Australian Prudential Regulation Authority

APRA

Annual Report 2012

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 $4.2 trillion in assets for almost 23 million Australian depositors, policyholders and superannuation fund members.

APRA vision, mission and values

Our vision is to be a world-class prudential regulator, with excellence of supervision as our foundation.

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.

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

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John F. Laker AO
CHAIRMAN

APRA

12 October 2012

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 2012.

Yours sincerely,

John Laker

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Chapter one

From the Chairman

Five years on

For five years now, the Australian financial system has operated against the backdrop of considerable – at times acute – uncertainties about the strength of the global economy and the functioning of global financial markets. A banking crisis that had its origins in the US subprime mortgage market has widened to ensnare banking systems and public finances in a number of European countries and has, increasingly, called into question the integrity of the euro. No immediate end to these uncertainties is in sight.

Over 2011/12, the mood of global financial markets swung in waves. A period of heightened market volatility in the first half as sovereign debt problems in the euro area came to the fore gave way, for a time, to improving market sentiment and asset market rallies after actions by the European Central Bank eased the funding risks facing European banks. The respite proved short-lived. Over the final months of the period, market confidence was again sapped by mounting concerns that governments in some euro countries may no longer be able to support their banks or their economies. Most major equity markets gave up their earlier gains and a 'flight to safety' saw yields on high-quality sovereign debt (including Australian Government debt) fall sharply. Economic activity in much of Europe contracted. Concerns about the US fiscal outlook and about the growth paths of the US and Chinese economies also weighed on global economic prospects.

The performance of the Australian economy over 2011/12 stood in sharp contrast to this global picture. Although the terms of trade declined from recent record highs, the Australian economy returned to growth at around its trend pace, boosted by historically high rates of business investment in the resources sector and a pick-up in consumption expenditure. However, the growth pattern was very uneven across industries and regions outside the resources sector. Inflation eased and the unemployment rate remained relatively low. Despite that, consumer and business sentiment (outside the resources sector) was still subdued.

This supportive domestic environment again proved a bulwark against global vagaries and ensured that the industries regulated by APRA ended 2011/12 in sound financial condition.

The asset quality of authorised deposit-taking institutions (ADIs, including banks, building societies and credit unions) improved, although the patchwork quality of domestic economic growth reflected in a steady flow of newly impaired assets. ADI profitability was strong, helped by relatively steady net interest margins – despite continued strong competition for deposits – and restraint on operating expenses. Profit retention allowed a further strengthening of ADI capital positions. Liquidity and funding positions also improved and Australian banks maintained good access to global term funding markets for all but the most extreme periods of market volatility; however, funding costs were elevated.

The general insurance industry remained profitable and well capitalised. The underwriting result reflected a significantly lower incidence of natural disasters, after a spate the previous year, but this was more than offset by falls in interest rates that increased the value of long-tail insurance liabilities. Those same falls in interest rates, however, produced significant realised and unrealised gains that boosted investment income. The substantial claims arising from the spate of natural disasters over recent years have been largely covered by reinsurance. This in turn has led to increases in reinsurance premia that in part have been, or will be, passed on to policyholders.

Compared to general insurers, life insurance companies hold proportionately less in fixed-income assets and more in other assets, such as equities. For that reason, falls in interest rates over 2011/12 had a more significant impact on the valuation of liabilities than on investment income, particularly for life insurers with large books of guaranteed business. Profitability for the industry was largely unchanged, with the impact of investment volatility largely offset by underwriting profits on risk insurance business. The industry's capital position fell a little, but still provides a strong buffer against future shocks.

Returns for superannuation funds were flat on average, after two years of positive returns.

Strategic challenges

Over the five years of the crisis, APRA-regulated institutions have strengthened their resilience through higher capital levels and improved capital management, more durable funding structures and, where relevant, larger liquidity buffers. The institutions are battle hardened but, fortunately, very few have been battle scarred. Though the possibility of failure must never be dismissed, boards and management have lifted their sights beyond survival to the strategic challenges of operating in an environment that is likely to remain very different from that before the crisis erupted, when volume growth seemed assured but risk was underpriced and capital and liquidity underappreciated. Strategic challenges have moved to centre stage in APRA's more intensive engagement with the boards of regulated institutions.

The challenges vary across regulated institutions and industries but have three broad themes. One theme is the choice of business model appropriate to a macroeconomic setting in which subdued business volumes, low investment returns and global uncertainties may persist for some time. A second is responding to changes in the competitive environment as industries consolidate but innovation spawns new participants. A third and common theme is adjusting to the more robust regulatory environment that is emerging from global and domestic reforms.

The ADI industry, accustomed to vigorous balance sheet growth in pre-crisis days, is confronting a period of sluggish credit demand and high funding costs. Consumer and business caution has resulted in a strong increase in household savings and the slowest pace in credit growth since the early 1990s recession. These developments have been helpful to funding dynamics, with strong deposit growth enabling the larger ADIs to shrink their reliance on short-term wholesale funding. At the same time, however, these developments are denying ADIs the volume growth that had been the key driver of revenue and profitability. Wisely, ADI boards and management have to this point resisted the temptation to 'break free' by pursuing aggressive volume targets that would inevitably put pressure on their credit standards. Growth ambitions are generally realistic, but credit standards need to remain under close watch.

ADIs are looking elsewhere for ways of maintaining their financial strength and profitability. Strategic responses have included, with varying emphasis, increasing efficiency and enhancing productivity through cost-cutting; technological innovation and systems enhancements; expansion into new markets and products; and greater focus on wealth management activities. Outsourcing and offshoring are coming to play a more prominent role in the efficiency programs of many ADIs.

The strategic challenges for general insurers are to maintain profitability in the face of lower interest rates, higher reinsurance premiums and new forms of competition. Balance sheets are largely immunised against interest rate movements because of asset/liability matching, but a sustained lower interest rate environment would have an impact on emerging profitability as maturing assets are reinvested at lower rates and existing policies are renewed or new ones written. The rise in reinsurance premiums has led some insurers to retain more property risks on their own balance sheets, which may increase future earnings volatility, and to look for new ways of accessing reinsurance capacity through capital markets. In the retail insurance market, the internet has become an important distribution channel with the arrival of new specialist insurers and direct-marketing 'aggregators' that compare and sell offerings of multiple insurers. These participants are yet to have a significant impact in Australia, as they have done in retail insurance markets overseas.

Low and volatile investment returns pose more significant challenges for the balance sheets and profitability of life insurers because of the broad range of asset classes that they hold. Low interest rates, in particular, also place upward pressure on pricing and can make some types of life insurance products, such as lifetime and term-certain annuities, less attractive in the market place.

Life insurers as a group have steadily lost market share in superannuation over many years, although they do manage significant superannuation business outside the life insurance companies themselves. The increasing popularity of self-managed superannuation funds for high net-worth individuals has seen an attractive market segment seep away from life insurers. Some insurers are developing administration, advice and investment services for self-managed superannuation funds to capture part of that market. New distribution channels are also emerging for traditional life insurance products. To compete more effectively, life insurers have been seeking scale through takeovers, investing heavily in technology and distribution networks, and building financial planning teams under insurer-owned dealer groups.

The superannuation industry itself is in the midst of its most significant change for a number of years. After a long pre-crisis period of strong growth in member balances and high investment returns, APRA-regulated superannuation funds have seen their member contributions virtually stall and returns swing into the negative in more recent years. Members have become more aware of returns, risks and costs. In a low investment return environment, superannuation funds including those provided by life insurers are offering more basic products with lower fees. Superannuation funds, too, are seeking scale through merger activity.

This environment has also heightened the focus – not just by APRA but in the community generally – on the quality of superannuation trustees and their governance and decision-making processes. Reinforcing this focus are the Government's Stronger Super reforms, which clarify and sharpen the onus on trustees to act in members' best interests. Trustees of APRA-regulated funds will need to adjust to a new and more robust prudential framework based on prudential standards, being developed by APRA under new powers. In the other APRA-regulated industries, in contrast, reforms are largely building on existing prudential frameworks.

