of the institutions in Normal remained in that stance and institutions in Oversight mostly remained where they were or improved. Institutions in Mandated Improvement have moved overwhelmingly towards an improved supervision stance or have exited the industry, confirming APRA's 'behind the scenes' work to improve the risk position of institutions. The majority of institutions in Restructure have remained in that stance, with all others exiting the industry.

SOARS matrix (2008/10) (%)

From/to	Normal	Oversight	Mandated Improvement	Restructure	Exit
Normal	58	21	1	0	20
Oversight	27	53	2	0	17
Mandated Improvement	6	41	6	0	47
Restructure	0	0	0	56	44

Over the past seven years, a total of 208 institutions have been in either Mandated Improvement or Restructure. Of that total, 52 have improved, 24 remain in the relevant SOARS category, 130 have exited without loss to beneficiaries and two small institutions have failed. While it is not possible to compare these outcomes with what would have happened had APRA not intervened, the direction of movement of institutions in these two supervisory stances is consistent with timely and effective intervention on APRA's part.

Entities in Mandated Improvement (2004/10)

Current stance	Total
Normal	15
Oversight	34
Mandated Improvement	18
Restructure	0
Exit	98
Failure	1
Total	**166**

Entities in Restructure (2004/10)

Current stance	Total
Normal	0
Oversight	3
Mandated Improvement	0
Restructure	6
Exit	32
Failure	1
Total	**42**

The second set of quantitative indicators of supervisory performance is linked to financial failures and losses to beneficiaries. APRA publishes two headline indicators:

- the Performing Entity Ratio (PER), which is the number of APRA-regulated institutions that met their commitments to beneficiaries in a given year, divided by the total number of APRA-regulated institutions; and
- the Money Protection Ratio (MPR), which is the dollar value of liabilities to beneficiaries in Australia that remained safe in a given year, divided by the total dollar value of liabilities to beneficiaries in Australia in APRA-regulated institutions.

These indicators are, however, silent about target outcomes against which APRA's performance can be assessed. The Government's *Statement of Expectations of APRA* (2007) confirmed that prudential regulation should not pursue a 'zero failure' objective. Rather, the objective is to maintain a low incidence of failure of supervised institutions while not impeding continued improvements in efficiency or hindering competition. APRA fully supports this objective. APRA's aim is to identify likely failures early enough so that corrective action can be initiated to prevent the failure, or at the least to set in train appropriate wind-up or other exit strategies to minimise losses to beneficiaries. Since APRA's inception in 1998, the annual PER has averaged 99.94 per cent and the annual MPR, which is dominated by the losses associated with HIH Insurance, has averaged 99.95 per cent.

Performing Entity Ratio (PER) and Money Protection Ratio (MPR)

Financial year	Number of failures[1]	Losses ($million)	Number of institutions[2]	Protected Accounts[3] ($million)	Annual PER %	Annual MPR %
1999	5	12	4,473	887,172	99.89	99.99
2000	3	308	4,407	993,369	99.93	99.97
2001	5	5,341[4]	4,350	1,043,111	99.89	99.49
2002	2	140	3,803	1,009,373	99.95	99.99
2003	5	19	3,252	1,068,081	99.85	99.99
2004	1	0[5]	2,745	1,207,119	99.96	100.00
2005	0	0	2,099	1,346,253	100.00	100.00
2006	0	0	1,596	1,548,454	100.00	100.00
2007	1	0[5]	1,244	1,837,363	99.92	100.00
2008	0	0	1,129	1,943,376	100.00	100.00
2009	0	0	1,028	2,049,612	100.00	100.00
2010	1	1	965	2,228,888	99.90	100.00

1 Includes failures due to employer sponsors in superannuation funds but excludes unresolved cases; if these later become failures, the prior year measurements are changed accordingly.

2 The number of institutions excludes Small APRA Funds and representative offices of foreign banks.

3 Protected Accounts is an estimate of the funds protected by APRA as defined by relevant legislation and is less than the total assets held by APRA-regulated institutions, which were $3,749 billion at end-June 2010.

4 Includes HIH Group's estimated $5.3 billion loss incurred by creditors and policyholders, based on liquidator's advice to creditors in April 2002.

5 Losses incurred, due to the failure of an employer sponsor in a superannuation fund, were less than $0.5 million. In the first case, the superannuation fund was not included in the PAIRS/SOARS database.

Chapter seven

Governance

Governance structure

APRA's governance structure comprises a full-time Executive Group of at least three and no more than five Members, as specified in Part 3 of the *Australian Prudential Regulation Authority Act 1998*. The Executive Group is responsible and accountable for the operation and performance of APRA.

APRA has the dual role of regulating bodies in the financial sector and developing the administrative practices and procedures to be applied in performing that regulatory role. In performing and exercising its functions and powers, APRA is required to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and, in balancing these objectives, is to promote financial system stability in Australia.

APRA's responsibilities include the development of regulatory and supervisory policies relating to the performance of its role as prudential regulator, including the making of prudential standards under relevant legislation.

APRA acts as a national statistical agency for the Australian financial system and plays a role in the early release of superannuation benefits. APRA is also responsible for administering the Financial Claims Schemes provided for in relevant banking and general insurance legislation.

The Executive Group meets formally on a monthly basis, and more frequently as required, to discuss and resolve the major prudential policy, supervisory and strategic issues facing APRA at the time. It also holds Management Group meetings with APRA's senior management team at least weekly for high-level information-sharing and decisions on more routine supervisory and organisational matters.

Members' attendance at Executive Group meetings from 1 July 2009 to 30 June 2010

	Meetings	Attended
John Laker	14	14
Ross Jones	14	12
John Trowbridge	14	13

Details on APRA Members are provided on pages 78-79 of this *Report*.

Risk Management and Audit Committee

APRA's Risk Management and Audit Committee provides independent assurance and assistance to the Executive Group on APRA's risk management and compliance framework and its external accountability responsibilities.

The Committee comprises an external chair (with casting vote), one external member, one member of APRA's Executive Group and one Executive General Manager. In addition, regular attendees at Committee meetings are the General Manager – Risk Management and Internal Audit, the Chief Financial Officer and a representative of the Australian National Audit Office. The Chairman of APRA may attend by invitation.

During 2009/10, the Committee met four times and at those meetings all audit reports were reviewed. The Committee also approved the Risk Management and Internal Audit annual plans and monitored APRA's Enterprise Risk Management Framework.

The members of the Committee in 2009/10 were:

Ms Elizabeth Alexander AM
BCom (Melb), FCA, FCPA, FAICD
Chair

Ms Alexander was appointed Chair of the Committee in 2003 and in 2008 was reappointed for a further two-year term. She is Chair of CSL Ltd and a non-executive director of Dexus Property Group and Medibank Private. She is an advisor to Blake Dawson and a former member of the Takeovers Panel. Ms Alexander is a former National President of the Australian Institute of Company Directors and of CPA Australia and an immediate former Deputy Chair of the Financial Reporting Council. A former partner of PricewaterhouseCoopers, she specialised in risk management and corporate governance issues.

Ms Alexander's term ended on 31 August 2010.

Mr W Peter Day
LLB (Hons), MBA, FCPA, FCA, FTIA, GAICD
External member

Mr Day was appointed for a five-year term in 2008. He is Chairman of Orbital Corporation Limited and Centro Retail Limited and a non-executive director of Ansell Limited, SAI Global Limited and Multiple Sclerosis Limited. He also serves as a non-executive director of the Accounting Professional and Ethical Standards Board.

Mr Day was, for seven years until 2007, Chief Financial Officer of Amcor Limited. He is a former Chairman of the Australian Accounting Standards Board, has participated in the setting of international accounting standards and was Deputy Chairman of the Australian Securities and Investments Commission from 1997 to 1999.

Mr Day assumed the role of Chair of the Committee on 1 September 2010.

Mr John Trowbridge
APRA Member

Mr Keith Chapman
Executive General Manager
– Supervisory Support Division

Attendance at Risk Management and Audit Committee meetings from 1 July 2009 to 30 June 2010

	Meetings	Attended
Elizabeth Alexander	4	4
Peter Day	4	4
John Trowbridge	4	4
Keith Chapman	4	4

Risk management in APRA

APRA has adopted an Enterprise Risk Management Framework for the identification, monitoring and management of risk within APRA. This APRA-wide approach has established defined risk categories that capture any substantial risk to APRA's mandate and objectives. For each risk category, an appropriate member of APRA's Management Group is allocated responsibility for the ongoing review, management and reporting of that risk.

APRA's Enterprise Risk Management Framework and its reporting processes were fully implemented in 2009/10. APRA's Executive Group and its Risk Management and Audit Committee receive consolidated risk reports on a quarterly basis. More detailed reports on each material risk category are reviewed by APRA's Management Group at least annually.

The Risk Management and Internal Audit unit plays an important role in APRA's governance, assurance and compliance framework through a detailed and structured approach to the assessment of risks and the review of APRA's systems and processes. The unit is independent of APRA's management structure and has a direct reporting line to the Chair of the Risk Management and Audit Committee and direct access to the Executive Group. It is staffed by officers with extensive experience in risk management, audit, regulated industries and prudential supervision.

Each year, following consultation with APRA management and staff and an assessment of APRA's strategies and risks, a broad-ranging and robust plan of internal audits is developed for approval by the Executive Group and endorsement by the Risk Management and Audit Committee. The plan covers specific aspects of APRA's supervisory and operational processes and its financial systems, and includes reviews of compliance with both internal and external requirements. Audit reviews identify and rate risks, and make recommendations aimed at improving APRA's internal controls and processes. The reviews also set out detailed and agreed management action plans and timetables to address issues identified. The unit monitors the implementation of agreed actions, undertakes follow-up reviews and reports the results of those reviews to the Executive Group and the Risk Management and Audit Committee.

Fraud risk management is an ongoing focus within APRA and a comprehensive fraud control framework is in place in line with Government requirements. All audits undertaken by the unit assess whether potential fraud exposures are appropriately addressed by APRA's processes and controls. APRA management makes formal six-monthly attestations on any fraud identified and actions implemented. There were no incidents of internal fraud reported for the year. Compulsory annual online fraud awareness training was delivered to all staff during 2009/10.

Other governance matters

The *Statutory report* provides details of various other aspects of governance in APRA, including executive and consultative committees.

APRA Members

Dr John Laker AO

BEc (Hons 1) (Syd), MSc PhD (London)
Chairman and Member

Dr Laker was appointed as a Member and Chairman of APRA on 1 July 2003, and was reappointed for a second five-year term commencing 1 July 2008.

Dr Laker is APRA's representative on the Reserve Bank of Australia's (RBA) Payments System Board, the Council of Financial Regulators, the Basel Committee on Banking Supervision and the Trans-Tasman Council on Banking Supervision. Dr Laker worked in the Commonwealth Treasury and International Monetary Fund before joining the RBA in 1982. He held senior positions in the economic, bank supervision and international areas before becoming the RBA's London-based Chief Representative in Europe from 1991 to 1993. On his return to Australia, Dr Laker took up the position of Assistant Governor (Corporate Services) and, in 1998, was appointed Assistant Governor (Financial System) and Deputy Chair of the RBA's Payments System Board. Dr Laker was made an Officer of the Order of Australia on Australia Day 2008 for services to the regulation of the Australian financial system and to the development and implementation of economic policies nationally and internationally.

Mr (Kerry) Ross Jones

BA, MCom (Newcastle)
Deputy Chairman and Member

Mr Jones was appointed as a Member and Deputy Chairman of APRA on 1 July 2003, and was reappointed for a second five-year term commencing 1 July 2008.

Mr Jones is also President of the International Organisation of Pension Supervisors, Deputy Chairman of the OECD Working Party on Private Pensions and a member of the International Network for Financial Education. Prior to joining APRA, Mr Jones held the position of Commissioner at the Australian Competition and Consumer Commission (ACCC) with responsibilities for mergers and acquisitions and telecommunications. Mr Jones was also an Associate Professor in the School of Finance and Economics at the University of Technology Sydney (UTS).

Mr John Trowbridge

BSc (Syd), BE (Syd), BA (ANU), FIA, FIAA
Member

Mr Trowbridge served as a Member of APRA from 1 July 2006 to 30 June 2010.

During this period, Mr Trowbridge was also a member of the Financial Reporting Council and the Executive Committee of the International Association of Insurance Supervisors. Mr Trowbridge founded Trowbridge Consulting in 1981, a firm which became a leading actuarial and management consulting firm during the next 20 years. In his time as a consultant, Mr Trowbridge's clientele included all major Australian insurance companies, banks and wealth management companies, governments or government authorities in all Australian States and New Zealand, and numerous major industrial organisations. He was President of the Institute of Actuaries of Australia in 1998 and served as a member of the Treasurer's Financial Sector Advisory Council from 1998 to 2004. He has also held senior executive positions with two insurers (QBE Insurance and Suncorp) and has been a director of Munich Reinsurance in Australia.

Mr Ian Laughlin

BSc (Qld), FIA, FIAA, FAICD
Member

Mr Laughlin was appointed as a Member of APRA on 1 July 2010 for a three-year term.

Mr Laughlin has extensive experience in the financial services industry. He has been a non-executive director of AMP Life Limited, serving as Chairman of its Board Audit Committee, Managing Director of the United Kingdom life insurance subsidiaries of AMP (Pearl, London Life and NPI), director of HHG plc and non-executive director of Diligenta Ltd in the United Kingdom. Before then, he held senior management positions in AMP, Suncorp and National Mutual in Australia, New Zealand and Hong Kong. Mr Laughlin has also served on the Council of the Institute of Actuaries of Australia.

Statement by Members and the Chief Financial Officer

In our opinion, the attached financial statements for the year ended 30 June 2010 are based on properly maintained financial records and give a true and fair view of the matters required by the Finance Minister's Orders made under the *Financial Management and Accountability Act 1997*, as amended.

Dr John F. Laker	**Mr K. Ross Jones**	**Mr Jim Flaye**
Chairman	Deputy Chairman	Chief Financial Officer
24 August 2010	24 August 2010	24 August 2010

Chapter eight

Financial statements

Table of contents

Notes

Statement of Comprehensive Income
for the year ended 30 June 2010

	Notes	2010 $'000	2009 $'000
Expenses			
Employee benefits	4A	**81,557**	72,768
Supplier expenses	4B	**30,059**	26,566
Depreciation and amortisation	4C	**4,542**	3,738
Finance costs	4D	**99**	89
Write-down and impairment of assets	4E	**–**	80
Losses from asset sales	4F	**11**	31
Total expenses		**116,268**	103,272
Less:			
Own-source income			
Own-source revenue			
Rendering of services	5A	**4,255**	3,854
Rental income	5B	**38**	22
Other revenue	5C	**654**	813
Total own-source revenue		**4,947**	4,689
Gains			
Other gains	5D	**118**	110
Total gains		**118**	110
Total own-source income		**5,065**	4,799
Net cost of (contribution by) services		**111,203**	98,473
Revenue from Government	5E	**121,940**	100,038
Operating surplus/(deficit)		**10,737**	1,565
Surplus (deficit) attributable to the Australian Government		**10,737**	1,565
Other comprehensive income			
Changes in asset revaluation reserves	6	**–**	–
Total other comprehensive income		**–**	–
Total comprehensive income (loss) attributable to the Australian Government		**10,737**	1,565

The above statement should be read in conjunction with the accompanying Notes.