An institution's strategic choices are, quite properly, the ultimate responsibility of its board. APRA does not direct these choices; it is neutral on such matters as the level of staff expenses or the selection of technology. Rather, APRA's role is to test and, where necessary, challenge the perceived risks and the realism of key strategies. APRA's dialogue with boards covers high-level issues such as the board's ability to articulate its strategy, its 'ownership' of strategic decisions and the information on which they were made, as well as specific issues such as the robustness of assumptions underlying the strategy or business model, the nature and types of risk being assumed, and the risk controls in place.

Board ownership of major strategic decisions is critical. A large outsourcing project or a sizeable acquisition can, if mismanaged, threaten the reputation and even the viability of an institution. APRA's discussions with boards covered a number of these sorts of decisions in 2011/12. In large outsourcing projects, APRA looks for close board involvement to ensure that the inevitable trade-off between costs savings and reductions in control are well understood and that risks are being considered in a transparent manner. For sizeable mergers or acquisitions, APRA reviews the due diligence undertaken by the board and the basis for the board's confidence that the institution has the capital, management and technical expertise to complete the integration and achieve a suitable cultural match.

In a well-governed institution, strategic planning is encompassed within the overall risk management framework. Integral to this framework is the board's appetite for risk. A well-considered risk appetite statement, against which actions can be assessed, provides a clear articulation of the degree of risk the institution is willing and able to assume in pursuing its strategic and business objectives. It sets the tone for the risk culture of the institution.

Over 2011/12, APRA continued its discussions with boards on risk appetite. An earlier review by APRA had identified a need for significant improvement in industry practice in this area; some institutions lacked a clear board risk appetite statement or even an understanding of the concept. As a catalyst for change, APRA has developed, and discussed publicly, a set of principles for use by supervisors in assessing an institution's approach to determining and managing risk appetite. The principles are grouped into four broad areas – governance, risk management, implementation and communication – and necessarily involve judgment on APRA's part, but many are objective in nature. APRA is pleased that boards are becoming more involved on risk appetite issues and improvements in the quality of risk appetite statements are becoming apparent. However, much work remains to be done, particularly in ensuring that there is a clear linkage between an institution's risk appetite and its risk, capital and operational management.

At the centre of a board's appetite for risk (for regulated institutions outside superannuation) is the target return on equity it sets for the institution. As the crisis has taught, 'stretch' targets – particularly if built into executive remuneration arrangements – can drive excessive risk-taking and push a sales culture into the ascendancy. The returns on equity achieved before the crisis would be stretch targets if the current subdued environment were to persist. Some institutions have been able to deliver returns approaching earlier highs, but time will tell whether these results are sustainable without unacceptable risks. At this point, it is also unclear how much the enhanced safety of regulated institutions in Australia, promoted by higher capital levels and other prudential reforms, has been factored into risk premia built into the rates of return sought by investors.

Under APRA's new prudential standards for superannuation, superannuation fund trustees will for the first time need to articulate the fund's appetite for risk. Trustees will need to develop a clear statement of the risks that it is comfortable for the fund to assume and those it seeks to avoid. APRA will also expect that trustees will be able to estimate the maximum impact on beneficiaries in the event that a particular risk is realised.

The prudential regime

APRA's prudential regime is undergoing substantial upgrading in each of its regulated industries. The motivation, in the case of the ADI industry, is the global reform agenda of the G-20 Leaders, which seeks improvements in the resilience of the global banking system through raising the quality, quantity and international consistency of bank capital and liquidity. Lessons from the crisis have also been incorporated into the enhancement and harmonisation of capital standards for the general and life insurance industries, the reforms in this case being driven by APRA. In superannuation, the Government's Stronger Super reforms are aimed at strengthening the governance, integrity and regulatory settings of the superannuation system in Australia.

Major elements of these various reform initiatives will come into effect over the course of 2012/13. APRA's policy resources have been augmented to deal with this peak load but are, nonetheless, at full stretch in developing and consulting on prudential standards and associated reporting.

The Basel Committee on Banking Supervision has had the main carriage of global banking reform and its new global capital and liquidity framework ('Basel III') has been largely finalised. There are three key milestones in APRA's implementation of the Basel III capital reforms. Enhanced ADI capital requirements against the risks arising in trading activities, securitisations and exposures to off-balance sheet vehicles came into effect from 1 January 2012. Measures to raise the quality and minimum required levels of capital come into effect from 1 January 2013. A capital conservation buffer above the regulatory minimum capital requirement that can, under certain conditions, be drawn down in periods of stress comes into effect from 1 January 2016. This timetable is at the early end of the globally agreed Basel III timetable and fully consistent with the Basel Committee's view that the reforms should not be delayed in strong banking systems.

An extensive consultation process on APRA's implementation of the Basel III capital reforms is now almost complete. APRA will maintain its longstanding conservative approach to capital: the Basel III rules text as globally agreed will be adopted but the concessional treatment available for certain items in calculating regulatory capital will not, for *in-principle* reasons. APRA's approach reflects its firmly held view that conservatism has served Australia well before and during the crisis, that the milestones are not demanding, and that the impact of higher capital requirements on the overall funding costs of ADIs are likely to be small. Any additional costs would represent a very modest insurance premium for a safer Australian banking system that can retain the confidence of depositors, investors and the community generally, in still unsettled times.

The Basel III liquidity reforms, which seek to promote stronger liquidity buffers and more stable sources of funding, are being implemented on a slower timeframe. A 30-day liquidity coverage ratio to strengthen the short-term resilience of banking institutions will come into effect from 1 January 2015 and a structural funding ratio to promote longer-term resilience from 1 January 2018. APRA intends to follow the Basel III timetable for these new global standards. The Basel Committee will be fine tuning details in the light of experience during the 'observation periods' before implementation. Over 2011/12, APRA consulted on its proposed adoption of the Basel III liquidity reforms and, more recently, has begun discussions with larger ADIs on how they can maximise their self-reliance in liquidity risk management.

A new element in global banking reform that is particularly relevant to countries like Australia with concentrated banking systems is a framework for dealing with domestic systemically important banks (D-SIBs). Proposals developed by the Basel Committee build on the framework for global systemically important banks (G-SIBs) and respond to the G-20 Leaders' dictum that no financial firm should be 'too big to fail'. The proposals introduce a set of principles under which, most importantly, supervisory authorities would establish a methodology for assessing the degree to which banks are D-SIBs, publish an outline of that methodology and impose 'higher loss absorbency' – that is, higher common equity requirements – on D-SIBs. APRA's consideration of how the D-SIB framework will be implemented in Australia will begin after the G-20 Leaders have endorsed the proposals.

APRA's reforms to capital standards for the general and life insurance industries are intended to make the standards more risk-sensitive and improve their alignment across regulated industries. This latter goal has meant fundamental changes for life insurance through introduction of the concept of a 'capital base', which is aligned with the capital structure for general insurers and ADIs. APRA's extensive policy consultations with industry, in four rounds over the past two years, are now winding down and the revised capital framework will take effect in both industries from 1 January 2013. The reforms will lead to a modest overall increase in required capital in both industries, although the impacts vary widely from insurer to insurer depending on their risk profile. The outcome of the reforms will be more resilient insurance industries and stronger protection for policyholders.

Under the Government's Stronger Super reforms, APRA has for the first time been granted prudential standards-making powers in superannuation. This is a major step in the harmonisation of the prudential framework in Australia, and APRA welcomes it. Prudential standards offer a number of benefits. They can be drafted using plain language conventions and industry terminology, making them a clearer and more accessible instrument for industry participants. They can enshrine a principles-based approach, emphasising the achievement of sound prudential outcomes without prescribing a 'one-size fits all' straitjacket. Over time, they will allow the prudential framework to respond to industry developments in a more flexible way than legislation. A suite of prudential standards for superannuation have been out for consultation and are expected to be finalised by the end of 2012. This will provide the basis for APRA authorisation of the new MySuper product, a simple low-cost product as a default option that is one of the centrepieces of the Stronger Super reforms.

The various reform initiatives summarised above do not complete APRA's prudential policy agenda. APRA has also been consulting on a proposed prudential framework for consolidated groups, aimed at minimising contagion, reputation and operational risks that may arise from a regulated institution's membership of such a group. It has also finalised prudential standards related to covered bonds and the implementation of the Financial Claims Scheme in the ADI industry, and has continued to consult on the latter topic.

Over the course of 2011/12, APRA participated in the second review of Australia under the International Monetary Fund's (IMF's) Financial Sector Assessment Program (FSAP), which evaluates the strength and potential vulnerabilities of a country's financial system and regulatory architecture. The first FSAP review of Australia in 2005/06 provided a strong endorsement of Australia's regulatory framework and of the effectiveness of APRA's prudential supervision. The latest FSAP report has not been finalised but preliminary indications suggest a similar strong endorsement.

APRA Members in 2011/12 – (left to right) Dr John Laker, Mr Ross Jones and Mr Ian Laughlin.

Our people

If it has been a year of 'hard grind' for regulated institutions, it has been equally so for APRA's staff. The need to maintain the intensity of supervision given prevailing uncertainties, the substantial prudential policy agenda and some large infrastructure projects internally have combined to make 2011/12 the busiest period since APRA's establishment, with little sign of immediate relief. In this context, APRA welcomed a new four-year funding arrangement from 2012/13 to ensure its continued capacity to supervise the Australian financial system.

APRA staff have been unstinting in their enthusiasm, resolve and skill over this testing period. Their tireless work in promoting financial safety is not well understood and is largely unsung within the wider community, but the APRA Members are proud of their outstanding contribution.

John Laker

Dr John F Laker
Chairman

Chapter two

APRA's supervisory activities in 2011/12

Authorised deposit-taking institutions

Authorised deposit-taking institutions (ADIs) in Australia faced an operating environment in 2011/12 characterised by subdued household and business sentiment and slow credit growth. This picture was little changed from the previous year. The household sector remained prudent about taking on new debt and maintained its stronger savings habit, which provided a benefit to ADIs from a funding perspective. Trading conditions in many parts of the business sector (outside mining-related activities) remained weak, particularly those parts exposed to the high exchange rate, although business credit returned to positive territory in the second half of the year. Overall, credit growth continued at its slowest pace for two decades, the dragging anchor being growth in housing credit at its lowest recorded rate. Notwithstanding this subdued environment and the shadow of global uncertainties, the ADI sector remained in generally healthy condition. Asset quality was sound, with the inflow of newly impaired assets well down from the peaks experienced in 2008/09; however, the slow process of working through impaired assets has left specific provisions elevated. The liquidity and funding positions of ADIs also improved significantly.

The ADI industry remained strongly profitable in 2011/12, particularly when compared with banking systems in many other countries. Profitability was supported by broadly stable net interest margins that underpinned steady core earnings, as well as by containment of costs. The reductions in bad debt expenses that had boosted profitability in the two preceding years appeared to have run their course and, for some mid-sized ADIs, these expenses actually rose. Continued profit retention and dividend reinvestment schemes led to a further strengthening in Tier 1 capital positions. However, this strengthening was not reflected in total capital positions, which have remained broadly steady over the past three years as industry awaited greater clarity on the eligibility criteria for lesser quality capital instruments under Basel III. That clarity has now been provided and total capital positions are expected to increase over the coming period.

Total ADI numbers were little changed in 2011/12. The arrival of new foreign bank branches largely offset a further reduction in credit union numbers through mergers. In addition, five credit unions and one building society, accounting for around 20 per cent of total credit union and building society assets, changed their status to mutually owned banks, having met APRA's substance test to become a bank.

APRA's supervision of the ADI industry during 2011/12 remained focussed on potential vulnerabilities to any further deterioration in the global economic environment, particularly through the direct transmission mechanism of global funding markets. Increasingly, as well, APRA's interactions with ADI boards and senior management have traversed the structural challenges facing ADIs as they seek to maintain shareholder returns without the sustained high asset growth of pre-crisis years.

Liquidity and funding

The larger ADIs continued to strengthen their liquidity and funding positions over the course of 2011/12. They increased their share of funding from deposits and lengthened the maturities of new wholesale funding, in that way reducing their dependence on short-term wholesale debt that is seen as a potential source of vulnerability. The governance, systems and controls around liquidity risk management also improved. In particular, the better managed ADIs now explicitly define their appetite for liquidity and funding risks.

Nonetheless, the acute dislocation in global funding markets in late 2011 again confirmed that liquidity and funding risk requires constant vigilance, by ADIs and APRA alike. At that time, the return of strong risk aversion on the part of investors led to the effective closure of global term unsecured funding markets for banks, whatever their origin. Funding conditions have improved in 2012 and the larger Australian banks have been active issuers in global term debt markets, initially in secured form through covered bonds and later, as risk aversion lessened, in unsecured form. As a consequence, they have moved ahead of schedule in their funding tasks. However, recurring market volatility meant that spreads have only recently returned to mid 2011 levels.

To support its vigilance, APRA has continued to apply additional resources to ensure ADIs are approaching the management of liquidity and funding risk in a prudent manner. The breadth and frequency of APRA's interactions with ADIs in this area ensures that APRA has an extensive understanding of ADI liquidity and funding risk. More recently, these interactions have encompassed ADI planning for the new Basel III liquidity and funding requirements (see Chapter 3). This intensive supervisory stance will be unchanged for some time to come.

The liquidity position of an ADI at any point is a combination of a number of factors but the most important is the funding that the ADI has undertaken in the past. These factors are brought together in an ADI's funding plan, a forward-looking plan with specific quantitative funding targets, which APRA expects to be prepared at least annually and more frequently when material changes occur. APRA's frontline supervisors, working together with its liquidity risk specialists, routinely review and interrogate these funding plans, benchmark projections of forward funding requirements across the industry and scrutinise asset growth targets. A robust understanding of funding plans, and progress in their execution, provides critical insight into emerging liquidity issues.

In addition, supervisors continue to review and analyse base-level ADI liquidity information, including a variety of key metrics such as the average duration of wholesale funding and the level of liquid assets relative to upcoming maturities. Supervisors monitor the 'name crisis' liquidity stress test that larger ADIs are required to meet until the introduction of the new Basel III liquidity standard. Supervisors are also in regular contact, either on a scheduled or *ad hoc* basis, with ADI treasury staff to understand market and funding conditions. Supervisory engagement on liquidity and funding issues is supplemented by formal on-site reviews. These wide-ranging reviews cover the effectiveness of strategies, policies and systems to measure, monitor and manage liquidity and funding risk in ordinary and stressed operating conditions.

The introduction of covered bonds (see Chapter 3), which are secured debt instruments with continuing recourse to the issuing ADI, was an important structural development in 2011/12, providing ADIs with access to a new source of longer-dated funding. For a time after the late 2011 dislocations, covered bonds were virtually the only instrument attractive to global investors and the larger Australian banks became active issuers, albeit at an elevated cost. The corollary of this investor preference for greater security, however, is that securitisation markets have been slower to recover, particularly for smaller ADIs that have tended to rely on securitisation as a source of funding. New issues of residential mortgage-backed securities (RMBS) have picked-up, supported in some cases by the Australian Office of Financial Management, but spreads are relatively high. Investor appetite for the subordinate tranches of these issues remains weak, in many cases forcing the originating ADIs to retain these tranches. No regulatory capital relief is available to the originating ADIs in these cases, since credit risks associated with a securitisation transaction are concentrated in these subordinated tranches. APRA will be reviewing its prudential framework for securitisation over 2012/13 with the aim of simplifying the framework for market participants and providing more supervisory flexibility.

Credit quality

Close attention to ADI credit quality has been a central element of APRA supervision of the ADI industry long pre-dating the crisis, and it must remain so. Credit quality has proven to be significantly more robust than in most other advanced economies. However, the crisis exposed some weaknesses. Further, as APRA has been warning, the industry faces a key risk that, given subdued credit growth and a competitive retail banking environment, ADIs may seek to gain or maintain market share by relaxing their credit standards.

APRA's supervisory activity involves regular assessments of ADIs' credit risk management frameworks and their implementation, including through on-site prudential reviews. These reviews assess an individual ADI's policies and procedures against those of its peer group as well as against the requirements of APRA's prudential standards. Increasingly, APRA is undertaking more targeted on-site reviews, reflective of the risk-based nature of its supervisory approach and the maturity of the review process. This is most noticeable in the case of credit risk reviews of the larger ADIs.