Balance Sheet
as at 30 June 2010

	Notes	2010 $'000	2009 $'000
Assets			
Financial assets			
Cash and cash equivalents	7A	**49,533**	31,303
Trade and other receivables	7B	**4,376**	6,499
Total financial assets		**53,909**	37,802
Non-financial assets			
Infrastructure, plant and equipment	8A,B	**5,399**	6,861
Intangibles	8C	**9,133**	5,656
Other non-financial assets	8E	**2,174**	1,975
Total non-financial assets		**16,706**	14,492
Total assets		**70,615**	52,294
Liabilities			
Payables			
Suppliers	9A	**328**	–
Unearned fees and charges	9B	**1,718**	941
Other payables	9C	**2,971**	2,525
Total payables		**5,017**	3,466
Provisions			
Employee provisions	10A	**25,126**	21,463
Other provisions	10B	**2,332**	1,919
Total provisions		**27,458**	23,382
Total liabilities		**32,475**	26,848
Net assets		**38,140**	25,446
Equity			
Contributed equity		**6,012**	4,055
Reserves		**9,809**	9,809
Retained surpluses		**22,319**	11,582
Total equity		**38,140**	25,446

The above statement should be read in conjunction with the accompanying Notes.

Statement of Changes in Equity

for the year ended 30 June 2010

	2010 $'000	2009 $'000	2010 $'000	2009 $'000	2010 $'000	2009 $'000	2010 $'000	2009 $'000	2010 $'000	2009 $'000
	Retained earnings		Asset revaluation reserves		Contingency Enforcement Fund		Contributed equity/capital		Total equity	
Opening balance	**11,582**	10,017	**3,809**	3,809	**6,000**	6,000	**4,055**	3,155	**25,446**	22,981
Comprehensive income										
Other comprehensive income	**–**	–	**–**	–	**–**	–	**–**	–	**–**	–
Surplus (deficit) for the period	**10,737**	1,565							**10,737**	1,565
Total comprehensive income	**10,737**	1,565	**–**	–	**–**	–	**–**	–	**10,737**	1,565
Contributions by owners										
Appropriations (equity injection)	**–**	–	**–**	–	**–**	–	**1,957**	900	**1,957**	900
Sub-total: transactions with owners	**–**	–	**–**	–	**–**	–	**1,957**	900	**1,957**	900
Closing balance as at 30 June	**22,319**	11,582	**3,809**	3,809	**6,000**	6,000	**6,012**	4,055	**38,140**	25,446

The above statement should be read in conjunction with the accompanying Notes.

Statement of Cash Flows
for the year ended 30 June 2010

	Notes	2010 $'000	2009 $'000
Operating activities			
Cash received			
Appropriations		**127,307**	99,695
Goods and services		**6,612**	1,882
Rental income		**38**	22
Net GST received		**2,400**	2,128
Other		**772**	924
Total cash received		**137,129**	104,651
Cash used			
Employees		**(77,637)**	(70,048)
Suppliers		**(32,357)**	(31,688)
Payment to the OPA		**(4,294)**	–
Total cash used		**(114,288)**	(101,736)
Net cash from/(used by) operating activities	11	**22,841**	2,915
Investing activities			
Cash used			
Purchase of property, plant and equipment		**(1,448)**	(1,695)
Purchase of intangibles		**(5,120)**	(2,167)
Total cash used		**(6,568)**	(3,862)
Net cash (used by) investing activities		**(6,568)**	(3,862)
Financing activities			
Cash received			
Capital injections		**1,957**	900
Net cash from financing activities		**1,957**	900
Net increase/(decrease) in cash held		**18,230**	(47)
Cash and cash equivalents at the beginning of the reporting period		**31,303**	31,350
Cash and cash equivalents at the end of the reporting period	7A	**49,533**	31,303

The above statement should be read in conjunction with the accompanying Notes.

Schedule of Commitments
as at 30 June 2010

	2010 $'000	2009 $'000
By type[1]		
Commitments receivable		
GST recoverable on commitments	**(1,835)**	(2,942)
Total commitments receivable	**(1,835)**	(2,942)
Other commitments		
Operating leases	**20,189**	32,366
Total other commitments	**20,189**	32,366
Net commitments by type	**18,354**	29,424
By maturity		
Commitments receivable		
GST recoverable on commitments		
One year or less	**(743)**	(822)
From one to five years	**(1,088)**	(2,050)
Over five years	**(4)**	(70)
Total operating lease income	**(1,835)**	(2,942)
Operating lease commitments		
One year or less	**8,170**	9,040
From one to five years	**11,972**	22,555
Over five years	**47**	771
Total operating lease commitments	**20,189**	32,366
Net commitments by maturity	**18,354**	29,424

Nature of lease	General description of leasing arrangement
Leases for office accommodation	Lease payments in Sydney are subject to prevailing market rates. Leases for all other offices are subject to fixed annual increment. Office leases, with current expiry dates shown in brackets, are current for space in Sydney (various levels 2012), Canberra (2015), Melbourne (2012), Adelaide (2012), Brisbane (2012) and Perth (2014).

The above schedule should be read in conjunction with the accompanying Notes.

1 Commitments are stated inclusive of GST where relevant.

Schedule of Contingencies
as at 30 June 2010

	2010 $'000	2009 $'000
Contingent assets		
Claims for damages/costs	–	200
Total contingent assets	–	200
Contingent liabilities		
Claims for damages/costs	–	(500)
Total contingent liabilities	–	(500)
Net contingent assets/(liabilities)	–	(300)

Details of each class of contingent liabilities and assets, including those not included above because they cannot be quantified or are remote, are disclosed in Note 12: *Contingent liabilities and assets.*

The above schedule should be read in conjunction with the accompanying Notes.

Schedule of Asset Additions
as at 30 June 2010

The following non-financial non-current assets were added in 2009/10:

	Infrastructure, plant and equipment $'000	Intangibles $'000	Total $'000
By appropriation – equity	–	783	783
By purchase – appropriation ordinary annual services	1,448	4,337	5,785
Total additions	1,448	5,120	6,568

The following non-financial non-current assets were added in 2008/09:

	Infrastructure, plant and equipment $'000	Intangibles $'000	Total $'000
By appropriation – equity	224	204	428
By purchase – appropriation ordinary annual services	1,471	1,963	3,434
Total additions	1,695	2,167	3,862

The above schedule should be read in conjunction with the accompanying Notes.

Schedule of Administered Items

	Notes	2010 $'000	2009 $'000
Income administered on behalf of Government for the year ended 30 June 2010			
Taxation revenue			
Financial Institutions Supervisory Levies	16	**124,891**	107,545
Total revenues administered on behalf of Government		**124,891**	107,545
Expenses administered on behalf of Government for the year ended 30 June 2010			
Supervisory Levy waivers and write-offs	17	**873**	684
Impairment allowance adjustment	17	**6**	–
Total expenses administered on behalf of Government		**879**	684
Assets administered on behalf of Government as at 30 June 2010			
Financial assets			
Receivables – Supervisory Levies	18	**38**	85
Liabilities administered on behalf of Government as at 30 June 2010			
Total liabilities administered on behalf of Government		**–**	–

This schedule should be read in conjunction with the accompanying Notes.

Schedule of Administered Items

	Note	2010 $'000	2009 $'000
Administered cash flows			
for the year ended 30 June 2010			
Operating activities			
Cash received			
Financial Institutions Supervisory Levies		124,070	109,428
Cash received from Official Public Account for refunds		11	2,418
Total cash received		124,081	111,846
Cash used			
Refunds for overpayment of levies		(11)	(1,813)
Refunds for incorrect deposits		–	(605)
Total cash used		(11)	(2,418)
Net cash flows from operating activities		124,070	109,428
Net increase/(decrease) in cash held		124,070	109,428
Cash at the beginning of the reporting period		–	–
Cash to Official Public Account for:			
– Financial Institutions Supervisory Levies		(124,070)	(109,428)
Cash and cash equivalents at the end of the reporting period	18	–	–

APRA administers the collection of Financial Institutions Supervisory Levies on behalf of the Government. While the revenues from Supervisory Levies are in part used to fund the operations of APRA, they are not directly available to be used by APRA for its own purposes. All administered collections are remitted to the Government's Official Public Account. Transactions and balances relating to levies are reported in Note 16: *Income administered on behalf of Government*.

This schedule should be read in conjunction with the accompanying Notes.

Notes to and Forming Part of the Financial Statements
for the year ended 30 June 2010

Note 1: Summary of significant accounting policies

1.1 Objectives of Australian Prudential Regulation Authority

The role of the Australian Prudential Regulation Authority (APRA) is developing and enforcing a robust prudential framework that promotes prudent behaviour by authorised deposit-taking institutions (ADIs), insurance companies, superannuation funds and other financial institutions it supervises, with the key aim of protecting the interest of their depositors, policyholders and superannuation fund members. In carrying out the role, APRA's objective is to enhance public confidence in Australia's financial institutions through a prudential framework that balances financial safety and efficiency, competition and competitive neutrality. Prudential regulation focuses on the quality of an institution's systems for identifying, measuring and managing the various risks in its business. In addition, APRA is responsible for administering the Financial Claims Schemes provided for in relevant banking and general insurance legislation.

APRA's activities contributing toward these outcomes are classified as either 'departmental' or 'administered'. Departmental activities involve the use of assets, liabilities, revenues and expenses controlled or incurred by APRA in its own right. Administered activities involve the management or oversight by APRA, on behalf of the Government, of items controlled or incurred by the Government.

APRA's continued existence in its present form and with its present programs is dependent on Government policy and on continuing appropriations by Parliament.

1.2 Basis of preparation of the financial statements

The financial statements and notes are required by section 49 of the *Financial Management and Accountability Act 1997* and are general purpose financial statements.

The financial statements and notes have been prepared in accordance with:

- Finance Minister's Orders (FMOs) for reporting periods ending on or after 1 July 2009; and
- Australian Accounting Standards and Interpretations issued by the Australian Accounting Standards Board (AASB) that apply for the reporting period.

The financial statements have been prepared on an accrual basis and in accordance with the historical cost convention, except for certain assets and liabilities at fair value. Except where stated, no allowance is made for the effect of changing prices on the results or the financial position.

The financial statements are presented in Australian dollars and values are rounded to the nearest thousand dollars unless otherwise specified.

Unless an alternate treatment is specifically required by an accounting standard or the FMOs, assets and liabilities are recognised in the *Statement of Financial Position* when and only when it is probable that future economic benefits will flow to the entity or a future sacrifice of economic benefits will be required and the amounts of the assets or liabilities can be reliably measured. However, assets and liabilities arising under agreements equally proportionately unperformed are not recognised unless required by an accounting standard. Liabilities and assets that are unrecognised are reported in the *Schedule of Commitments* and the *Schedule of Contingencies*.

Unless alternative treatment is specifically required by an accounting standard, income and expenses are recognised in the *Statement of Comprehensive Income* when and only when the flow, consumption or loss of economic benefits has occurred and can be reliably measured.

Administered revenues, expenses, assets, liabilities and cash flows reported in the *Schedule of Administered Items* and related notes are accounted for on the same basis and using the same policies as for departmental items, except where otherwise stated at Note 1.18.

There were no administered commitments in 2009/10 or in 2008/09.

1.3 Significant accounting judgments and estimates

In the process of applying the accounting policies listed in this note, APRA has made the following judgments that have the most significant impact on the amounts recorded in the financial statements:

- the fair value of leasehold improvements has been taken to be the market value of similar installations as determined by an independent valuer in May 2008.

No accounting assumptions and estimates have been identified that have a significant risk of causing a material adjustment to carrying amount of assets and liabilities within the next accounting period.

APRA has assessed the value of its non-financial assets as at 30 June 2010 and is satisfied that they reflect the fair value.

1.4 Changes in Australian Accounting Standards

Australian Accounting Standards require a statement of compliance with International Financial Reporting Standards (IFRS) to be made where the financial *Report* complies with these standards. Some Australian equivalents to IFRS and other Australian Accounting Standards contain requirements specific to not-for-profit entities that are inconsistent with IFRS requirements. APRA is a not-for-profit entity and has applied these requirements. Hence, this financial *Report* complies with Australian Accounting Standards including Australian Equivalents to International Financial Reporting Standards (AEIFRS) but not fully with IFRS.

Adoption of new Australian Accounting Standard requirements

No accounting standard has been adopted earlier than the application date as stated in the standard. No new accounting standards, amendments to standards and interpretations issued by the AASB that were issued prior to the signing of the financial statements by Members and the Chief Financial Officer and that are applicable in the current period, have had a material financial affect on APRA and are not expected to have a future financial impact on APRA.

Future Australian Accounting Standard requirements

New accounting standards, amendments to standards and interpretations that were issued prior to the signing of the financial statements by Members and the Chief Financial Officer and are effective for future reporting periods have been issued by the AASB. It is expected that these changes, when effective, will have no material financial impact on future reporting periods.

AASB 1053 *Application of Tiers of Australian Accounting Standards* has been issued but is not yet effective. As at 30 June 2010, no Government decision has been taken on whether this standard will apply to Government-controlled entities.

Notes to and Forming Part of the Financial Statements
for the year ended 30 June 2010

1.5 Revenue

Revenues from Government

APRA is funded primarily through levies imposed on the industries it supervises. These levies, known as the Financial Institutions Supervisory Levies, are administered transactions collected on behalf of the Government and paid into the Consolidated Revenue Fund (CRF). An amount equal to the net levy revenue, less an amount specified by the Minister in an annual determination made under subsection 50(1) of the *Australian Prudential Regulation Authority Act 1998* (APRA Act), is credited to the APRA Special Account as a Special Appropriation, in accordance with subsections 50(2), (3) and (5) of the APRA Act. The amounts specified in the Minister's Determinations are retained in the CRF to cover the costs of providing market integrity and consumer protection functions for prudentially regulated institutions, functions that are conducted by other Australian Government entities. The calculation of the Special Appropriation is shown at Note 3.

Amounts appropriated for APRA's outputs for the year (adjusted for any formal additions and reductions) are recognised as revenue when APRA gains control of the appropriation, except for certain amounts that relate to activities that are reciprocal in nature, in which case revenue is recognised only when it has been earned. Appropriations receivable are recognised at their nominal amounts.

Other revenue

Revenue from the sale of goods, if any, is recognised when:

- the risks and rewards of ownership have been transferred to the buyer;
- the agency retains no managerial involvement nor effective control over the goods;
- the revenue and transaction costs incurred can be reliably measured; and
- it is probable that the economic benefits associated with the transaction will flow to the entity.

Revenue from rendering of services is recognised by reference to the stage of completion of contracts at the reporting date. The revenue is recognised when:

- the amount of revenue, stage of completion and transaction costs incurred can be reliably measured; and
- the probable economic benefits associated with the transaction will flow to the entity.

The stage of completion of contracts at the reporting date is determined by reference to the proportion that costs incurred to date bear to the estimated total costs of the transaction.