Credit quality improved over 2011/12, with further falls in the share of impaired assets in business and commercial property lending. Credit quality in housing lending was little changed. That said, non-performing loan ratios overall are still above pre-crisis levels and there has been a relatively constant flow of newly impaired assets, particularly in commercial property lending and certain sectors of business lending. Some ADIs have portfolios of troublesome commercial property loans that will take further time to work out.

In business and commercial property lending, APRA supervisors monitor a range of indicators of credit quality and continue to receive ADIs' own 'watch lists' of difficult credits. In addition to on-site reviews, APRA's supervisors and credit risk specialists have regular discussions with and receive lending survey information from Chief Risk Officers and Chief Credit Officers of the larger ADIs. These discussions also cover, where relevant, credit exposures to European-domiciled counterparties, particularly those counterparties located in the troubled eurozone countries; these latter exposures are relatively small and are being closely managed by ADIs.

In housing lending, APRA's recent supervision of credit risk has been conducted against the background of the high debt levels of Australian households, the concentration of housing lending on ADI balance sheets and some weakness in housing prices in certain areas. APRA's supervisors and credit risk specialists look for any changes in risk appetite and lending strategy of ADIs, variations in credit quality across different geographical regions, and the robustness of governance, credit standards and risk management controls. Broadly speaking, ADIs have reined in their appetite for higher-risk housing lending since the crisis began, although there are signs more recently of a pick-up in high loan-to-valuation ratio lending in response to competitive pressures.

APRA also draws on other 'lines of defence' in its oversight of housing lending risks. Most important are the boards of ADIs, which set the risk appetite for their institution and approve the credit risk framework. Boards of the larger ADIs have provided assurances to APRA that they are actively monitoring housing loan portfolios and are comfortable with their current credit standards. Also important are the external auditors of ADIs, who undertake targeted reviews of particular topics at APRA's behest. The 2011/12 targeted review topic was collateral management and foreclosure management; the 2012/13 topic is housing loan approval standards.

This current targeted review focusses on the income tests that ADIs use to assess whether borrowers can afford the interest and principal repayments on their loans. Loan serviceability criteria are a critical part of the approval process; weaknesses in serviceability policies can quickly lead to increases in the volume of loans defaulting in an economic downturn. In Australia, the very high proportion of variable rate housing lending means that housing credit quality is more sensitive to changes in interest rates than in many other jurisdictions. Further, debt interest payments as a proportion of disposable income, though falling recently, remain quite elevated compared with the experience of earlier decades. The targeted review asks external auditors of the ADIs involved to assess the strengths and weaknesses of the serviceability criteria and serviceability calculators used for housing loan approvals. The assessment will also cover how serviceability policies have worked in practice, including the nature and frequency of policy 'overrides'.

Stress testing

Since the global financial crisis began, there has been an increasing focus globally on the use of stress testing by banking institutions and their supervisors. Consistent with this direction, APRA is investing additional resources in its stress-testing activities as a core area of frontline supervision. In both the ADI and insurance industries, APRA assesses the stress-testing capabilities and analysis of individual institutions to ensure the analysis is robust and factored into decision-making, strategic planning and the institution's Internal Capital Adequacy Assessment Process (ICAAP). APRA also conducts its own stress tests to better understand the vulnerabilities facing individual institutions and industries and the potential for systemic threats. At the individual level, APRA's stress testing can be desk-based by APRA supervisors or by each institution at APRA's request. From time to time, APRA also conducts more comprehensive stress tests at the industry level.

APRA's first comprehensive macroeconomic stress test in the ADI industry was conducted in 2009/10, when the resilience of the 20 largest ADIs was tested against a continued deterioration in global economic conditions that generated a substantial economic downturn in Australia. The stress test confirmed the capital strength of the ADIs involved. As a follow-up, APRA conducted another macroeconomic stress test for five of the largest ADIs in 2011/12. The scenario, developed in conjunction with the Reserve Bank of Australia and the Reserve Bank of New Zealand, involved a sharp slowdown in economic activity in China and a disorderly resolution of sovereign debt problems in Europe, triggering protracted dislocation in global funding markets. Within this context, the scenario envisaged a sharp fall in economic activity in Australia, accompanied by a rapid rise in unemployment and a significant drop in house prices. Despite the severity of this scenario, the stress test showed that none of the five ADIs would have breached the four per cent minimum Tier 1 capital requirement of the Basel II framework but that there was a need to rebuild Tier 2 capital levels, which had been run down ahead of finalisation of the Basel III capital standards.

As part of its 2011/12 Financial Sector Assessment Program review of Australia (see Chapter 3), the IMF conducted a macroeconomic stress test for the five largest ADIs using the same macroeconomic scenario, but taking a 'top-down' modelling approach. The results were consistent with the more granular 'bottom-up' approach of APRA's stress test, providing a cross-check on the process.

Living wills

The concept of 'living wills' arose out of the commitment of global policymakers to strengthen the powers and tools available to supervisory agencies to restructure or resolve financial institutions in crisis. A living will refers to two separate but related matters: recovery planning, in which a financial institution sets out the actions it would take to survive a severe crisis without public sector intervention; and resolution planning, which focusses on measures that would enable a cost-effective resolution of the institution by the authorities where recovery is not possible. The living will concept is central to global reforms designed to ensure that systemically important financial institutions can remain operational in the event of severe distress, in a way that minimises adverse systemic impact and the need for taxpayer assistance.

In the latter part of 2010/11, APRA commenced a pilot program on recovery planning involving a number of the larger ADIs. These institutions were asked to prepare a comprehensive recovery plan identifying a list of possible actions to restore financial soundness in the event of a major depletion of capital and associated liquidity pressures. The recovery actions needed to generate a material improvement in capital and funding within a reasonable period of time, and be credible and realistic. Finalised recovery plans, signed off by the board of each ADI, were received by the end of July 2012.

The recovery plans are comprehensive, with all ADIs involved in the pilot program developing reasonably extensive lists of recovery actions and most providing alternative projections of recovery adopting different selected actions. APRA expects that recovery planning for these ADIs will now be integrated within their existing risk management processes, ensuring that the initial recovery plans are periodically reviewed and updated. APRA also expects these ADIs to challenge their recovery planning with alternative and potentially more severe events, and consider mitigating actions that would ensure effective recovery in a timely manner. In this context, recovery plans need to consider the preparatory steps ('pre-positioning') that could improve the likelihood of recovery, particularly for recovery actions that would have to be taken quickly in need.

The pilot program has provided APRA with a better understanding of the strategic and operational complexities associated with planning and implementing recovery actions and has helped to shape APRA's thinking on the application of recovery planning beyond the larger ADIs. APRA is extending the recovery planning exercise to the next tier of ADIs and is considering its extension to the larger general insurers and life insurers in 2013.

Executive remuneration

During 2011/12, APRA met with the Board Remuneration Committees of a number of the largest listed ADIs and insurers chosen for a detailed review of their executive remuneration arrangements. These were part of a wider group of institutions for which APRA undertook peer group comparisons the previous year. APRA's focus on executive remuneration arrangements is not on the size of executive packages but how they are structured. Its prudential requirements on remuneration, which came into force in April 2010, reflect the lessons of the crisis that poorly structured remuneration arrangements provide incentives for excessive risk-taking, encouraging an accumulation of risk rather than its prudential management.

APRA's conclusions from its detailed review confirmed its views from the earlier peer group comparisons that the remuneration policy and practices for senior executives in the institutions concerned were generally sound, but there was room for improvement in aligning risk and reward. The issues raised now form part of APRA's ongoing supervisory activities.

All of the boards with which APRA met had well established Board Remuneration Committees, with reasonably clear and robust governance arrangements and strong linkages to the Board Risk Committee. In a limited number of cases, however, there seemed to be a degree of tension between the roles of the board, which has ultimate responsibility for the structure and outcomes of remuneration arrangements for senior executives, and of the Chief Executive Officer. Moreover, there appeared some inconsistencies in the extent of board approval of the remuneration of material risk-takers below the senior executive level and of executives in APRA-regulatd subsidiaries within a group. APRA also found that approaches to the use of performance scorecards to determine remuneration varied widely. The design and application of scorecards is critical to ensuring risk and reward are properly aligned. A scorecard based solely on judgment does not provide a sound basis for remuneration decisions while an entirely mechanical or formulaic approach prevents Board Remuneration Committees from providing a sensible overlay where key performance indicators do not present a true measure of an individual's performance. A balance between the two approaches needs to be achieved.

Finally, on the structure of remuneration arrangements, APRA found that almost all institutions with which it met use a combination of short-term and long-term incentives for senior executives. For both types of incentives, there was welcome progress in extending deferment terms, consistent with the intent of APRA's remuneration requirements. However, the ability to clawback unvested payments was not always evident. For some institutions, the scope for withholding unvested payments if, for example, there was subsequent evidence of financial misconduct, was very restricted.

In July 2011, the Basel Committee on Banking Supervision released its *Pillar 3 disclosure requirements for remuneration*, requiring both qualitative and quantitative disclosure on remuneration by banking institutions. In October 2011, APRA wrote to locally incorporated ADIs encouraging them to include these disclosures in their next annual report or Pillar 3 disclosures. APRA will be consulting with the ADI industry in 2012/13 on the formal inclusion of these disclosure requirements in an expanded version of *Prudential Standard APS 330 Capital Adequacy: Public Disclosure of Prudential Information.*

Operational risk

The number of material operational risk incidents during 2011/12 was smaller than the previous year, when natural disasters in Queensland as well as security breaches and some serious payment system outages impacted on operations. Though there were incidents of system outages and denial of service attacks, the number of high severity outages fell.

A number of ADIs are in the process of, or are planning for, replacement of their core banking systems. There are considerable risks in doing so, reflecting the age, scale and complexity of these systems. APRA's supervisors and technology risk specialists require regular updates on these core system replacement programs so that they can assess the risks involved. That said, the replacement or upgrading of outdated operating systems, hardware and software must remain a priority if the reliability of banking services, and public and market confidence in ADIs, is to be maintained. APRA and the Reserve Bank of Australia are coordinating efforts to promote greater resilience in ADIs' retail systems, including encouraging continued progress in programs of remediation. APRA's role is to promote the right incentives, governance and transparency to ensure that ADIs are dedicating the necessary effort to the task.

APRA has been reviewing the extent to which the operational risk capital models of the 'advanced' ADIs – those ADIs with APRA approval to determine their operational risk capital requirements using an internal model – have adequately captured changes in operational risk profiles. The adequacy of operational risk capital held by banks has become a concern globally and APRA has been participating actively in work on this topic with overseas counterparts, under the auspices of the Basel Committee on Banking Supervision. APRA has concluded that the current models of advanced ADIs generally understate operational risk capital requirements and are not sufficiently sensitive to material changes in operational risk profiles. As a result, APRA has been working closely with these ADIs in pursuing a range of improvements in their operational risk modelling and increases in the capital held against operational risk.

General insurance

The general insurance industry remained profitable and was able to build up its capital position in 2011/12, after the experience of a spate of natural disasters in Australia and New Zealand the previous year. The size and structure of the industry remained relatively stable.

A significant proportion of the industry's premium revenue is generated from underwriting property risks and, hence, the industry's financial performance can be heavily influenced by the occurrence of natural disasters, in terms both of their frequency and their severity. The main influence in 2011/12 was the significantly lower level of gross claims from natural disasters compared to the previous year. The interest rates used in valuing long-tail insurance liabilities fell in 2011/12 and this in turn drove these liabilities higher. However, those falls in interest rates also flowed though to higher investment income in the form of significant realised and unrealised gains on fixed-income securities. The aggregate capital ratio rose over the year to around 1.8 times APRA's minimum capital requirements.

A large portion of the industry's gross property claims from the recent spate of natural disasters have been covered by reinsurance. The consequence, however, has been a general hardening of the reinsurance market, including higher reinsurance premiums and revisions to terms and conditions when insurers sought to renew their property catastrophe reinsurance arrangements in 2011/12. Many insurers responded to the hardening market conditions by reviewing their risk appetites and, in some cases, changing their property catastrophe reinsurance arrangements, particularly by retaining more catastrophe risk on their balance sheets. Insurers also sought to offset the impact of higher reinsurance costs by increasing premium rates in some classes of business. Some insurers reviewed their exposures in geographical regions exposed to catastrophe perils to determine if premiums were commensurate with the risk, leading in some cases to increases in premiums or a withdrawal from underwriting risks in a particular geographic region.

One key outcome of the natural disasters in Australia in 2010/11 has been the prominence given to the availability and affordability of insurance for riverine flood in those communities most at risk. More insurers have made riverine flood insurance available and, increasingly, the cover is mandatory under the policy. However, the challenges involved in pricing riverine flood risk are significant, particularly for small and medium-sized insurers that may not have the volume and range of data that are available to the larger insurers. The Government's intention to provide a central national access point containing all existing flood risk information will be an important resource in assisting all insurers in their pricing of riverine flood risk.

APRA continues to monitor the development of price comparison platforms (known as 'aggregators') in the general insurance market in Australia, which to date have been more prominent in the retail market. These are businesses using the internet to allow consumers to compare the offerings of multiple insurers when purchasing insurance. Overseas experience has shown that, because they highlight pricing differences between insurers, aggregators can generate increased customer switching behaviour and this can lead to pressure on insurer profitability. Thus far, aggregators have had limited impact in the retail market in Australia, mainly because the larger insurers do not offer their products through aggregator sites. It is too early to assess the impact of commercial lines aggregators on the broader commercial insurance market.

Reinsurance counterparty exposure

The exposure of the general insurance industry to reinsurers is a material source of counterparty risk and this risk was heightened in 2010/11 following the spate of natural disasters. APRA's special data collection in that year showed that the industry is well diversified in terms of reinsurance counterparties and that most reinsurers used were rated AA- or A+. The data collection was a valuable addition to APRA's regular data collection on reinsurance counterparty exposure, which has a more insurer-specific focus and, accordingly, is difficult to aggregate across the industry. APRA is currently consulting on whether the regular reporting should be augmented with information similar to that in the special data collection.

Reinsurance placement risk

APRA has been closely monitoring trends and developments in the property reinsurance market, described above, drawing on its frontline supervisors and insurance risk specialists. The work has mainly involved reviews of documentation from individual property insurers, such as their Reinsurance Arrangements Statements and business plans, and assessment of the impacts of changes in their catastrophe reinsurance programs and capital management strategies. The work has also involved examination of industry-wide themes, such as quality of stress testing performed – where there is clearly room for improvement – and the catastrophe modelling used in the determination of reinsurance arrangements. Any general issues identified are communicated to industry through various forums, while feedback specific to individual insurers is provided by frontline supervisors.

Catastrophe modelling processes

The reinsurance arrangements in place during recent natural disasters have been an essential underpinning of the resilience of the industry. A key influence on the structure and nature of reinsurance arrangements is catastrophe modelling, which is used extensively by insurers. Effective risk management and governance practices are important controls in the catastrophe modelling process. Poor practices can lead to inadequate levels and/or structure of reinsurance arrangements, which in turn can have significant impact on insurer risk exposure and profitability, and lead to inappropriate pricing and inadequate capital targets. APRA is concerned that boards and senior management may rely too heavily on catastrophe modelling output and the model's 'black box', without sufficient challenge and debate. In particular, boards and senior management need to recognise the limitations of the models used, and the potential sensitivity of results in the tail of the distribution, when designing their reinsurance requirements. APRA is currently assessing the catastrophe modelling governance practices of a number of insurers to understand the range of industry practices adopted. At a minimum, these findings will inform APRA's supervisory approach to this issue across the industry.

Adequacy of pricing processes

Reviews of the pricing processes and controls of insurers, using its insurance risk and actuarial specialists, form a significant part of APRA's ongoing supervision of the industry. APRA sees heightened risk in this area, not only from increased competition in some classes and the need for improved pricing for riverine flood insurance, but also from the current low interest rate environment. A sustained low interest rate environment is likely to cause upward pressure on premiums, particularly for the long-tail classes of business. Strong competition and subdued demand in some of these classes, however, may hinder an insurer's willingness or ability to obtain the required premium rating to meet profitability requirements for these classes.