Receivables for goods and services, which have 30-day terms, are recognised at the nominal amounts due less any impairment allowance account. Collectability of debts is reviewed at balance date. Allowances are made when collectability of the debt is no longer probable.

1.6 Gains

Resources received free of charge

Resources received free of charge are recognised as gains when and only when a fair value can be reliably determined and the services would have been purchased if they had not been donated. Use of those resources is recognised as an expense.

Contributions of assets at no cost of acquisition or for nominal consideration are recognised as gains at their fair value when the asset qualifies for recognition.

Resources received free of charge are recorded as either revenue or gains depending on their nature.

Sale of assets

Gains from disposal of non-current assets are recognised when control of the asset has passed to the buyer.

1.7 Transactions with the Government as owner

Equity injections

Amounts appropriated as 'equity injections' for a year (less any formal reductions) are recognised directly in contributed equity in that year.

Other distributions to owners

The FMOs require that distributions to owners be debited to contributed equity unless in the nature of a dividend.

1.8 Employee benefits

Liabilities for 'short-term employee benefits' (as defined in AASB 119 *Employee Benefits*) and termination benefits due within
12 months of balance date are measured at their nominal amounts. The nominal amount is calculated with regard to the rates expected to be paid on settlement of the liability.

All other employee benefit liabilities are measured as the present value of the estimated future cash outflows to be made in respect of services provided by employees up to the reporting date.

Leave

The liability for employee benefits includes provision for annual leave and long service leave. No provision has been made for sick leave as all sick leave is non-vesting and the average sick leave taken in future years by employees of APRA is estimated to be less than the annual entitlement for sick leave.

The annual leave liabilities are calculated on the basis of employees' remuneration, at the estimated salary rates that will be applied at the time the leave is taken, including APRA's employer superannuation contribution rates, assuming that the leave is likely to be taken during service rather than paid out on termination.

The liability for long service leave has been recognised and measured at the present value of the estimated future cash flows to be made in respect of all employees at the end of the financial year. The estimate of the present value of the liability takes into account attrition rates and pay increases through promotion and inflation.

Separation and redundancy

Provision is made for separation and redundancy benefit payments in cases where APRA has developed a detailed formal plan for the terminations and has informed the employees affected that it will carry out the terminations.

Notes to and Forming Part of the Financial Statements
for the year ended 30 June 2010

Superannuation

Certain employees of APRA are members of the Commonwealth Superannuation Scheme (CSS), the Public Sector Superannuation Scheme (PSS), or the PSS Accumulation Plan (PSSap). The CSS and PSS are defined benefit schemes for the Australian Government. The PSSap is a defined contribution scheme. The liability for defined benefits is recognised in the financial statements of the Australian Government and is settled by the Australian Government in due course. The liability is reported by the Department of Finance and Deregulation as an administered item. APRA makes employer contributions to the employee superannuation scheme at rates determined by an actuary to be sufficient to meet the cost to the Government of the superannuation entitlements of APRA's employees. APRA accounts for the contributions as if they were contributions to defined contribution plans.

APRA also makes employer contributions to the Reserve Bank Officers' Superannuation Fund and to State-based superannuation schemes for former employees of the Reserve Bank of Australia and State-based regulators, respectively.

For all other employees, employer contributions are made to other superannuation (accumulation) funds, as nominated by the employee (see Note 4A).

The liability for superannuation recognised at 30 June 2010 represents outstanding contributions for the final fortnight of the year.

1.9 Leases

A distinction is made between finance leases and operating leases. Finance leases effectively transfer from the lessor to the lessee substantially all the risks and rewards incidental to ownership of leased assets. In operating leases, the lessor effectively retains substantially all such risks and benefits.

Operating lease payments are expensed on a straight-line basis that is representative of the pattern of benefits derived from the leased assets. APRA has no finance leases.

1.10 Cash

Cash and cash equivalents means notes and coins held and any deposits with a bank or financial institution with an original maturity of three months or less that are readily convertible to known amounts of cash and subject to insignificant risk of changes in value. Cash is recognised at its nominal amount.

1.11 Financial assets

In addition to cash and cash equivalents, APRA holds financial assets in the form of trade and other receivables.

The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Financial assets are recognised and derecognised upon trade date.

Loans and receivables

Trade receivables, loans and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as 'loans and receivables'. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. Loans and receivables are measured at amortised cost using the effective interest method less impairment. Interest is recognised by applying the effective interest rate.

Impairment of financial assets

Financial assets are individually assessed for impairment at each balance date. Where there is sufficient evidence to suggest that an impairment loss has been incurred, the carrying amount is reduced by way of an allowance account. The loss is recognised in the *Statement of Comprehensive Income*.

1.12 Financial liabilities

APRA classifies its financial liabilities as 'suppliers and other payables'.

Financial liabilities are recognised and derecognised upon 'trade date'.

Other financial liabilities

Other financial liabilities are initially measured at fair value, net of transaction costs.

They are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period.

Supplier and other payables are recognised at amortised cost. Liabilities are recognised to the extent that the goods or services have been received (and irrespective of having been invoiced).

1.13 Contingent liabilities and contingent assets

Contingent liabilities and contingent assets are not recognised in the *Balance Sheet* but are reported in the relevant Schedules and Notes. They may arise from uncertainty as to the existence of a liability or asset, or represent a liability or asset in respect of which amount cannot be reliably measured. Contingent assets are disclosed when settlement is probable but not virtually certain and contingent liabilities are disclosed when the probability of settlement is greater than remote.

There were no administered contingent assets or contingent liabilities in the current or prior period.

1.14 Acquisition of assets

Assets are recorded at cost on acquisition, except as stated below. The cost of acquisition includes the fair value of assets transferred in exchange and liabilities undertaken. Financial assets are initially measured at their fair value plus transaction costs where appropriate.

Assets acquired at no cost, or for nominal consideration, are initially recognised as assets and income at their fair value at the date of acquisition, unless acquired as a consequence of restructuring of administrative arrangements. In the latter case, assets are initially recognised as contributions by owners at the amounts at which they were recognised in the transferor entity's accounts immediately prior to the restructuring.

Notes to and Forming Part of the Financial Statements
for the year ended 30 June 2010

1.15 Property, plant and equipment

Asset recognition threshold

Purchases of property, plant and equipment are recognised initially at cost in the *Balance Sheet*, except for purchases costing less than $5,000, which are expensed in the year of acquisition (other than where they form part of a group of similar items that are significant in total).

The initial cost of an asset includes an estimate of the cost of dismantling and removing the item and restoring the site on which it is located. This is particularly relevant to 'make good' provisions in property leases taken up by APRA where there exists an obligation to restore the property to its original condition. These costs are included in the value of APRA's leasehold improvements with a corresponding provision for the 'make good' recognised. Adjustments to the value of the provision are recognised in the *Statement of Comprehensive Income* as expenses or gains as incurred.

Revaluations

Following initial recognition at cost, property, plant and equipment are carried at fair value, less subsequent accumulated depreciation and accumulated impairment losses. Valuations are conducted with sufficient frequency such that the carrying amount of each class of asset is not materially different, at reporting date, from its fair value. Valuations are undertaken every three years as at 30 June (last valuation 2007/08).

Fair values for each class of asset are determined as shown below.

Asset class	Fair value measured at:
Leasehold improvements	Depreciated replacement cost
Computer hardware and office equipment	Market selling price

Revaluation adjustments are made on a class basis. Any revaluation increment is credited to equity under the heading of asset revaluation reserve except to the extent that it reverses a previous revaluation decrement of the same asset class that was previously recognised through the *Statement of Comprehensive Income*. Revaluation decrements for a class of assets are recognised directly through the *Statement of Comprehensive Income* except to the extent that they reverse a previous revaluation increment for that class.

Any accumulated depreciation as at the revaluation date is eliminated against the gross carrying amount of the asset and the asset restated to the revalued amount.

Depreciation and amortisation

Depreciable plant and equipment assets are written off to their estimated residual values over their estimated useful lives to APRA using, in all cases, the straight-line method of depreciation. Leasehold improvements are amortised on a straight-line basis over the lesser of the estimated useful life of the improvements or the unexpired period of the lease.

Depreciation/amortisation rates and methods are reviewed at each reporting date and necessary adjustments are recognised in the current, or current and future reporting periods, as appropriate.

Depreciation rates applying to each class of depreciable asset are based on the following useful lives:

Asset class	2010	2009
Leasehold improvements	**Lesser of 10 years or lease term**	Lesser of 10 years or lease term
Computer hardware and office equipment	**3 to 12 years**	3 to 12 years

Impairment

All assets are assessed for impairment at 30 June. Where indications of impairment exist, the asset's recoverable amount is estimated and an impairment adjustment made if the asset's recoverable amount is less than its carrying amount.

The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use. Value in use is the present value of the future cash flows expected to be derived from the asset. Where the future economic benefit of an asset is not primarily dependent on the asset's ability to generate future cash flows, and the asset would be replaced if APRA were deprived of the asset, its value in use is taken to be its depreciated replacement cost.

Derecognition

An item of property, plant and equipment is derecognised upon disposal or when no further future economic benefits are expected from its use or disposal.

1.16 Intangibles

APRA's intangibles comprise internally developed software and purchased software for internal use. These assets are carried at cost less accumulated depreciation and accumulated impairment losses.

Software is amortised on a straight-line basis over its anticipated useful life. The useful lives of APRA's software are the lesser of five years or assessed useful life (2008/09: lesser of five years or assessed useful life).

All software assets were assessed for indications of impairment as at 30 June 2010.

1.17 Taxation

APRA is exempt from all forms of taxation except fringe benefits tax and the Goods and Service Tax (GST).

Revenue, expenses and assets are recognised net of GST except where the amount of GST incurred is not recoverable from the Australian Taxation Office and for receivables and payables.

Notes to and Forming Part of the Financial Statements
for the year ended 30 June 2010

1.18 Reporting of administered activities

Administered revenues, expenses, assets, liabilities and cash flows are disclosed in the *Schedule of Administered Items* and related Notes.

Except where otherwise stated below, administered items are accounted for on the same basis and using the same policies as for departmental items, including the application of Australian Accounting Standards.

Administered cash transfers to and from the Official Public Account

Revenue collected by APRA for use by the Government rather than by APRA is administered revenue. Collections are transferred to the Official Public Account (OPA) maintained by the Department of Finance and Deregulation. Conversely, cash is drawn from the OPA to make payments under Parliamentary appropriation on behalf of Government. These transfers to and from the OPA are adjustments to the administered cash held by APRA on behalf of the Government and reported as such in the Administered Cash Flows, in the *Schedule of Administered Items* and in the *Administered reconciliation table* in Note 19.

Revenue

All administered revenues relate to the course of the ordinary activities performed by APRA on behalf of the Australian Government. These revenues are not directly available to be used by APRA for its own purposes and are remitted to the OPA.

APRA undertakes the collection of certain levies on behalf of the Government. These comprise Financial Institutions Supervisory Levies, the Financial Assistance Levy and late payment penalties collected under the *Financial Institutions Supervisory Levies Collection Act 1998*. These administered items are distinguished from departmental items throughout these financial statements by background shading.

Administered revenue arising from levies on superannuation entities (including the Financial Assistance Levy) is recognised upon issue of invoice while administered revenue in respect of levies on all other entities is recognised on the date it becomes due and payable to APRA or on the date the payment is received, whichever occurs first. Levies are recognised at the nominal amounts due less any impairment allowance account. The collectability of debts is reviewed at balance date. Provisions are made when collection of the debt is judged to be less, rather than more, likely.

Expenses

Administered expenses arising from waiver and write-off of levy debts are recognised at the time of approval by delegated APRA officers.

Waivers of levies under the *Financial Institutions Supervisory Levies Collection Act 1998* are shown at Note 23, as required by the FMOs. Waivers generally occur due to a change of status of a supervised entity during the year, resulting in the annual levy being wholly or partly waived.

Note 2: Events after the balance sheet date

No events occurring after balance sheet date were noted.

Note 3: Calculation of APRA Special Appropriation

The APRA Special Appropriation is calculated in accordance with the provisions of s50 of the *Australian Prudential Regulation Authority Act 1998.*

Details are as follows:

	2010 $'000	2009 $'000
Table 1: Summary		
Current year levies and penalties (see Note 16, Table 1)	**124,891**	107,545
Less: Waivers, write-offs and doubtful debts (see Note 17)	**(879)**	(684)
Net current year levies and penalties (see Table 2 below)	**124,012**	106,861
Less: Amount retained in the CRF (see Table 3 below)	**(25,800)**	(21,000)
Total	**98,212**	85,861
Table 2: Net current year levies and penalties by levy type		
Superannuation funds	**43,682**	38,898
Authorised deposit-taking institutions	**42,674**	36,615
Life insurers and friendly societies	**12,814**	10,441
General insurers	**24,842**	20,907
Total	**124,012**	106,861
Table 3: Amounts retained in the CRF by levy type[1]		
Superannuation funds	**(16,800)**	(15,400)
Authorised deposit-taking institutions	**(3,600)**	(2,300)
Life insurers and friendly societies	**(2,200)**	(1,800)
General insurers	**(3,200)**	(1,500)
Total	**(25,800)**	(21,000)
Table 4: Equivalent amounts of levy payable to APRA under the APRA Special Appropriation by levy type		
Superannuation funds	**26,882**	23,498
Authorised deposit-taking institutions	**39,074**	34,315
Life insurers and friendly societies	**10,614**	8,641
General insurers	**21,642**	19,407
Total	**98,212**	85,861

1 As determined by the Minister in accordance with subsection 50 (1) of the *Australian Prudential Regulation Authority Act 1998.*

Notes to and Forming Part of the Financial Statements
for the year ended 30 June 2010

Note 4: Operating expenses

	2010 $'000	2009 $'000
Note 4A: Employee benefits		
Salaries and wages	**64,573**	57,412
Superannuation	**7,206**	6,896
Leave and other entitlements	**9,326**	7,887
Separation and redundancies	**202**	245
Other employee benefits	**250**	328
Total employee benefits	**81,557**	72,768
Note 4B: Supplier expenses		
Goods and services		
Consultants	**2,023**	1,467
Contractors	**3,027**	3,062
Travel-related expenses	**4,068**	4,743
Operational expenses	**8,546**	6,937
Training and conference expenses	**2,262**	1,728
Other professional services	**2,660**	2,108
Total goods and services	**22,586**	20,045
Goods and services are made up of:		
Provision of goods – external parties	**2,961**	2,613
Rendering of services – related entities	**447**	559
Rendering of services – external parties	**19,178**	16,873
Total goods and services	**22,586**	20,045
Other supplier expenses		
Operating lease rentals – external entities:		
– minimum lease payments	**7,302**	6,395
Workers' compensation premiums	**171**	126
Total other supplier expenses	**7,473**	6,521
Total supplier expenses	**30,059**	26,566

Note 4: Operating expenses (continued)

	2010 $'000	2009 $'000
Note 4C: Depreciation and amortisation		
Depreciation:		
Computer hardware	**1,260**	1,065
Leasehold improvements	**1,642**	1,291
Total depreciation	**2,902**	2,356
Amortisation:		
Intangibles – computer software	**1,640**	1,382
Total amortisation	**1,640**	1,382
Total depreciation and amortisation	**4,542**	3,738
Note 4D: Finance costs		
Unwinding of discount	**99**	89
Total finance costs	**99**	89
Note 4E: Write-down and impairment of assets		
Net write-down of assets from:		
Impairment of internally developed software	**–**	80
Total write-down and impairment of assets	**–**	80
Note 4F: Losses from asset sales		
Computer hardware/software	**11**	31
Total losses from asset disposals	**11**	31

Notes to and Forming Part of the Financial Statements
for the year ended 30 June 2010

Note 5: Income

	2010 $'000	2009 $'000
Revenue		
Note 5A: Rendering of services		
Rendering of services – related entities	**1,192**	1,218
Rendering of services – external entities	**3,063**	2,636
Total sale of goods and rendering of services	**4,255**	3,854
Note 5B: Rental income		
Rental income	**38**	22
Total rental income	**38**	22
Note 5C: Other revenue		
Licence fees from finance sector entities	**359**	469
Superannuation trustee applications	**71**	68
Fees from foreign bank representative offices	**70**	80
Recoveries from RBA for scholarship	**11**	23
Other revenue	**143**	173
Total other revenue	**654**	813
Note 5D: Other gains		
Resources free of charge	**118**	110
Total other gains	**118**	110
Revenue from Government		
Note 5E: Revenue from Government		
Special Appropriations	**98,212**	85,861
Departmental outputs	**23,728**	14,177
Total revenue from Government	**121,940**	100,038

Note 6: Other comprehensive income

	2010 $'000	2009 $'000
Note 6A: Reclassification adjustments		
Total reclassication adjustments of other comprehensive income	**–**	–

Note 7: Financial assets

	2010 $'000	2009 $'000
Note 7A: Cash and cash equivalents		
APRA Special Account	**49,530**	31,300
Cash on hand	**3**	3
Total cash and cash equivalents	**49,533**	31,303
Note 7B: Trade and other receivables		
Goods and services:		
Goods and services – related entities	**785**	1,065
Goods and services – external parties	**2,501**	2,849
Total receivables for goods and services	**3,286**	3,914
Appropriations receivable:		
For existing outputs	**723**	2,500
Special Appropriations	**44**	85
Total appropriations receivable	**767**	2,585
Other receivables:		
GST receivable from the Australian Taxation Office	**329**	–
Total other receivables	**329**	–
Total trade and other receivables (gross)	**4,382**	6,499
Less: impairment allowance account		
Goods and services	**(6)**	–
Total impairment allowance account	**(6)**	–
Total trade and other receivables (net)	**4,376**	6,499
Receivables are expected to be recovered in:		
Less than 12 months	**4,376**	6,499
Total trade and other receivables (net)	**4,376**	6,499

Notes to and Forming Part of the Financial Statements
for the year ended 30 June 2010

Note 7: Financial assets (continued)

	2010 $'000	2009 $'000
Receivables are aged as follows:		
Not overdue	**4,329**	–
Overdue by:		
– 0 to 30 days	**3**	6,451
– 31 to 60 days	**7**	2
– 61 to 90 days	**8**	17
– more than 90 days	**29**	29
Total receivables (gross)	**4,376**	6,499
The impairment allowance account is aged as follows:		
Not overdue	**–**	–
Overdue by:		
– 0 to 30 days	**–**	–
– 31 to 60 days	**–**	–
– 61 to 90 days	**–**	–
– more than 90 days	**(6)**	–
Total impairment allowance account	**(6)**	–

Note 7: Financial assets (continued)

Note 7B: Trade and other receivables (continued)

Reconciliation of the impairment allowance account

Movements in relation to 2010	Goods and services $'000	Other receivables $'000	Total $'000
Opening balance	–	–	–
Amounts written off	–	–	–
Amounts recovered and reversed	–	–	–
Increase/decrease recognised in net surplus	(6)	–	(6)
Closing balance	**(6)**	**–**	**(6)**

There was no impairment allowance for 2008/09.

Note 8: Non-financial assets

	2010 $'000	2009 $'000
Note 8A: Infrastructure, plant and equipment		
Computer hardware and office equipment		
– fair value	**4,727**	4,390
– accumulated depreciation	**(3,027)**	(2,291)
– work in progress	**–**	113
Total computer hardware and office equipment	**1,700**	2,212
Leasehold improvements		
– fair value	**6,696**	5,958
– accumulated depreciation	**(2,997)**	(1,355)
– work in progress	**–**	46
Total leasehold improvements	**3,699**	4,649
Total infrastructure, plant and equipment	**5,399**	6,861

All assets are assessed for impairment at 30 June, using internal expertise. All fit-outs were revalued by an independent valuer in May 2008. The next revaluation is due in 2010/11.

No indicators of impairment were found for property, plant and equipment.

APRA has assessed the value of its non-financial assets as at 30 June 2010 and is satisfied that they reflect the fair value.

Notes to and Forming Part of the Financial Statements
for the year ended 30 June 2010

Note 8B: Reconciliation of the opening and closing balances of property, plant and equipment

Table A 2009/10	Computer hardware and office equipment $'000	Leasehold improvements $'000	Total $'000
As at 1 July 2009			
Gross book value	**4,503**	**6,004**	**10,507**
Accumulated depreciation and impairment	(2,291)	(1,355)	(3,646)
Net book value 1 July 2009	**2,212**	**4,649**	**6,861**
Additions:			
By purchase	756	692	1,448
Depreciation expense	(1,260)	(1,642)	(2,902)
Disposals:			
Disposals by write-off (at cost)	(532)	–	(532)
Disposals by write-off (less accumulated depreciation)	524	–	524
Net book value 30 June 2010	**1,700**	**3,699**	**5,399**
Net book value as of 30 June 2010 represented by:			
Gross book value	**4,727**	**6,696**	**11,423**
Accumulated depreciation	**(3,027)**	**(2,997)**	**(6,024)**
	1,700	**3,699**	**5,399**

Note 8B: Reconciliation of the opening and closing balances of property, plant and equipment

Table B 2008/09	Computer hardware and office equipment $'000	Leasehold improvements $'000	Total $'000
As at 1 July 2008			
Gross book value	**4,029**	**5,239**	**9,268**
Accumulated depreciation and impairment	(1,677)	(64)	(1,741)
Net book value 1 July 2008	**2,352**	**5,175**	**7,527**
Additions:			
By purchase	931	764	1,695
Depreciation expense	(1,065)	(1,290)	(2,355)
Disposals:			
Disposals by write-off (at cost)	(457)	–	(457)
Disposals by write-off (less accumulated depreciation)	451	–	451
Net book value 30 June 2009	**2,212**	**4,649**	**6,861**
Net book value as of 30 June 2009 represented by:			
Gross book value	**4,503**	**6,004**	**10,507**
Accumulated depreciation	**(2,291)**	**(1,355)**	**(3,646)**
	2,212	**4,649**	**6,861**

Notes to and Forming Part of the Financial Statements
for the year ended 30 June 2010

Note 8C: Intangibles

	2010 $'000	2009 $'000
Computer software:		
– internally developed – in progress	**2,748**	2,411
– internally developed – in use	**16,868**	12,832
– purchased	**29**	116
Total computer software (gross)	**19,645**	15,35
Accumulated amortisation	**(10,512)**	(9,703)
Total computer software (net)	**9,133**	5,656
Total intangibles	**9,133**	5,656

Note 8D: Reconciliation of the opening and closing balances of intangibles

Table A 2009/10	Computer software internally developed $'000	Computer software purchased $'000	Total $'000
As at 1 July 2009			
Gross book value	**11,073**	**4,286**	**15,359**
Accumulated amortisation and impairment	(6,853)	(2,850)	(9,703)
Net book value 1 July 2009	**4,220**	**1,436**	**5,656**
Additions:			
Internally developed	3,870	–	3,870
By purchase	–	1,250	1,250
Amortisation	(893)	(747)	(1,640)
Disposals:			
Disposal by write off (at cost)	(730)	(104)	(834)
Disposals by write off (less accumulated amortisation)	730	101	831
Net book value 30 June 2010	**7,197**	**1,936**	**9,133**
Net book value as of 30 June 2010 represented by:			
Gross book value	**14,213**	**5,432**	**19,645**
Accumulated amortisation	**(7,016)**	**(3,496)**	**(10,512)**
	7,197	**1,936**	**9,133**

Note 8D: Reconciliation of the opening and closing balances of intangibles (continued)

Table B 2008/09	Computer software internally developed $'000	Computer software purchased $'000	Total $'000
As at 1 July 2008			
Gross book value	**9,400**	**3,957**	**13,357**
Accumulated amortisation and impairment	(6,234)	(2,226)	(8,460)
Net book value 1 July 2008	**3,166**	**1,731**	**4,897**
Additions:			
Internally developed	1,672	–	1,672
By purchase	–	495	495
Amortisation	(618)	(764)	(1,382)
Disposals:			
Disposal by write off (at cost)	–	(166)	(166)
Disposals by write off (less accumulated amortisation)	–	140	140
Net book value 30 June 2009	**4,220**	**1,436**	**5,656**
Net book value as of 30 June 2009 represented by:			
Gross book value	**11,073**	**4,286**	**15,359**
Accumulated amortisation and impairment	**(6,853)**	**(2,850)**	**(9,703)**
	4,220	**1,437**	**5,656**

Note 8E: Other non-financial assets

	2010 $'000	2009 $'000
Prepayments	**2,174**	1,975
Total other non-financial assets	**2,174**	1,975
Total other non-financial assets are expected to be recovered in:		
Less than 12 months	**2,155**	1,975
More than 12 months	**19**	–
Total other non-financial assets	**2,174**	1,975

Notes to and Forming Part of the Financial Statements
for the year ended 30 June 2010

Note 9: Payables

	2010 $'000	2009 $'000
Note 9A: Suppliers		
Operating lease rentals	**328**	–
Total supplier payables	**328**	–
Supplier payables are expected to be settled in greater than 12 months:		
Related entities	**–**	–
External parties	**328**	–
Total supplier payables	**328**	–
Note 9B: Unearned fees and charges		
Unearned revenue	**1,718**	941
Total unearned fees and charges	**1,718**	941
Unearned fees and charges are expected to be settled in:		
Less than 12 months	**1,718**	941
More than 12 months	**–**	–
Total unearned fees and charges	**1,718**	941
Note 9C: Other payables		
Accrued expenses	**1,482**	1,393
GST payable to the ATO	**–**	73
PAYG withholding	**1**	–
Salary accrual	**1,488**	1,059
Total other payables	**2,971**	2,525
Total other payables are expected to be settled in:		
Less than 12 months	**2,971**	2,525
More than 12 months	**–**	–
Total other payables	**2,971**	2,525

Note 10: Provisions

	2010 $'000	2009 $'000
Note 10A: Employee provisions		
Salaries and wages	**4,492**	4,000
Leave	**20,558**	17,380
Other	**76**	83
Total employee provisions	**25,126**	21,463
Employee provisions are expected to be settled in:		
Less than 12 months	**20,361**	17,440
More than 12 months	**4,765**	4,023
	25,126	21,463
Note 10B: Other provisions		
Lease incentive	**114**	169
Provisions for 'make good'	**2,218**	1,750
Total other provisions	**2,332**	1,919
Other provisions are expected to be settled in:		
Less than 12 months	**51**	59
More than 12 months	**2,281**	1,860
	2,332	1,919

Reconciliation of other provisions	Lease incentive $'000	Provision for 'make good' $'000	Total $'000
Carrying amount 1 July 2009	**169**	**1,750**	**1,919**
Additional provisions made	**–**	**369**	**369**
Amount used	**(55)**	**–**	**(55)**
Unwinding of discount	**–**	**99**	**99**
Closing balance 30 June 2010	**114**	**2,218**	**2,332**

APRA leases premises in Sydney, Melbourne, Canberra, Brisbane, Perth and Adelaide.

In the lease conditions of all locations except Canberra, there is a requirement for APRA, upon expiration of the lease, to restore the premises to the condition they were in at the commencement of the lease. The required level of 'make good' provision is being accumulated for each location over the terms of the various leases.

Notes to and Forming Part of the Financial Statements
for the year ended 30 June 2010

Note 11: Statement of cash flows reconciliation

	2010 $'000	2009 $'000
Reconciliation of cash and cash equivalents as per *Balance Sheet* to *Statement of Cash Flows*		
Cash and cash equivalent as per		
Statement of Cash Flows	**49,533**	31,303
Balance Sheet	**49,533**	31,303
Difference	**–**	–
Reconciliation of net cost of services to net cash from operating activities		
Net cost of services	**111,203**	98,473
Add: revenue from Government	**121,940**	100,03
Adjustments for non-cash items		
Depreciation/amortisation	**4,542**	3,738
Loss on disposal of assets	**12**	31
Change in assets/liabilities		
(Increase)/decrease in net receivables	**2,123**	(2,614)
(Increase)/decrease in other non-financial assets	**(199)**	(404)
Increase/(decrease) in unearned fees and charges	**777**	(303)
Increase/(decrease) in employee provisions	**3,662**	2,478
Increase/(decrease) in supplier payables	**774**	(1,559)
Increase/(decrease) in other provisions	**412**	(16)
Net cash from/(used by) operating activities	**22,840**	2,916

Note 12: Contingent assets and liabilities

	Claims for damages or costs	
	2010 $'000	2009 $'000
Contingent assets		
Balance from previous period	**200**	–
New	**38**	200
Assets recognised	**(238)**	–
Total contingent assets	**–**	200
Contingent liabilities		
Balance from previous period	**500**	–
New	**–**	500
Re-measurement	**–**	–
Liabilities recognised	**–**	–
Obligations expired	**(500)**	–
Total contingent liabilities	**–**	500
Net contingent assets (liabilities)	**–**	(300)

Unquantifiable contingencies

APRA is party to civil litigation matters arising out of its statutory duty to administer and enforce laws for which it is responsible. At 30 June 2010, there were no significant matters for which a reliable estimate of the outcome and costs can be ascertained.

Notes to and Forming Part of the Financial Statements
for the year ended 30 June 2010

Note 13: Remuneration of APRA Members and senior executives

Note 13A: Remuneration paid to APRA Members and senior executives

APRA Members are appointed by the Governor General under Part 3 of the *Australian Prudential Regulation Authority Act 1998* and remuneration is set by the Remuneration Tribunal under the *Remuneration Tribunal Act 1973*. Total remuneration as determined by the Tribunal for 2009/10 was Chairman $621,230 (2008/09: $603,130); Deputy Chairman $519,800 (2008/09: $504,660); and Member $494,470 (2008/09: $480,060). Any difference between the Tribunal determination and the cost to APRA is due to changes in unused annual and long service leave entitlements accumulated in the year and funding changes to defined benefit superannuation schemes where relevant.