Adequacy of reserving

APRA's supervision also focusses closely on reserving risk – the risk of inadequate reserving for insurance liabilities that can expose insurers to significant losses if their claims experience proves to be worse than estimated. Prior-year reserve releases have made a significant contribution to industry profitability in recent years. A key driver of these releases has been insurers' favourable claims experience following tort law reform, which had a significant impact on the compulsory third party (CTP) and liability classes. APRA is concerned that current pressures on industry from natural disasters and other factors may increase the likelihood of unwarranted reserve weakening in order to sustain short-term profitability. APRA is undertaking a review of the relative reserving strength of a range of insurers, concentrating on the underlying reserving assumptions and methodologies used in major classes of business.

Life insurance and friendly societies

Notwithstanding the volatility in global and domestic fixed-income and equity markets, the profitability of the life insurance industry (including friendly societies) was largely unchanged in 2011/12. The nature of the business in force meant that much of the effect of investment volatility was passed on to policyholders and the lower investment income attributable to shareholders was largely offset by underwriting profits from individual risk insurance business. Over the year, life insurance assets increased slightly but the capital position fell a little. Even so, capital adequacy remains around pre-crisis levels and life insurers have the capital resources and robust capital management needed to absorb further shocks, reflecting the priority that APRA and life insurance boards gave to capital strength through the crisis. Nonetheless, life insurance boards and management will need to remain vigilant about their capital positions in these unsettled times. Australian life insurers and reinsurers that have ceded risk to their European parents via reinsurance must be particularly alert to developments in Europe.

There were no major changes to the structure of the life insurance industry over 2011/12, although financial groups continued to rationalise their multiple licences. The size and structure of the friendly society industry was little changed.

The risk insurance business, the major area of activity for life insurers outside their superannuation business, has grown strongly for some years now. This is likely to continue, as much of the growth in premium revenue is due to age increases and indexation of the in-force book. Moreover, while investment markets remain uncertain, financial planners are likely to direct more attention to this market. Competition is largely driven by the need to gain the support of financial planners, and policy features regularly expand and underwriting requirements decline in response. This business has been generally profitable and a number of insurers have specialised in it. However, some poor underwriting and claims practices have emerged in more recent years, which have had a damaging impact on emerging profits. There are some indications that, in response, insurers are starting to adopt a more disciplined approach to their pricing and/or underwriting. Time will tell how the tension between the need to attract business from financial planners and sensible business practices plays out. This business is coming under increasing APRA scrutiny.

For the life insurance industry, a range of regulatory developments has the potential to cause disruption and require a review of business models. These developments relate to distribution (the Future of Financial Advice reforms), superannuation (the Stronger Super reforms), capital requirements (APRA's life and general insurance capital review), accounting requirements (International Financial Reporting Standards) and operations (the US Foreign Account Tax Compliance Act). APRA continues to work closely with the industry to ensure that it fully understands the operational risks and other prudential implications of these developments.

In its ongoing supervision, APRA has been reviewing the availability of relevant skills for management and boards of life insurers and friendly societies. Skilled resources appear to be in short supply in the areas of underwriting and claims management particularly. Boards need appropriate breadth of relevant skills and industry experience and an understanding of the business, including its operating model, its strategy and its capital and risk management, and should not rely solely on senior management or Appointed Actuaries in these areas. Friendly societies tend to have less complex business models and product offerings, which may be reflected in the skills requirements for boards and management, but they face the same regulatory environment as life insurers and so should be appropriately skilled. APRA has continued to emphasise to boards the importance of strong risk management, including effective risk appetite statements and robust stress testing and scenario testing. APRA intends to provide further guidance in these areas.

Group risk insurance

Group risk insurance, mainly servicing large superannuation funds, now accounts for about one-third of risk insurance business. A small number of insurers, particularly those without a strong brand or distribution capabilities, have been active in this market as a way of building market share. Prudential risks associated with the capital support, operational management and pricing processes for group risk insurance have been of concern to APRA for some time. Some of the practices in this area have been poor. The fact that this business delivers only about 10 to 20 per cent of the profits from risk insurance business confirms a narrowing of profit margins and illustrates the importance of economies of scale for group business. Insurers need to capture and retain large volumes of group business from a range of customers to ensure this business line is sufficiently diversified and robust.

The Stronger Super reforms provide an opportunity to improve practices from the 'demand' side as well as the 'supply' side, since they put an onus on superannuation trustees to ensure that their members are best served by the insurance made available to them through their fund. New prudential standards and guidance will sharpen trustees' focus in this regard.

Directly marketed business

Direct marketing of life insurance has blossomed with the emergence of new distribution channels. These involve marketing of life insurance products directly to the public through call centres, the internet and television advertising, often at high prices. APRA's focus is on the governance associated with this business, the risks such products might pose to the reputation and viability of insurers and whether these risks are being appropriately managed. Many of the concepts in this area are unproven and the market is becoming crowded, which will put pressure on profitability. APRA has also been in discussions with the Australian Securities and Investments Commission (ASIC) over directly marketed business to ensure consistent understanding and coordination of scrutiny in this area.

Claims experience

A recent deterioration in death and disability claims experience has put pressure on the profit margins of some insurers, although the pattern is not consistent across the industry and it is not yet clear whether the deterioration represents the beginning of a trend or is just a short-term fluctuation. The deterioration is particularly evident in products offering income protection, where adverse claims incidence and claims termination are reducing product profitability. This deterioration may be a consequence of weaknesses in some sectors of the Australian economy; it may also reflect the increasing sums insured due to indexation, the changing mix of business from underwritten and guaranteed acceptance (with higher associated claims rates), and/or past relaxation of underwriting requirements. APRA will continue to monitor these developments closely.

APRA has continued its dialogue with the life insurance industry over the importance of industry-based death and disability experience studies and on the quality of data used to produce them. Currently, life insurers are unable to correctly identify the level of underwriting at risk commencement, or even when a policy is on the books because of replacement, continuation or buy-back of cover, meaning that the impact of any raising or waiving of medical requirements is uncertain. APRA welcomes the production of industry lump-sum death/disability experience studies that cover the majority of the yearly renewable term insurance market. An experience study covering one year of disability income protection has been produced and an analysis of the period 2007-09 has commenced.

APRA continues to support a research project with the University of New South Wales to develop an integrated framework for the economic, actuarial and regulatory aspects of longevity. The four-year project produced a further seven working papers in 2011/12, taking the total to 21 working papers.

Superannuation

Although the superannuation industry continued to grow, the volatility in global and domestic investment markets resulted in returns for superannuation funds that were flat on average in 2011/12. Though lower than the previous year, returns on fixed-income investments helped to offset the decline in equity markets. Continuing net inflows to superannuation provided much of the growth in total industry assets over the year. Trustees are giving greater scrutiny to the structure and cost of investments, with many trustees turning their attention towards delivering good outcomes to members in investment markets that threaten to remain unsettled.

Many defined benefits funds continue to work through funding challenges that have been evident since the global financial crisis began. Overall, however, APRA believes that the solvency of defined benefit funds is being managed appropriately and there is near-universal compliance of employers with funding requirements and rectification plans (where required).

Continuing superannuation fund mergers and consolidation saw the number of trustees with Registrable Superannuation Entities (RSE) licenses fall by 11 to 214, and the number of registered funds under their trusteeship fall by 379 to 3,694.

Anticipation of the Government's Stronger Super reforms (see Chapter 3) has led trustees to examine and evaluate their current products, operations and governance structures. APRA's supervisory efforts during 2011/12 have been focussed on working closely with trustees to determine their strategies and state of preparedness for these reforms. Ongoing issues such as the quality of trustee oversight, the robustness of risk management frameworks (especially those relating to investment risk) and the challenges posed by volatile investment markets have also received close attention from APRA.