Remuneration of APRA Members and senior executives

	2010	2009
The remuneration of APRA Members and senior executives, measured in terms of the cost to APRA[1], is shown in the relevant income bands:		
$0 – $144,999	**1**	1
$175,000 – $189,999	**–**	2
$235,000 – $249,999	**–**	1
$250,000 – $264,999	**1**	2
$265,000 – $279,999	**4**	6
$280,000 – $294,999	**4**	3
$295,000 – $309,999	**2**	2
$310,000 – $324,999	**2**	1
$325,000 – $339,999	**2**	–
$340,000 – $354,999	**3**	1
$370,000 – $384,999	**–**	1
$415,000 – $429,999	**1**	2
$430,000 – $444,999	**1**	
$445,000 – $459,999	**1**	–
$490,000 – $504,999	**1**	2
$505,000 – $519,999	**–**	1
$535,000 – $549,999	**1**	–
$550,000 – $564,999	**1**	1
$625,000 – $639,999	**–**	1
$655,000 – $669,999	**1**	–
Total	**26**	27

1 The total remuneration of APRA Members and senior executives, as measured in terms of cost to APRA, includes changes in annual leave provisions, changes in long service leave provisions and, in the case of senior executives, a performance bonus.

Note 13: Remuneration of APRA Members and senior executives (continued)

Total expense recognised in relation to APRA Members and senior executives

	$ 2010	$ 2009
Short-term employee benefits:		
Salary (including annual leave)	**7,209,796**	6,951,926
Changes in annual leave provisions	**208,632**	46,952
Performance bonus	**408,642**	412,694
Other	**874,705**	882,538
Total short-term employee benefits	**8,701,775**	8,294,110
Superannuation (post-employment benefits)	**–**	–
Other long-term benefits	**378,478**	570,989
Total	**9,080,253**	8,865,099

Note 13B: Salary packages of APRA Members and senior executives

Average annualised remuneration costs in relation to APRA Members and senior executives

	As at 30 June 2010			As at 30 June 2009		
	No.	**Base salary**	**Total remuneration[1]**	No.	Base salary	Total remuneration[1]
$205,000 – $219,999	**–**	**–**	**–**	1	207,692	210,774
$235,000 – $249,999	**1**	**223,860**	**238,338**	1	213,325	239,402
$250,000 – $264,999	**1**	**244,131**	**262,966**	2	231,037	259,585
$265,000 – $279,999	**4**	**256,633**	**275,988**	6	251,741	274,103
$280,000 – $294,999	**4**	**251,930**	**289,275**	3	258,335	282,486
$295,000 – $309,999	**2**	**263,539**	**306,433**	2	277,477	306,334
$310,000 – $324,999	**2**	**266,642**	**316,658**	1	271,982	320,581
$325,000 – $339,999	**2**	**290,100**	**328,848**	–	–	–
$340,000 – $354,999	**3**	**294,385**	**348,414**	1	298,311	353,598
$370,000 – $384,999	**–**	**–**	**–**	1	307,075	372,402
$415,000 – $429,999	**1**	**397,700**	**428,430**	2	374,209	428,106
$430,000 – $444,999	**1**	**395,972**	**430,170**	–	–	–
$445,000 – $459,999	**1**	**400,027**	**450,975**	–	–	–
$490,000 – $504,999	**1**	**481,549**	**502,169**	2	448,772	499,153
$505,000 – $519,999	**–**	**–**	**–**	1	382,229	519,320
$535,000 – $549,999	**1**	**453,374**	**540,305**	–	–	–
$550,000 – $564,999	**1**	**515,004**	**552,411**	1	496,430	550,808
$625,000 – $639,999	**–**	**–**	**–**	1	556,560	626,669
$655,000 – $669,999	**1**	**617,249**	**666,656**	–	–	–
Total	**26**			25		

1 The total remuneration of APRA Members and senior executives, as measured in terms of cost to APRA, includes changes in annual leave provisions, changes in long service leave provisions and, in the case of senior executives, a performance bonus.

Notes to and Forming Part of the Financial Statements
for the year ended 30 June 2010

Note 14: Remuneration of auditors

	2010 $'000	2009 $'000
Financial statement audit services were provided free of charge to APRA in 2009/10.		
The fair value of audit services provided by the Australian National Audit Office was:	**118**	110

No other services are provided by the Auditor-General.

Note 15: Financial instruments

Note 15A: Categories of financial instruments

	2010 $'000	2009 $'000
Financial assets		
Loans and receivables:		
Cash and cash equivalents	**49,533**	31,303
Trade and other receivables	**3,286**	3,914
Carrying amount of financial assets	**52,819**	35,217
Financial liabilities		
At amortised cost:		
Trade creditors	**328**	–
Other payables	**2,971**	2,452
Carrying amount of financial liabilities	**3,299**	2,452

The carrying amounts of financial instruments are a reasonable representation of their fair value.

Note 15: Financial instruments (continued)

Note 15B: Credit risk

APRA's maximum exposure to credit risk at reporting date is the carrying amount of receivables reported in the *Statement of Financial Position*.

APRA has no significant exposures to any other concentrations of credit risk.

Credit quality of financial instruments not past due or individually determined as impaired

	$'000 Not past due nor impaired 2010	$'000 Not past due nor impaired 2009	**$'000 Past due or impaired 2010**	$'000 Past due or impaired 2009
Loans and receivables:				
Cash and cash equivalents	**49,533**	31,303	**–**	–
Trade and other receivables	**3,233**	278	**53**	3,914
Total	**52,766**	31,581	**53**	3,914

Ageing of financial assets that are past due but not impaired for 2010

	$'000 0 to 30 days	**$'000 31 to 60 days**	**$'000 61 to 90 days**	**$'000 90+ days**	**$'000 Total**
Loans and receivables:					
Trade and other receivables	**3**	**7**	**8**	**29**	**47**

Ageing of financial assets that are past due but not impaired for 2009

	$'000 0 to 30 days	$'000 31 to 60 days	$'000 61 to 90 days	$'000 90+ days	$'000 Total
Loans and receivables:					
Trade receivables	3,870	2	15	27	3,914

Notes to and Forming Part of the Financial Statements
for the year ended 30 June 2010

Note 15:Financial instruments (continued)

Note 15C: Liquidity risk

APRA is funded annually by appropriations from Government based on the actual cost of regulation to the financial sector, fee for service activities and other activities that APRA may be required to perform from time to time. In addition, APRA maintains reserves and a Contingency Enforcement Fund. These arrangements, along with strictly controlled cash flow monitoring and forecasting, expose APRA to negligible liquidity risk.

Note 15D: Market risk

APRA is not exposed to any form of currency risk, interest rate risk or other price risk.

Note 16: Income administered on behalf of Government

	2010 $'000	2009 $'000
Revenue		
Taxation revenue		
Financial Institutions Supervisory Levies		
Current year levies and penalties (see Table 1)	**124,891**	107,545
Total Financial Institutions Supervisory Levies	**124,891**	107,545
Table 1: Financial Institutions Supervisory Levies revenue by levy type		
Levy:		
Superannuation funds	**44,228**	39,507
Authorised deposit-taking institutions	**42,679**	36,616
Life insurers and friendly societies	**12,815**	10,441
General insurers	**25,133**	20,906
Total levies	**124,855**	107,470
Late payment penalties		
Superannuation funds	**36**	75
Total late payment penalties	**36**	75
Total current year levies and penalties	**124,891**	107,545

Note 17: Expenses administered on behalf of Government

	2010 $'000	2009 $'000
Expenses		
Supervisory Levy waivers and write-offs	**873**	684
Impairment allowance adjustment	**6**	–
Total Supervisory Levy waivers and write-offs	**879**	684
Table 1: Levies and late payment penalties waived by levy type		
Superannuation funds	**582**	485
General insurers	**286**	192
Other	**5**	7
	873	684

Notes to and Forming Part of the Financial Statements
for the year ended 30 June 2010

Note 18: Assets administered on behalf of Government

	2010 $'000	2009 $'000
Financial assets		
Receivables		
Financial Institutions Supervisory Levies	**44**	85
Total receivables (gross)	**44**	85
Less: impairment allowance account		
Goods and services	**(6)**	–
Total receivables (net)	**38**	85
Receivables are aged as follows:		
Not overdue	**14**	–
Overdue by:		
– 0 to 30 days	**24**	82
– 31 to 60 days	**–**	–
– 61 to 90 days	**–**	2
– more than 90 days	**6**	1
Total receivables (gross)	**44**	85
The impairment allowance account is aged as follows:		
Not overdue	**–**	–
Overdue by:		
– 0 to 30 days	**–**	–
– 31 to 60 days	**–**	–
– 61 to 90 days	**–**	–
– more than 90 days	**6**	–
Total impairment allowance account	**6**	–

Reconciliation of the Impairment Allowance Account:

Movements in relation to 2010

	$'000 Other Receivables	$'000 Total
Opening balance	–	–
Increase/decrease recognised in net surplus	6	6
Closing balance	6	6

There was no impairment allowance for 2008/09.

Note 19: Administered reconciliation table

	2010 $'000	2009 $'000
Opening administered assets less administered liabilities as at 1 July	**85**	838
Plus administered income	**124,891**	107,545
Less administered expenses	**(879)**	(1,289)
Plus transfers from the Official Public Account for refunds	**11**	1,813
Less transfers to the Official Public Account	**(124,070)**	(108,822)
Closing administered assets less administered liabilities as at 30 June	**38**	85

Note 20: Administered financial instruments

	2010 $'000	2009 $'000
Note 20A: Categories of financial instruments		
Financial assets		
Loans and receivables:		
Trade and other receivables	**44**	85
Total	**44**	85

The carrying amounts of the financial instruments are a reasonable representation of their fair value.

Notes to and Forming Part of the Financial Statements
for the year ended 30 June 2010

Note 20B: Credit risk

APRA's maximum exposure to credit risk at reporting date is the carrying amount of levy receivable as recognised in the *Schedule of Administered Items*.

APRA has no significant exposures to any other concentrations of credit risk.

Credit quality of financial instruments not past due or individually determined as impaired

	Not past due nor impaired 2010 $'000	Not past due nor impaired 2009 $'000	**Past due or impaired 2010 $'000**	Past due or impaired 2009 $'000
Loans and receivables:				
Trade and other receivables	**14**	–	**30**	85

Ageing of financial assets that are past due but not impaired for 2010

	0 to 30 days $'000	31 to 60 days $'000	61 to 90 days $'000	90+ days $'000	Total $'000
Loans and receivables:					
Trade and other receivables	24	–	–	–	24

Ageing of financial assets that are past due but not impaired for 2009

	0 to 30 days $'000	31 to 60 days $'000	61 to 90 days $'000	90+ days $'000	Total $'000
Loans and receivables:					
Trade and other receivables	82	–	2	1	85

Note 20C: Liquidity risk

APRA does not hold any administered financial liabilities and is therefore not exposed to any liquidity risk.

Note 20D: Market risk

APRA is not exposed to any form of currency risk, interest rate risk or other price risk.

Note 21: Appropriations

Table A1: Acquittal of authority to draw cash from the Consolidated Revenue Fund for Ordinary Annual Services Appropriations

Particulars	Departmental Outputs 2010 $'000	Total 2009 $'000
Balance brought forward from previous period (Appropriation Acts)	**1,600**	–
Appropriation Act:		
Appropriation Act (No. 1 & 3) 2009 – 2010	**23,545**	13,372
Relevant agency receipts (FMA Act s31)	**4,294**	–
Total appropriations available for payments	**29,439**	13,372
Appropriations credited to special accounts (GST exclusive)	**(28,716)**	(11,772)
Balance of authority to draw cash from the Consolidated Revenue Fund for ordinary annual services appropriations and as represented by	**723**	1,600
Departmental appropriations receivable:	**723**	1,600
Total as at 30 June	**723**	1,600

Notes to and Forming Part of the Financial Statements
for the year ended 30 June 2010

Note 21: Appropriations (continued)

Table B1: Acquittal of authority to draw cash from the Consolidated Revenue Fund for other than ordinary annual services appropriations

Particulars	Operating Outcome 1[1] SPPs[2] 2010 $'000	SPPs[2] 2009 $'000	Operating Outcome 1[1] NAE[3] 2010 $'000	NAE[3] 2009 $'000	Non-operating Equity 2010 $'000	Equity 2009 $'000	Non-operating Previous years' outputs 2010 $'000	Previous years' outputs 2009 $'000	Total 2010 $'000	Total 2009 $'000
Balance brought forward from previous period (Appropriation Acts)	–	–	–	–	**900**	–	–	–	**900**	–
Appropriation Act:										
Appropriation Act (No. 2, & 4) 2009 – 2010	–	–	**1,524**	–	**1,957**	900	**773**	–	**4,254**	900
Other annual appropriation acts	–	–	–	–	–	–	–	–	–	–
Total appropriations available for payments	–	–	**1,524**	–	**2,857**	900	**773**	–	**5,154**	900
Appropriations credited to special accounts (GST exclusive)	–	–	–	–	**(2,857)**	–	**(773)**	–	**(3,630)**	–
Balance of authority to draw cash from the Consolidated Revenue Fund for ordinary annual services appropriations and as represented by:	–	–	**1,524**	–	–	900	–	–	**1,524**	900
*Undrawn, unlapsed administered appropriations	–	–	**1,524**	–	–	900	–	–	**1,524**	900
	–	–	–	–	–	–	–	–	–	–
Total as at 30 June	–	–	**1,524**	–	–	900	–	–	**1,524**	900

1 Outcome 1: The role of APRA is developing and enforcing a robust prudential framework that promotes prudent behaviour by ADIs, insurance companies, superannuation funds and other financial institutions it supervises, with the key aim of protecting the interests of their depositors, policyholders and superannuation fund members.

2 SPP: Specific Purpose Payments

3 NAE: New Administered Expenses

Note 21: Appropriations (continued)

Table B2: Acquittal of authority to draw cash from the Consolidated Revenue Fund for other than ordinary annual services appropriations (reduction in administered items)

Particulars	2010	2009	2010	2009	2010	2009
	Operating Outcome 1				Total	
	SPPs		NAE			
Appropriation Act (No. 4) 2009-2010	–	–	1,524,000.00	–	1,524,000.00	–
Spent/Retained	–	–	–	–	–	–
Total reduction in administered items – effective 2010-11	–	–	1,524,000.00	–	1,524,000.00	–

Table C: Acquittal of authority to draw cash from the Consolidated Revenue Fund – Special Appropriations (limited amount)

Australian Prudential Regulation Authority Act 1998 – section 50

Purpose: To provide as appropriation for levy money that exceeds the amount determined by the Minister under section 50(1) of the *Australian Prudential Regulation Act 1998*.

	2010 $'000	2009 $'000
	Outcome 1	
Amount brought forward from previous period	85	838
Appropriation for reporting period	98,218	85,861
Available for payments	98,303	86,699
Appropriations credited to Special Account	98,259	86,614
Refunds paid from Special Account	–	–
Appropriations lapsed	–	–
Amount available carried to the next period and as represented by:	44	85
Cash	–	–
Appropriation receivable	44	85

Notes to and Forming Part of the Financial Statements
for the year ended 30 June 2010

Note 22: Special accounts

APRA Special Account (Departmental)

Appropriation: *Financial Management and Accountability Act 1997*, section 21

Establishing Instrument: *Australian Prudential Regulation Authority Act 1998*, section 52

Purpose: Payment of goods and services, salaries and expenses incurred for activities entered into by the Australian Prudential Regulation Authority.

	2010 $'000	2009 $'000
Balance carried from previous period	31,300	31,347
Special Appropriation for reporting period	98,259	86,614
Appropriation Act No 1 Transfer	25,338	5,036
Appropriation Act No 2 Transfer	3,630	–
Appropriation Act No 3 Transfer	3,378	6,736
Available for payments	161,905	129,733
Payments made	(112,375)	(98,433)
Balance carried to next period (excluding investment balances) and represented by:	49,530	31,300
Cash – held in the Official Public Account	48,463	31,268
Cash – held by APRA	1,067	32
Total balance carried to the next period	49,530	31,300

Note 22: Special accounts (continued)

Lloyd's Deposit Trust Special Account (Administered)

Appropriation: *Financial Management and Accountability Act 1997*, section 20

Establishing Instrument: *Financial Management and Accountability Determination 2006/26*

Purpose: To disburse amounts in accordance with section 92Q of the *Insurance Act 1973.*

	2010 $000	2009 $000
Balance carried from previous period	2,000	2,000
Available for payments	2,000	2,000
Payments made	–	–
Balance carried to next period (excluding investment balances) and represented by:	2,000	2,000
Securities held by APRA	2,000	2,000
Total balance carried to the next period	2,000	2,000

Responsibility for the administration of the Lloyd's Deposit Trust Special Account was transferred from the Department of the Treasury to the Australian Prudential Regulation Authority with effect from 26 May 2008.
The market valuation as at 30 June 2010 for Lloyd's inscribed stock is $2,028,820.

Services for Other Entities and Trust Moneys

Appropriation: *Financial Management and Accountability Act 1997*, section 20

Establishing Instrument: *Financial Management and Accountability Act Determination 2007/09*

Purpose: To distribute amounts temporarily held on trust for the benefit of another person other than the Commonwealth; disburse amounts in connection with services performed on behalf of other Governments and bodies that are not FMA Act agencies; and repay amounts where an Act or other law requires or permits the repayment of an amount received.

	2010 $'000	2009 $'000
Balance brought forward from previous year	–	–
Available for payments	–	–
Balance carried to next period (excluding investment balances) and represented by:	–	–
Cash – transferred to the Official Public Account	–	–
Cash – held by the agency	–	–
Total balance carried to the next period	–	–

Notes to and Forming Part of the Financial Statements
for the year ended 30 June 2010

Note 22: Special accounts (continued)

Financial Claim Scheme Special Account (Administered)

Appropriation: *Financial Management and Accountability Act 1997*, section 21

Establishing Instrument: *Australian Prudential Regulation Authority Act 1998* section 54A

Purpose: meeting account holders entitlements, paying APRA's agents/delegates entitlements, repayment of principal, interest and other costs connected with the borrowings under Division 2 of the APRA Act.

	2010 $'000	2009 $'000
Balance brought forward from previous year	–	–
Appropriation for reporting period	–	–
Available for payment	–	–
Payments made	–	–
Balance carried to next period (excluding investment balances) and represented by:	–	–
Cash – transferred to the Official Public Account	–	–
Cash – held by the agency	–	–
Total balance carried to the next period	–	–

Note 23: Compensation and debt relief

	2010 $	2009 $
Administered		
126 waivers of amounts owing to the Commonwealth were made pursuant to section 12 of the *Financial Institutions Supervisory Levies Collection Act 1998* (2008/09: 40)	878,415	683,849

Note 24: Reporting of outcomes

Note 24A: Net cost of outcome delivery

APRA is structured to meet the following outcome:

Outcome 1: To enhance public confidence in Australia's financial institutions through a framework of prudential regulation that balances financial safety and efficiency, competition, contestability and competitive neutrality.

	2010 $'000	2009 $'000	2010 $'000	2009 $'000
	Outcome 1		Total	
Expenses				
Administered	**879**	684	**879**	684
Departmental	**116,268**	103,272	**116,268**	103,272
Total	**117,147**	103,956	**117,147**	103,956
Income from non-government sector				
Administered	**–**	–	**–**	–
Activities subject to cost recovery	**–**	–	**–**	–
Activities subject to competitive neutrality	**–**	–	**–**	–
Other	**–**	–	**–**	–
Total administered	**–**	–	**–**	–
Departmental				
Activities subject to cost recovery	**3,063**	2,636	**3,063**	2,636
Other	**692**	835	**692**	835
Total	**3,755**	3,471	**3,755**	3,471
Other own source income				
Administered	**124,885**	107,545	**124,885**	107,545
Departmental – related entities	**1,310**	1,218	**1,310**	1,218
Total	**126,195**	108,763	**126,195**	108,763
Net cost/(contribution) of outcome	**(12,803)**	(8,278)	**(12,803)**	(8,278)

Australian National
Audit Office

INDEPENDENT AUDITOR'S REPORT

To the Minister for Financial Services, Superannuation and Corporate Law

Scope

I have audited the accompanying financial statements of the Australian Prudential Regulation Authority (the Authority) for the year ended 30 June 2010, which comprise: the Statement by Members and the Chief Financial Officer; Statement of Comprehensive Income; Balance Sheet; Statement of Changes in Equity; Statement of Cash Flows; Schedule of Commitments; Schedule of Contingencies; Schedule of Asset Additions; Schedule of Administered Items; and Notes to and forming part of the Financial Statements, including a Summary of Significant Accounting Policies.

The Responsibility of the Chair for the Financial Statements

The Authority's Chair is responsible for the preparation and fair presentation of the financial statements in accordance with the Finance Minister's Orders made under the *Financial Management and Accountability Act 1997*, including the Australian Accounting Standards (which include the Australian Accounting Interpretations). This responsibility includes establishing and maintaining internal controls relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

My responsibility is to express an opinion on the financial statements based on my audit. I have conducted my audit in accordance with the Australian National Audit Office Auditing Standards, which incorporate the Australian Auditing Standards. These auditing standards require that I comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor

GPO Box 707 CANBERRA ACT 2601
19 National Circuit BARTON ACT
Phone (02) 6203 7300 Fax (02) 6203 7777

considers internal control relevant to the Authority's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Authority's Chair, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Independence

In conducting the audit, I have followed the independence requirements of the Australian National Audit Office, which incorporate the requirements of the Australian accounting profession.

Auditor's Opinion

In my opinion, the financial statements of the Australian Prudential Regulation Authority:

(a) have been prepared in accordance with the Finance Minister's Orders made under the *Financial Management and Accountability Act 1997*, including the Australian Accounting Standards; and

(b) give a true and fair view of the matters required by the Finance Minister's Orders including the Australian Prudential Regulation Authority 's financial position as at 30 June 2010 and its financial performance and cash flows for the year then ended.

Australian National Audit Office

Carla Jago

Executive Director

Delegate of the Auditor-General

Canberra

25 August 2010

Chapter nine

Statutory report

Statutory reporting requirements

APRA reports in accordance with the following Commonwealth legislation and other requirements:

- *Australian Prudential Regulation Authority Act 1998;*
- *Environment Protection and Biodiversity Conservation Act 1999;*
- *Equal Employment Opportunity (Commonwealth Authorities) Act 1987;*
- *Freedom of Information Act 1982;*
- *Occupational Health and Safety (Commonwealth Employment) Act 1991;*
- *Commonwealth Fraud Control Guidelines;* and
- *Requirements for annual reports for departments, executive agencies and FMA Act bodies.*

APRA's financial arrangements are also subject to the *Financial Management and Accountability Act 1997*.

Australian Prudential Regulation Authority Act 1998 (APRA Act)

Section 59 of the APRA Act requires APRA to report on:

- the activities of ADI statutory managers within the meaning of the *Banking Act 1959* and persons conducting investigations under Division 2 of Part II and section 61 of that Act;
- the operation of Division 2AA (Financial Claims Scheme for account-holders with insolvent ADIs) of Part II of the *Banking Act 1959*;
- the operation of Part VC (Financial Claims Scheme for policyholders with insolvent general insurers) of the *Insurance Act 1973*; and
- the exercise during the year of APRA's powers under Part 15 of the *Retirement Savings Accounts Act 1997* (RSA Act) and Part 29 of the *Superannuation Industry (Supervision) Act 1993* (SIS Act).

APRA did not appoint any ADI statutory managers or persons to conduct an investigation under Division 2 of Part II or section 61 of the *Banking Act 1959* during 2009/10. There were no continuing appointments during the year.

There were no schemes in operation under Division 2AA of Part II of the *Banking Act 1959*.

On 15 October 2009, the Minister made a declaration under section 62ZZC of the *Insurance Act 1973* that Division 3 of Part VC of that Act applied in relation to a general insurer[1]. APRA's *Financial statements* detail the administrative arrangements for the crediting of various accounts. No payments were made out of the Financial Claims Scheme Special Account in 2009/10.

APRA did not exercise its powers under Part 15 of the RSA Act in 2009/10.

1 Australian Family Assurance Limited (in liquidation)

APRA exercised its powers under Part 29 of the SIS Act as set out below:

Exemption number	Date	Provision of SIS Act/regulations exempted
A23 of 2009	20/07/2009	Regulation 6.17(2)
A24 of 2009	16/07/2009	Regulation 6.17(2)
A25 of 2009	11/08/2009	Regulation 6.42
A26 of 2009	11/09/2009	Regulation 9.29(1)(a)
A27 of 2009	11/08/2009	Regulation 6.17 (2)
A28 of 2009	07/10/2009	Revoking exemption A32 of 2008
A29 of 2009	07/10/2009	Regulation 93 (4)
A30 of 2009	07/10/2009	Regulation 93 (4)
A31 of 2009	24/09/2009	Regulation 13.17A(1)(b)
A32 of 2009	17/11/2009	Regulation 9.04D
A33 of 2009	16/11/2009	Regulation 13.17A
A34 of 2009	09/12/2009	Regulation 9.29(1)(a)(i)
A35 of 2009	17/12/2009	Regulation 7.04(3)
A36 of 2009	31/12/2009	Regulation 6.17(2)
A1 of 2010	29/01/2010	Regulation 6.17(2)
A2 of 2010	29/01/2010	Regulation 9.29(1)(a)
A3 of 2010	31/03/2010	Regulation 9.04D(1)
A4 of 2010	08/02/2010	Regulation 9.04D(1)
A5 of 2010	12/02/2010	Regulation 6.17(2)
A6 of 2010	17/02/2010	Regulation 6.17(2)
A7 of 2010	01/04/2010	Regulation 7.04(3)
A9 of 2010	30/03/2010	Regulation 9.04I
A10 of 2010	30/03/2010	Regulation 9.04 D(1)
A11 of 2010	19/04/2010	Regulation 29 E (3) (b)
A12 of 2010	13/04/2010	Regulation 6.17
A13 of 2010	30/04/2010	Regulation 9.04D(1)
A14 of 2010	24/05/2010	Regulation 6.17(2)
A15 of 2010	08/06/2010	Regulation 6.34

Exemption number	Date	Provision of SIS Act/regulations exempted
A16 of 2010	03/06/2010	Regulation 7.04(3)
A18 of 2010	30/06/2010	Regulations 9.29 and 9.30

Modification declaration number – Class	Date	Provision of SIS regulations modified
A1 of 2009	7/10/2009	Revocation of modification declaration No. 24 of 2002 (published as No. 25 of 2002)
A2 of 2009	7/10/2009	Section 93A

Modification declaration number – Particular entity	Date	Provision of SIS regulations modified
A1 of 2009	13/07/2009	Regulations 6.20A, 6.21, 7A.03J, 7A.03K, 7A.12 and 7A.13
A2 of 2009	17/12/2009	Regulations 7A.03H, 7A.03J, 7A.03K, 7A.12 and 7A.13
A1 of 2010	27/01/2010	Varying modification declaration No A1 of 2009, Regulations 7A.03H, 7A.03J, 7A.03K, 7A.12 and 7A.13
A1 of 2010	13/05/2010	Regulation 1.03
A2 of 2010	03/06/2010	Regulation 1.03(1)

Environment Protection and Biodiversity Conservation Act 1999

Ecologically sustainable development and environmental performance

APRA's Environmental Policy Statement reinforces its commitment to operating in an ecologically sustainable manner and APRA continues to take practical steps to reduce its environmental impact. Measures include zone-controlled lighting; energy-efficient power management settings on office equipment; recycling of paper, cardboard and printer cartridges; and staff awareness.

During 2009/10, APRA's Staff Consultative Group formed an Environmental Issues Subgroup (EIS) whose core purpose is to consider 'going green' issues in APRA's day-to-day operations referred by staff as well as areas where APRA could reduce wastage and carbon emissions. The EIS has been active in encouraging a 'mobile muster' mobile phone recycling program among APRA staff and in providing education about alternatives to hard-copy publications to reduce paper waste.

In 2010, APRA's Canberra office was accredited in the ACT Government's 'Smart Office' initiative, which provides a step-by-step best practice guide to waste management as well as advice and assistance to establish waste management systems, conduct waste audits and staff education.

EEO staff data – staff diversity as at 30 June 2010[1]

Level	Female	Male	ATSI	NESB1	NESB2	PWD
Level 1	57	23	0	13	0	1
Level 2	76	31	0	26	1	0
Level 3	74	89	0	44	5	0
Level 4	81	119	1	48	2	2
Senior	18	71	0	9	1	1
Executive	0	7	0	1	1	0
Total	**306**	**340**	**1**	**141**	**10**	**4**

1 Includes permanent and fixed-term staff but excludes casuals. Fixed-term employees (30 as at 30 June 2010) were not included in the 2008/09 table.

ATSI Aboriginal and Torres Strait Islander
NESB1 Non-English-speaking background, first generation
NESB2 Non-English-speaking background, second generation
PWD People with disability

APRA will continue to make improvements in its environmental management and, where possible, adopt environmentally friendly options.

Equal Employment Opportunity (Commonwealth Authorities) Act 1987 (EEO Act)

Workplace diversity program report

APRA has taken a proactive and innovative approach to meeting its responsibilities under the EEO Act by establishing a comprehensive workplace diversity strategy. This includes flexible and inclusive employment that values and utilises the contribution of people of different backgrounds, experiences, perspectives and abilities. The strategy retains the essential EEO principles in relation to non-discrimination and equal employment opportunity, and also recognises the broader concept of diversity in ensuring a tolerant workplace free from all forms of harassment.

Each year, members of APRA's Staff Consultative Group and selected human resources staff receive detailed training by a specialist diversity provider, Diversity Council Australia, in order to perform the important role of Contact Officer. APRA's Contact Officers are available to provide confidential and impartial assistance to any staff with workplace diversity concerns at APRA.

APRA is committed to ensuring that staff are given appropriate assistance in balancing their work, home, family and other personal commitments. In line with this, APRA offers a range of flexible work arrangements including coreless variable hours, a compressed work week and purchased additional leave, job-sharing, telecommuting, and leave options for the purpose of family responsibilities and career/personal development. APRA also provides a range of 'family friendly' benefits including 14 weeks paid maternity leave, two weeks paid partner's leave and a 'Keep-in-Touch' program for women on maternity leave. In recognising that staff with dependents may require further assistance, APRA has services available to assist such staff in making care arrangements. In addition, APRA is committed to retaining the skills, expertise and corporate knowledge of staff approaching retirement age through a 'Transition to Retirement' program and other measures.