Preparing for Stronger Super

Many trustees have begun planning for the Stronger Super reforms and have been assessing possible gaps between their current practices and the new prudential regime. However, a number of trustees are less advanced in their preparations and will need to devote time and resources to this task. APRA supervisors have been working closely with trustees to gain an understanding of their strategy and, in particular, their ability to meet the requirements for offering the new MySuper product. This engagement will intensify as trustees commence submitting draft applications before their formal applications are able to be lodged from 1 January 2013. APRA has been encouraging trustees to work closely with their responsible supervisor to ensure a smooth transition.

The introduction of prudential standards in superannuation will require a heightened level of governance and management for all trustees. Many trustees have a solid base to build on in adapting to the new requirements but others will need to make considerable effort to ensure that they will comply.

While the Stronger Super reforms do not, of themselves, necessitate any need for the merger of superannuation funds, there is a level of ongoing discussion between trustees about potential fund mergers. The Government's proposal to allow an extension of tax loss relief for merging APRA-regulated funds is also likely to facilitate further mergers and consolidation. Although APRA does not have the power to approve or reject mergers, it is ever mindful of the risks to members posed by a poorly performed (or aborted) merger. APRA has been encouraging trustees to conduct thorough due diligence on potential partners and devise their own specific plans, objectives and timeframes before entering into formal arrangements, so as to ensure that when mergers do take place they occur smoothly.

Governance and risk management

A key element in APRA's supervisory framework is its assessment of the adequacy of trustee risk management frameworks. Trustees have been devoting more attention to risk management but further progress is needed to meet APRA's expectations and achieve the level of maturity of other APRA-regulated industries. A general finding from APRA's supervision is that risk management functions suffer from inadequate resourcing; the effectiveness of these functions could also be enhanced through more detailed reporting to and engagement by trustee boards. Another recurring finding is a lack of compliance with trustee policies and procedures. This is particularly prevalent in the case of policies on fitness and propriety of directors and responsible officers, and the management and oversight of outsourced service providers.

Data integrity

APRA has been emphasising to trustees that, if they are to successfully meet their obligations to members, they must have a data management framework that ensures complete, accurate and timely member data. In April 2012, APRA released two prudential practice guides in the area of contribution and benefit accrual standards, and payment standards, that encourage trustees to develop a data reliability framework. In July 2012, APRA wrote to trustees about data integrity issues, noting that funds still have a good way to go before the industry can be considered as handling this issue well. In this context, the introduction of SuperStream, which aims to streamline superannuation transactions, will mandate data and e-commerce standards and allow members to more easily consolidate multiple superannuation accounts.

Liquidity

The superannuation industry continues to benefit from strong net inflows and ongoing momentum in the domestic economy and further increases to the Superannuation Guarantee should see this trend continue. Nonetheless, trustees need to guard against complacency in their overall liquidity management. APRA supervisors regularly liaise with trustees on how they assess liquidity needs in relation to their fund's demographics and liability obligations, the strategies being undertaken to meet these obligations and the impact of investments that became illiquid. APRA has noted an improvement in how trustees conduct liquidity management, including greater use of stress testing.

There has been little tangible improvement in the area of frozen funds, which are predominantly property and mortgage schemes. A number of the underlying schemes are in the process of restructuring or terminating and trustees are working with scheme managers to obtain redemptions or return of capital. APRA continues to assess and, where appropriate, grant applications from portability requirements under the *Superannuation Industry Supervision Regulations 1994.*

Enforcement activities

APRA's supervisory approach is based on the fundamental premise that the primary responsibility for financial soundness and prudent risk management within an APRA-regulated institution rests with its board of directors and senior management. APRA seeks to work constructively and openly with these parties to address any prudential issues and ensure that institutions can meet their financial promises to beneficiaries (depositors, policyholders and superannuation fund members). However, where that cooperative approach does not resolve any outstanding prudential issues, APRA has available to it a range of graduated remedial actions to protect beneficiaries, culminating if necessary in enforcement action.

Enforcement actions include instigating formal investigations into the affairs of a regulated 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, where necessary, initiate criminal actions, seek restraining orders or seek to disqualify individuals from holding senior roles within regulated institutions. APRA can also take action to prevent unlicensed entities from conducting business that can only be conducted by an APRA-regulated institution.

During 2011/12, APRA undertook 431 enforcement and related actions. This was an increase on the 377 actions reported the previous year, reflecting the processing of claims under the Financial Claims Scheme in the general insurance industry (see page 32) and a step-up in the intensity of APRA's major investigations.

APRA continued its investigation in relation to Trio Capital Limited, which was the trustee of four superannuation funds and two pooled superannuation trusts prior to its failure in December 2009. APRA's investigation has resulted in six former Trio directors giving enforceable undertakings to remain out of the superannuation industry for periods ranging from four to 15 years. These undertakings related to the failure of the directors to meet the high standards expected of them as trustee directors and not acting in the best interests of members, including in relation to investments in offshore hedge funds. APRA's investigation in relation to Trio is now focussing on former Trio directors who had been involved in Trio's operations before its collapse in late 2009.

In May 2012, the Parliamentary Joint Committee on Corporations and Financial Services reported on the collapse of Trio. In response to the Committee's recommendations, APRA is undertaking activities in four main areas:

- giving consideration, in conjunction with the Government, to legislative gaps that may need to be addressed;
- reviewing APRA's internal supervision processes in light of issues raised by the Trio collapse;
- enhancing APRA's approach to intelligence gathering and analysis, in cooperation with the Australian Federal Police, the Australian Crime Commission and other agencies; and
- enhancing APRA's information sharing with the Australian Securities and Investments Commission (ASIC) and the Australian Taxation Office.

APRA is cooperating with other agencies undertaking criminal investigations of key figures responsible for defrauding Trio.

In April 2011, the then Assistant Treasurer announced his decision to grant financial assistance of $55 million under Part 23 of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) in respect of the members of the APRA-regulated Trio superannuation funds who were affected by loss due to fraud or theft. In February 2012, the Acting Trustee of Trio paid compensation totalling $52.4 million to these members. In May 2012, the Acting Trustee lodged a further application for financial assistance to provide additional compensation to members and meet further Acting Trustee costs.

During 2011/12, APRA received 35 complaints relating to the failure by employers to remit employees' voluntary post-tax employee superannuation contributions to their superannuation fund. Although it has no specific prudential powers in this area, APRA's investigations resulted in the successful recovery of all outstanding contributions, except where the employer had gone into administration or liquidation.

In the general insurance industry, APRA continued the administration of the Financial Claims Scheme (the Policyholder Compensation Facility), which had been triggered in 2009/10 in relation to a small general insurer, Australian Family Assurance Limited, to which a judicial manager had been appointed. During 2011/12, an amount of around $1.3 million was paid out under the Scheme to eligible policyholders. The scheme was closed to new claimants from October 2011. APRA continues to work through the small number of remaining claims applications with the judicial manager (now liquidator) to finalise the liquidation of the insurer.

APRA has continued working closely with the judicial manager (now liquidator) appointed in June 2010 to another small general insurer, formerly known as Rural and General Insurance Limited. The liquidator has now declared a dividend in the liquidation and determined that there will be no eligible policyholder shortfall in the liquidation.

In the banking industry, APRA considered 76 matters during 2011/12 relating to the use of restricted words 'bank', 'banker', 'banking' or like names under s66 of the *Banking Act 1959*. A substantial proportion of these related to the use of the restricted words by entities outside the financial services industry.

In November 2011, responsibility for the early release of superannuation benefits was transferred to the Department of Human Services. However, APRA continued to finalise three remaining investigations into early release of benefit frauds. The briefs of evidence on these matters have been provided to the Commonwealth Department of Public Prosecution. As a result, two matters have been heard (resulting in two guilty verdicts) and the final matter will shortly go to court.

Enforcement and related actions[1]

	ADIs		Superannuation		General insurance		Life insurance		Friendly societies		Other[2]		Total	
	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012
Directions and contravention notices[3]	9	7	164	157	2						5	25	180	189
Enforceable undertaking				6										6
Follow-up delayed contributions			40	35							2		42	35
Investigation action			73	50									73	50
Other actions[4]	37	32	13	10		5					11	44	61	91
Prosecution				3										3
Refer to other agency/police	1	6	15	12		1					5	4	21	23
Removal, withdrawal or revocation of license				2										2
Show cause letter				2										2
Determinations under Financial Claims Scheme						30								30
Total	**47**	**45**	**305**	**277**	**2**	**36**	**0**	**0**	**0**	**0**	**23**	**73**	**377**	**431**

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 foreign bank representative offices.