Freedom of Information Act 1982 (FOI Act)

The FOI Act provides the public with a general right of access to documents held by Commonwealth agencies, including APRA. This general right is limited by exceptions needed to protect essential public interests or the privacy and business affairs of those who give information to APRA or the Commonwealth.

In 2009/10, APRA received 12 applications for access to documents under section 15 of the FOI Act and one application for internal review under section 54. APRA had no applications on hand at the beginning of the period.

During the year, the FOI applications for access were dealt with as follows:

Granted in full	1
Granted in part	7
Access refused	2
Withdrawn	0
Transferred to another agency	0
On hand at 30 June 2010	2
Total	**12**

Charges collected were $405 and the estimated cost of handling initial FOI requests and internal review requests in 2009/10 was approximately $17,788.

Initial contact for requests under FOI Act

Requests under the FOI Act should be made in writing, together with the prescribed fee, to:

The FOI Coordinator
Legal Services
Australian Prudential Regulation Authority
GPO Box 9836
Sydney NSW 2001
Phone: 02 9210 3000
Fax: 02 9210 3424

Access to documents

APRA makes its publications available to the public on the APRA website, free of charge. The website contains application forms, regulatory information, prudential statements, circulars and guidelines covering the types of entities that APRA regulates.

Questions about publications should be made to:

Media and Communications
Australian Prudential Regulation Authority
GPO Box 9836
Sydney NSW 2001
Phone: 02 9210 3000
Fax: 02 9210 3170

Categories of documents

APRA maintains the following categories of documents covered by section 8(1) (a)(iii) of the FOI Act available to the public free via APRA's website at www.apra.gov.au:

- lists of regulated entities and industry bodies;
- superannuation circulars, superannuation prudential practice guides and guidance notes relating to the *Superannuation Industry (Supervision) Act 1993* and the *Retirement Savings Accounts Act 1997*, and 'frequently asked questions' on superannuation industry issues;
- statutory instruments issued by APRA, including modification declarations, determinations and approvals;
- prudential standards and rules made under the *Banking Act 1959, the Insurance Act 1973* and the *Life Insurance Act 1995*, guidance notes and prudential practice guides;
- 'frequently asked questions' on the Financial Claims Schemes;
- transitional prudential standards made under the *Financial Sector Reform (Amendments and Transitional Provisions) Regulations 1999*;

- reporting standards made under the *Financial Sector (Collection of Data) Act 2001* together with reporting forms and instructions for the lodgement of returns;
- transfer rules made under the *Financial Sector (Transfers of Business) Act 1999*;
- class consents under section 66 of the *Banking Act 1959*;
- market statistics (including APRA's *Insight* and other various industry-based statistical performance publications) and other research material;
- policy discussion papers;
- media releases and other news updates;
- copies of Enforceable Undertakings issued by APRA and the APRA Disqualification Register;
- seminar papers and copies of speeches given by APRA Members and officers;
- APRA's *ADI Points of Presence* (concerning the availability of banking services in rural and regional areas);
- corporate information;
- procedural guidelines;
- enabling legislation; and
- indexed file list for the purposes of Senate Continuing Order No. 6.

Occupational Health and Safety (Commonwealth Employment) Act 1991 (OHS Act)

Details of investigations and other matters as prescribed

In compliance with reporting obligations under section 74 of the OHS Act, there were:

- no investigations conducted during the year that related to undertakings carried on by APRA;
- no tests conducted on any plant, substance or thing in the course of such investigations;
- no directions to APRA by an investigator that the workplace not be disturbed; and
- no prohibition or improvements and provisional notices given to APRA.

Measures taken to ensure health, safety and welfare of employees and contractors

Responsibilities imposed by the OHS Act were identified and allocated to individual staff members. They included the identification and training of three new health and safety staff representatives in Melbourne and Sydney.

Procedures for dealing with health and safety issues are published on APRA's intranet site and are included in staff induction programs.

Drawing on the assistance of a consultant ergonomic specialist, APRA has developed a policy and procedures aimed at identifying, assessing and controlling hazards associated with work processes, particularly computer-based work. In 2009/10, sessions informing staff of the ideal ergonomic set-up for their individual workstations were held in Canberra and Sydney.

First-aid services for the treatment of work-related injury or illness, including appropriately trained first-aid officers, are situated at all work locations. Rehabilitation services and support are provided to injured employees. Six new first-aid/deputy first-aid officers were trained in 2009/10.

Comprehensive health assessments are provided to staff at senior levels as well as to those aged 50 and over. Shorter health checks are provided to staff aged 40-49 and a 15-minute 'healthy heart' check to all other staff. These assessments are not compulsory and APRA is provided with statistical data only (not personal details or results of the assessments). As in previous years, all staff are offered an annual influenza vaccination; in 2009/10, 53 per cent of staff accepted this offer compared with 40 per cent the previous year.

OHS policies including establishment of staff committees and selection of health and safety representatives

APRA has arrangements for consultation on all occupational health and safety issues, including maintenance of the OHS Committee with four staff and four management representatives.

The OHS Committee satisfies legislative requirements, including meeting at least every three months and providing all staff with access to minutes of the meetings.

Statistics requiring the giving of notice under section 68

During the year, three incidents were notified to APRA, none of which required a report to Comcare under section 68 of the OHS Act. No incidents were on APRA premises.

Other reporting

Advertising and market research

The *Commonwealth Electoral Act 1918* requires Commonwealth agencies to report annually on their expenditure on advertising and market research. In 2009/10, APRA spent $156,300 on recruitment advertising, of which $153,600 was paid to Adcorp Australia Ltd. APRA conducted no advertising campaigns during 2009/10.

Auditor-General's activities

The Australian National Audit Office (ANAO) undertook the required statutory financial audits of APRA for 2009/10. APRA was not subject to any performance audits by the ANAO during the year.

Certified Employment Agreements

As at 30 June 2010, 560 staff were covered by the collective *APRA Employment Agreement, 2008*. Ninety-six senior staff were covered by common law agreements.

All staff are appointed under the APRA Act. APRA applies a total remuneration approach whereby all salary, superannuation and 'salary sacrifice' benefits are included in an employee's total remuneration package (TRP). The TRP pay ranges for non-executive staff as at 30 June 2010 were:

Level 4	$108,200 – $180,400
Level 3	$75,800 – $126,400
Level 2	$52,100 – $86,800
Level 1	$36,800 – $61,300

Commonwealth Disability Strategy

APRA's operations encompass the typical activities of regulator, policy adviser and employer as those roles are defined in the Commonwealth Disability Strategy.

As a regulator and policy adviser, APRA continues to ensure that those with disabilities face no obstacles in public access to information through APRA's internet website. For those services that are not provided electronically (particularly early release of superannuation benefits), there is regular assessment to ensure that particular groups are not excluded by virtue of either their financial circumstances or their physical or intellectual disability.

APRA supports access for people with speech or hearing disabilities via Telstra's service for TTY (Text Telephone) users and maintains a freecall number and email address to accept and respond to enquiries and feedback.

As an employer, APRA ensures that all employment policies, guidelines and processes meet the requirements of the *Disability Discrimination Act 1992* and do not discriminate on the basis of disability. APRA's commitment to the Disability Discrimination Act is included in its Human Resources Policy Manual and Code of Conduct. All staff and managers are responsible for supporting the principles of workplace diversity. APRA is a member of Diversity Council Australia, an independent, not-for-profit diversity adviser to business in Australia.

APRA's recruitment policy ensures that recruitment advertising does not dissuade people with disabilities who have the necessary experience, skills and qualifications from submitting applications for employment. The policy also ensures that selection processes take into account the special needs of applicants, so that those with disabilities are not disadvantaged.

Commonwealth Fraud Control Guidelines

The Chairman of APRA certifies that he is satisfied that:

- fraud risk assessments and fraud control plans have been prepared that meet APRA's needs and comply with the *Commonwealth Fraud Control Guidelines*;
- appropriate fraud prevention, detection, investigation and reporting procedures and processes are in place; and
- annual fraud data have been collected and reported in compliance with the *Commonwealth Fraud Control Guidelines*.

Commonwealth Ombudsman

In 2009/10, the Commonwealth Ombudsman conducted investigations into 20 matters, all of which related to applications for early release of superannuation benefits. As a result of these investigations, the Commonwealth Ombudsman recorded an 'administrative deficiency' in one case. One additional case of 'administrative deficiency' was also recorded in relation to a matter investigated in 2008/09. The lessons from these cases were used to improve APRA's processes to prevent recurrence of these situations.

In September 2009, the Commonwealth Ombudsman commenced an 'own motion' investigation into APRA's processing of applications for early release of superannuation benefits. APRA formally responded to the initial request for information in November 2009.

In June 2010, the Commonwealth Ombudsman notified APRA that he was no longer investigating this matter and would not issue a report or make recommendations at this time. The improvements to the processing of early release of benefit applications made by APRA were cited as a key reason for discontinuing the investigation.

Commonwealth Procurement Guidelines

The APRA *Chairman's Finance Instructions and Financial Policies*, and associated operational procedures, ensure that APRA's procurement process complies with the *Commonwealth Procurement Guidelines* (CPGs). In particular, they ensure that the core procurement principle of value for money is observed.

As an FMA Act agency, APRA conducts its procurement processes within the CPGs, including but not limited to:

- conducting open tenders for procurement activities of more than $80,000 (unless otherwise exempted under the CPGs);
- reporting all procurements over $10,000 on AusTender; and
- reporting all purchases over $100,000 on APRA's website.

In 2009/10, APRA had no AusTender-exempt contracts and all APRA competitively tendered contracts over $100,000 provided for the Auditor-General to have access to the contractor's premises.

Consultancies

APRA's *Chairman's Finance Instructions and Financial Policies,* and associated operational procedures, include specific provisions on consultants. Considerations prior to engagement include whether in-house resources are available; the cost-effectiveness of the operation and whether the project is essential; availability of funds; a selection and evaluation process resulting in fair competition, effective services and value for money; project definition and outcomes; and superannuation implications.

The main purposes for which consultants were engaged in 2009/10 were training, financial and accounting services, IT consultancies, legal advice, litigation services and professional services.

During 2009/10, APRA entered into 19 new consultancy contracts each valued at over $10,000, involving total expenditure of $1.7 million. In addition, 21 other consultancy suppliers were active during the year, involving total expenditure of $0.38 million. Total expenditure on consultancies in 2009/10 was $2.08 million, including $0.06 million of capitalised expenses.

Annual reports contain information about actual expenditure on contracts for consultancies. Information on the value of contracts and consultancies is available on the AusTender website www.tenders.gov.au.

Consultative arrangements

APRA consults extensively with regulated entities, industry bodies and other interested parties prior to formulating or amending prudential policies or finalising prudential standards.

APRA complies with the Government's policy on best practice regulation. During 2009/10, APRA fully met the requirements of the Office of Best Practice Regulation (OBPR) for Regulation Impact Statements on new legislative instruments (two in number). In addition, APRA completed 32 preliminary assessments for other regulations made or tabled during this period, for which the OBPR advised that no further regulation analysis was required.

Courts and tribunals

Over 2009/10, there were no judicial decisions that had or may have a significant effect on APRA's operations.

APRA's supervisory activities in 2009/10 section of this *Report* contains details of court and tribunal decisions relating to enforcement action taken by APRA during the year.

Executive and consultative committees from 1 July 2009 to 30 June 2010

Management Group

This Group comprises the APRA Members and the Executive General Managers and is responsible for high-level information-sharing and decisions on more routine supervisory and organisational matters. It meets weekly or more frequently as required.

Leadership Team

The Leadership Team, which comprises APRA Members, Executive General Managers and General Managers, meets twice a year to develop APRA's strategic and business plans, to monitor performance against plans and to discuss major operational issues.

Steering Groups

To strengthen its efficiency and effectiveness and to coordinate decision-making across its different divisions, APRA has three Steering Groups responsible for the prioritisation and implementation of a range of initiatives. These Groups comprise an APRA Member as Chair and relevant Executive General Managers and General Managers. The Groups are:

- Supervision Steering Group. This Group oversees the development and integration of APRA's supervisory systems, tools and processes.
- Infrastructure Steering Group. This Group oversees the development of APRA's physical and IT infrastructure and its business, financial and resource planning systems.
- People and Engagement Steering Group. This Group addresses initiatives on management and leadership, performance management, rewards and recognitions, and APRA culture.

Industry groups

There are four industry groups, comprising representatives of the various divisions of APRA. They cover APRA's four regulated industries:

- ADIs;
- superannuation;
- general insurance; and
- life insurance (including friendly societies).

These groups are important fora for identifying and seeking an APRA-wide assessment of emerging industry issues. Their main roles are to liaise with industry so as to identify emerging trends and to act as a sounding board for prudential policy issues in the different industries, prior to presentation of these issues to the Executive Group.

Cross-Divisional Licensing Committee

This Committee, comprising representatives from across APRA, seeks to assist supervisors considering licence applications and ensure consistency in licensing practice and application across all APRA-regulated industries. It provides APRA-wide guidance on issues that need to be considered in licensing submissions and, after consideration of an application, recommends to the relevant Executive General Manager action to be taken.

Enforcement Committee

This Committee comprises an APRA Member as Chair, an Executive General Manager and representatives of Supervision, Enforcement and Legal. It ensures that a whole-of-APRA perspective is brought to potential, and actual, investigation and enforcement actions. The Committee monitors ongoing enforcement actions and provides a forum to ensure a consistent approach is taken to any significant use of coercive powers by areas within APRA.

International committees

APRA has two committees that coordinate its involvement with international bodies, one for banking and one for insurance. Their purpose is to prioritise resource allocation for APRA's involvement in international activities, coordinate consistent and timely responses to issues raised in the relevant international fora and ensure information from international sources is communicated effectively within APRA. Membership includes senior APRA staff involved in international committee work and also draws on other APRA staff with relevant expertise.

Occupational Health and Safety Committee

This Committee, which includes both staff and management representatives, focuses on issues to do with the health, safety and wellbeing of staff and ensures that these are integrated into broader management systems and practices.

Staff Consultative Group

This Group facilitates communication and consultation with all APRA staff below the senior management level on the terms and conditions of their employment (including the Human Resources Policy Manual) and the impact of these on APRA's organisational culture and values.

Security Group

This Group is the key forum for maintaining strategic and operational oversight of APRA's security policy, initiatives and their implementation. Its main priority is to develop an over-arching policy and governance strategy on all security matters affecting APRA and to take the measures necessary to implement the strategy.

Grant Programs

Grant programs, including discretionary grant programs, that APRA either jointly administers or participates in are the:

- Brian Gray Scholarship;
- University of New South Wales (UNSW) Coop Actuarial Scholarship;
- Australian Research Council Linkage Grants with UNSW and Australian National University; and
- sponsorship of PhD research students through the Capital Markets Cooperative Research Centre.

Information on the Brian Gray Scholarship program and a list of previous winners is on APRA's website (www.apra.gov.au/Careers/Brian-Gray-Scholarship-Program.cfm). Information on other grants awarded by APRA is available on APRA's website at: www.apra.gov.au/Research/Grants-and-Scholarships.cfm.

Indemnities and insurance premiums

APRA Members and officers are covered by the professional indemnity insurance cover of the Commonwealth-managed insurance scheme, Comcover. The generic terms and conditions of the insurance cover provided by Comcover to Commonwealth agencies are available on the Comcover website www.finance.gov.au/comcover. Under the conditions of the cover, APRA is prohibited from disclosing the specific nature and limit of the liabilities covered and the amount of the premium.

Legal Services Directions 2005

The *Legal Services Directions 2005* require Commonwealth agencies to make available publicly information on records of their legal services expenditure for the previous financial year.

During 2009/10, APRA's total expenditure on external legal advice and litigation services was $1.41 million (including GST).

Parliamentary committees

Avenues through which APRA is accountable to the Parliament include Parliament's *ad hoc* and standing committees, and specific references on legislation or issues of particular interest to Parliamentary committees.

During 2009/10, APRA Members and officers made themselves available for public hearings before the:

- Senate Economics Legislation Committee (sitting as Senate Estimates) on 22 October 2009, 11 February 2010 and 3 June 2010;
- Senate Economics References Committee in its Inquiry into Bank Funding Guarantees on 28 July 2009; and
- Senate Economics References Committee in its Inquiry into Access for Small Business to Finance on 12 April 2010.

In July 2009, APRA also made a joint submission, with the Reserve Bank of Australia, to the Senate Economics References Committee's Inquiry into Bank Funding Guarantees.

Transcripts of APRA's appearances before, and copies of its submissions to, parliamentary committees may be downloaded from its website at www.apra.gov.au/submissions/.

Performance pay

APRA has a performance bonus system, designed in consultation with staff and management and covering all employees. For 2009/10, the aggregate bonus pool was $4.24 million. Under deferred bonus arrangements introduced in the APRA Employment Agreement, 2009/10 bonuses will be paid in December 2010 to eligible staff still in APRA's employ at that date.

Privacy Commission

There were no investigations by the Privacy Commissioner under section 36 of the *Privacy Act 1988* during 2009/10. No reports were served under section 30 of the Act. The Privacy Commission made no determinations under section 52, nor did APRA seek any under section 72.

There were no adverse or favourable comments made by the Privacy Commissioner in respect of APRA's operations.

Privacy inquiries relating to APRA should be addressed to:

The Privacy Officer
Legal Services
Australian Prudential Regulation Authority
GPO Box 9836
Sydney NSW 2001
Phone: 02 9210 3000
Fax: 02 9210 3424

Responsible Ministers

The Hon Wayne Swan MP, Treasurer of the Commonwealth of Australia, has portfolio responsibility for APRA.

He is assisted in this role by the Hon Bill Shorten MP, Assistant Treasurer and Minister for Financial Services and Superannuation.

Staff statistics

Staff by location and full-time/part-time as at 30 June 2010

Location	Full-time	Part-time	Total
Adelaide	4	0	4
Brisbane	14	1	15
Canberra	38	21	59
Melbourne	71	4	75
Perth	3	1	4
Sydney	455	34	489
Total	**585**	**61**	**646**

Staff by division and full-time/part-time as at 30 June 2010[1]

Division	Full-time	Part-time	Total
Corporate	130	29	159
Diversified Institutions	102	8	110
Policy, Research and Statistics	75	6	78
Specialised Institutions	141	8	149
Supervisory Support	140	10	150
Total	**585**	**61**	**646**

1 Includes permanent and fixed-term staff but excludes casuals. Fixed-term employees (30 as at 30 June 2010) were not included in the 2008/09 table.

Full-time equivalent (FTE) staff strength as at 30 June 2010

Permanent	606.0
Fixed-term	25.7
Casual	10.5
Total	**642.2**

List of requirements

The following list of mandatory annual reporting requirements, as outlined in the *Requirements for annual reports for departments, executive agencies and FMA Act bodies* approved by the Joint Committee of Public Accounts and Audit, has been annotated with either 'not applicable' or the location of the information in this *Report*.

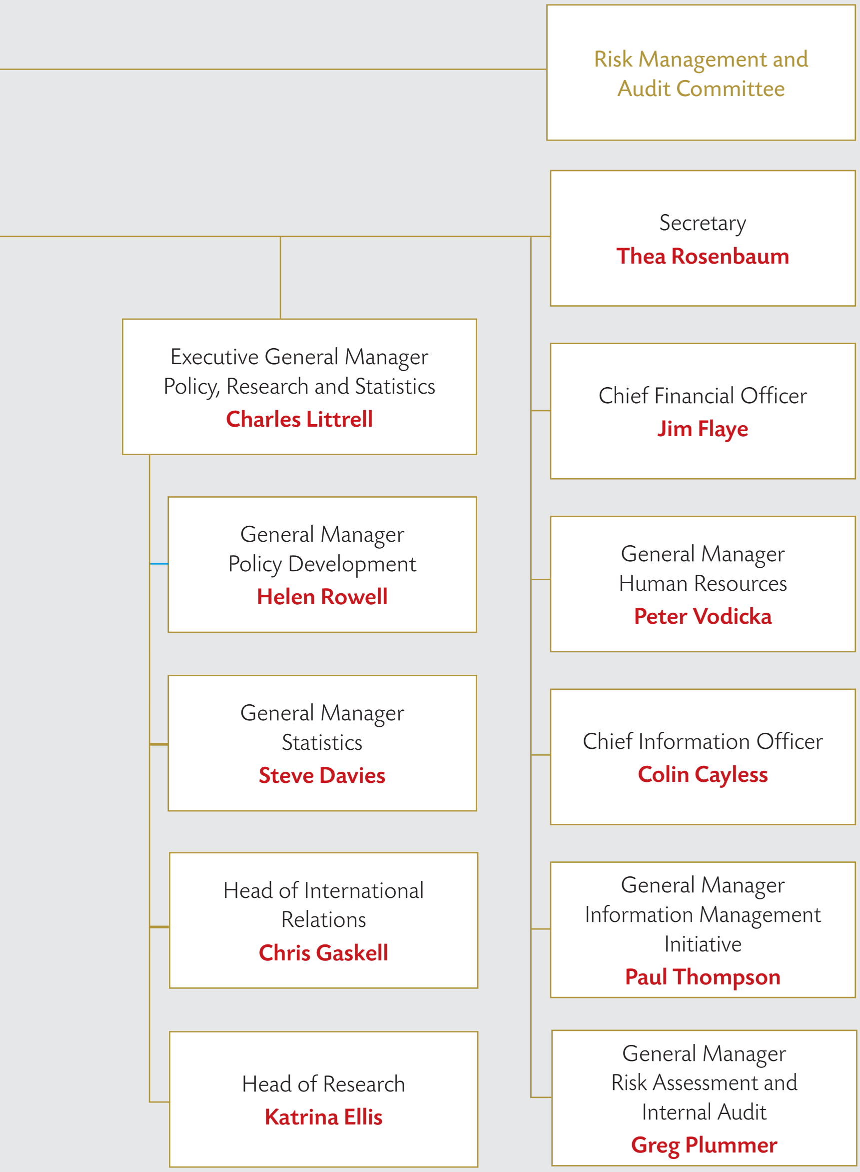
Part of *Report*	Description	Location or applicability
	Letter of transmittal	Page 2
	Table of contents	Page 3
	Index	Pages 154-155
	Glossary	Pages 152-153
	Contact officer(s)	Page 140
	Internet home page address and internet address for report	Page 156
Review by Chairman		Chapter 1
Overview of Authority	Overview	Chapter 7
	Role and functions	Chapter 7
	Organisational structure	Pages 150-151
	Outcome and program structure	Chapter 6
Report on performance	Review of performance in relation to programs and contribution to outcomes	Chapter 6
	Actual performance in relation to deliverables and KPIs	Chapter 6
	Narrative discussion and analysis of performance	Chapter 2 – Chapter 5
	Trend information	Chapter 2 – Chapter 5
	Performance against service charter customer service standards	Not applicable
	Discussion and analysis of the Authority's financial performance	Chapter 6
	Authority's resource statement and summary resource tables by outcomes	Chapter 6
	Developments since the end of the financial year that have affected or may significantly affect the Authority's operations or financial results in future	Not applicable
Corporate governance	Statement of the main corporate governance practices in place	Chapter 7
	Compliance with the *Commonwealth Fraud Control Guidelines*	Chapter 9

Part of *Report*	Description	Location or applicability
External scrutiny	Significant developments in external scrutiny	Chapter 9
	Judicial decisions and decisions of administrative tribunals	Chapter 2 and Chapter 9
	Reports by the Auditor-General, a Parliamentary Committee or the Commonwealth Ombudsman	Chapter 9
Management of human resources	Assessment of effectiveness in managing and developing human resources to achieve the Authority's objectives	Chapter 4
	Statistics on staffing	Chapter 4 and Chapter 9
	Enterprise or collective agreements, determinations, common law contracts and AWAs	Chapter 9
	Performance pay	Chapter 9
Assets management	Assessment of effectiveness of assets management	Not applicable
Purchasing	Assessment of purchasing against core policies and principles	Chapter 9
Consultants	Summary statement detailing consultancy arrangements and confirming that information on contracts and consultancies is available through the AusTender website.	Chapter 9
Australian National Audit Office access clauses	Absence of provisions in contracts allowing access by the Auditor-General	Chapter 9
Exempt contracts	Contracts exempt from the AusTender process	Chapter 9
Commonwealth Disability Strategy	Report on performance in implementing the Commonwealth Disability Strategy	Chapter 9
Financial statements		Chapter 8
Other information	Occupational health and safety (section 74 of the *Occupational Health and Safety Act 1991*)	Chapter 9
	Freedom of Information (subsection 8(1) of the *Freedom of Information Act 1982*)	Chapter 9
	Advertising and market research (Section 311A of the *Commonwealth Electoral Act 1918*) and statement on advertising campaigns	Chapter 9
	Ecologically sustainable development and environmental performance (Section 516A of the *Environment Protection and Biodiversity Conservation Act 1999*)	Chapter 9
	Grant programs	Chapter 9
	Correction of material errors in previous annual report	Not applicable

Executive Group

Dr John Laker (Chairman)
Mr Ross Jones (Deputy Chairman)
Mr Ian Laughlin (Member)

- Executive General Manager
  Diversified Institutions
  Wayne Byres
  - General Manager
    Branch 1
    Neil Grummitt
  - General Manager
    Branch 2
    Heidi Richards
  - General Manager
    Branch 3
    Denis Wilkinson
  - General Manager
    Branch 4
    Harvey Crapp
- Executive General Manager
  Specialised Institutions
  Brandon Khoo
  - General Manager
    Central Region
    Senthamangalam Venkatramani
  - General Manager
    South West Region
    Stephen Glenfield
  - Head of Northern Region
    Clayton Osborne
- General Manager
  Supervision Framework Team
  David Lewis
- Executive General Manager
  Supervisory Support
  Keith Chapman
  - General Manager
    Industry Technical Services
    Graham Johnson
  - General Manager
    AMIRS[1]
    Greg Brunner
  - General Manager
    CORS[2]
    Puay Sim
  - General Manager
    Legal
    Warren Scott
  - General Manager
    Enforcement
    Louis Serret



[1] AMIRS – Actuarial Market and Insurance Risk Services

[2] CORS – Credit and Operational Risk Services

AASB	Australian Accounting Standards Board
AAT	Administrative Appeals Tribunal
ACCC	Australian Competition and Consumer Commission
ADI	Authorised deposit-taking institution
AFSPC	Association of Financial Supervisors of Pacific Countries
ANAO	Australian National Audit Office
APEC	Asia-Pacific Economic Cooperation
APRA	Australian Prudential Regulation Authority
APRA Act	*Australian Prudential Regulation Authority Act 1998*
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
AUSTRAC	Australian Transaction Reports and Analysis Centre
BFIAAG	Banking and Finance Infrastructure Assurance Advisory Group
BCBS	Basel Committee on Banking Supervision
CAC Act	*Commonwealth Authorities and Companies Act 1997*
CoFR	Council of Financial Regulators
CRF	Consolidated Revenue Fund
D2A	Direct to APRA
DOFIs	Direct offshore foreign insurer
EAFD	Early Access Facility for Depositors
EEO	Equal Employment Opportunity
FCS	Financial Claims Scheme
FHSA	First Home Saver Account
FMA Act	*Financial Management and Accountability Act 1997*
FMO	Finance Minister's Order
FOI Act	*Freedom of Information Act 1982*
FSAP	Financial Sector Assessment Program (of the IMF)
FSB	Financial Stability Board
IAA	International Actuarial Association
IAAust	Institute of Actuaries of Australia

IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IOPS	International Organisation of Pension Supervisors
IOSCO	International Organisation of Securities Commissions
LIASB	Life Insurance Actuarial Standards Board
LMI	Lenders mortgage insurer
MoU	Memorandum of Understanding
MPR	Money Protection Ratio
NCPD	National Claims and Policies Database
OECD	Organisation for Economic Co-operation and Development
OHS	Occupational Health and Safety
OPA	Official Public Account
OBPR	Office of Best Practice Regulation
PAIRS	Probability and Impact Rating System
PCF	Policyholder Compensation Facility
PER	Performing Entity Ratio
PHIAC	Private Health Insurance Administration Council
RBA	Reserve Bank of Australia
RBNZ	Reserve Bank of New Zealand
RSA Act	*Retirement Savings Accounts Act 1997*
RSE	Registrable Superannuation Entity
SCCI	Specialist credit card institution
SEACEN	South-East Asian Central Banks
SEANZA	South-East Asia New Zealand and Australia (Forum of Banking Supervisors)
SIS Act	*Superannuation Industry (Supervision) Act 1993*
SOARS	Supervisory Oversight and Response System
UFI	Unauthorised Foreign Insurer

Head office

New South Wales

Delivery address:
APRA
Level 26
400 George Street
SYDNEY NSW 2000

Mailing address:
GPO Box 9836
SYDNEY NSW 2001

T: 02 9210 3000
F: 02 9210 3411

Other offices

Australian Capital Territory

Delivery address:
APRA
Level 2
243–251 Northbourne Avenue
LYNEHAM ACT 2602

Mailing address:
GPO Box 9836
CANBERRA ACT 2601

T: 1300 131 060
F: 02 6213 5307

Queensland

Delivery address:
APRA
Level 23
300 Queen Street
BRISBANE QLD 4000

Mailing address:
GPO Box 9836
BRISBANE QLD 4001

T: 07 3001 8500
F: 07 3001 8501

South Australia

Delivery address:
APRA
Level 5
100 Pirie Street
ADELAIDE SA 5000

Mailing address:
GPO Box 9836
ADELAIDE SA 5001

T: 08 8235 3200
F: 08 8232 5180

Victoria

Delivery address:
APRA
Level 21, Casselden Place
2 Lonsdale Street
MELBOURNE VIC 3000

Mailing address:
GPO Box 9836
MELBOURNE VIC 3001

T: 03 9246 7500
F: 03 9663 5085

Western Australia

Delivery address:
APRA
Level 15, QV.1 Building
250 St Georges Terrace
PERTH WA 6000

Mailing address:
GPO Box 9836
PERTH WA 6001

T: 08 9481 8266
F: 08 9481 8142

Info line: 1300 131 060 **Website: www.apra.gov.au** **Email: info@apra.gov.au**