Chapter three

The prudential framework

The prudential framework in Australia has made a significant contribution to the relative success of the Australian financial system in negotiating the global financial crisis. Further acknowledgment of that contribution came during 2011/12 from the Financial Stability Board (FSB) in its Peer Review of Australia and by the International Monetary Fund (IMF) in its 2011 Article IV Consultation with Australia. As the IMF noted, 'Banks [in Australia] were resilient to the global crisis, mainly because of sound regulation and supervision. Prudential rules, often tighter than the minimum international standards... together with a proactive approach to supervision, helped maintain a healthy and stable financial sector.'

In response to lessons learned in the crisis, prudential frameworks globally are being substantially reinforced to ensure that financial institutions will be able to withstand future stresses without extraordinary government support. Notwithstanding its relative success, Australia cannot stand aloof from these developments and, indeed, APRA's prudential policy workload in 2011/12 was more intense than at any time since its establishment. Implementation of key aspects of the global reform agenda has been a major driving force but APRA has also had significant initiatives of domestic origin under way in the general and life insurance industries, and in superannuation.

The global reform agenda of the G-20 Leaders has four objectives:

- a strong regulatory framework for banks built on much higher quality and quantity of capital and liquidity buffers;
- more effective oversight and supervision to complement new, stronger rules (see Chapter 4);
- reducing the risks posed by systemically important financial institutions; and
- transparent international assessment and peer review.

APRA's prudential policy activities under the first objective have centred on the Basel Committee on Banking Supervision's broad program of capital and liquidity reforms. Implementation of these reforms has made good progress. A new area of activity for APRA is now opening up under the third objective. The Basel Committee has finalised a framework for dealing with domestic systemically important banks and, once it is endorsed by the G-20 Leaders, APRA will consider how this framework will be implemented in Australia. In line with the fourth objective, APRA is now subject to greater external scrutiny on its adherence to global standards and the rigour of its supervisory approach. The FSB's Peer Review of Australia in 2011 was the first such review of Australia under a commitment by FSB members to undergo periodic peer reviews, and APRA was actively involved. APRA also had a significant involvement in the IMF's Financial Sector Assessment Program review of Australia in 2011/2012.

APRA's domestic policy agenda involves three main initiatives. The first, now largely complete, is the updating and harmonisation of capital requirements for general and life insurers. The second, an important outcome of the Government's Stronger Super reforms, is a substantial enhancement to the prudential regime for superannuation based on APRA's new standards-making powers. The third major initiative is the development of a prudential framework for conglomerate groups.

Response to the global financial crisis

Strengthening banking system capital requirements

The first step in APRA's implementation of the Basel Committee's capital reforms was a package of measures to enhance the Basel II Framework. The measures aim to ensure that the risks inherent in ADIs' portfolios related to trading activities, securitisations and exposures to off-balance sheet vehicles are better reflected in minimum capital requirements, risk management practices and accompanying disclosures to the public.

Amendments to relevant ADI prudential standards and reporting requirements that gave effect to these so called Basel 2.5 enhancements came into force in Australia from 1 January 2012, in line with the internationally agreed timetable. As expected, they have had only limited impact on ADI capital positions.

The second step is the more comprehensive Basel III package, which includes measures to raise the quality and minimum required levels of capital, promote the build-up of capital buffers and establish a back up leverage ratio. There are two new regulatory capital buffers. One is a conservation buffer above the regulatory minimum capital requirement that can be utilised in periods of stress, subject to restrictions on distributions. The other is a countercyclical buffer that will be imposed when excessive credit growth and other indicators point to a build up in systemic risk. Central to the package is a new definition of regulatory capital that gives greater weight to common equity, the highest quality form of capital. The Basel Committee's package was endorsed by the G-20 Leaders in November 2010 and the Basel III rules text was released the following month.

APRA's formal consultation on the Basel III capital reforms began in September 2011 and concluded, for the major measures, with the release of a final set of prudential standards and reporting standards in September 2012. These standards come into effect on 1 January 2013. The remaining Basel III measures on counterparty credit risk will be finalised later in 2012. Consultation has involved separate rounds of discussions on APRA's proposed approach and on the prudential standards in draft form, as well as an industry-wide public conference, hosted by the Financial Services Institute of Australia (Finsia), on the Basel III reforms and their implementation.

APRA's approach to the Basel III capital reforms has three main elements. Firstly, APRA is adopting the Basel III rules text as globally agreed, with minor exceptions in areas where APRA has to date taken a more conservative approach and will continue to do so. Secondly, for *in-principle* reasons, APRA is not utilising the discretion available under the Basel III reforms to provide a concessional treatment for certain items in calculating regulatory capital. In APRA's view, adoption of the concessional treatment would not be consistent with the principle of raising the quality and quantity of regulatory capital. Thirdly, APRA's Basel III timetable commences at the early end of the globally agreed timetable in some areas. This is fully consistent with the Basel Committee's view that, where they can, banking institutions should comply with the Basel III reforms as soon as possible. ADIs must meet the revised Basel III minimum requirements for common equity (after regulatory adjustments) from 1 January 2013, and the capital conservation buffer from 1 January 2016, without any additional phase-in arrangements. Starting from a strongly capitalised position, ADIs are well placed to meet this accelerated timetable.

The Basel Committee has developed a standardised disclosure template that is intended to address concerns raised during the crisis in a number of jurisdictions, including Australia, about the international comparability of 'headline' regulatory capital ratios. APRA will be consulting with the ADI industry to ensure that the template provides a simple and straight-forward reconciliation between the Basel III rules text and APRA's more conservative approach.

Strengthening banking system liquidity requirements

In parallel with its Basel III capital reforms, the Basel Committee in December 2010 released its rules text for a new global liquidity framework, intended to promote stronger liquidity buffers that will make banking systems more resilient to liquidity stresses. The centrepiece of the Basel III liquidity reforms are two new quantitative global standards – the Liquidity Coverage Ratio, aimed at strengthening the short-term resilience of banks, and the Net Stable Funding Ratio, aimed at promoting longer-term resilience by requiring banking institutions to fund their activities with more stable sources of funding. The Liquidity Coverage Ratio will come into effect on 1 January 2015 and the Net Stable Funding Ratio on 1 January 2018. The Basel III liquidity reforms also involve a strengthening of governance and risk management of liquidity risks – the so-called qualitative requirements – consistent with the Basel Committee's revised *Principles for Sound Liquidity Risk Management and Supervision.*

In November 2011, APRA released a discussion paper and draft prudential standard setting out its proposals for implementation of the Basel III liquidity reforms, continuing a consultation process on liquidity risk management that had begun in September 2009. APRA is proposing that all ADIs in Australia meet the enhanced qualitative requirements, in a way that is commensurate with the nature, scale and complexity of the institution. However, only the larger, more complex ADIs will need to meet the two new quantitative requirements. In this area, APRA is proposing to introduce the Basel III rules text with only minor modifications, related either to the exercise of supervisory discretions or where clarifications are required for Australian circumstances. APRA is also proposing to follow the globally agreed implementation timetable.

The Basel Committee is using the lead-in periods before implementation as observation periods, monitoring the implications of the two standards for financial markets, credit extension and economic growth, and it will address unintended consequences as necessary. Monitoring is covering some general issues, such as the impact of the standards on smaller institutions versus larger and on retail versus wholesale business activities, as well as some specific technical issues. APRA will finalise its prudential standard once the detailed elements of the Basel III liquidity reforms are in place.

Under the Liquidity Coverage Ratio, liquidity stresses are intended to be addressed as much by expanding stable funding sources and extending the maturity of liabilities as by building up high-quality liquid asset portfolios. This point is especially relevant for Australia, which does not have sufficient high-quality liquid assets (particularly sovereign debt) for inclusion in liquidity buffers. Australia will adopt an alternative treatment available to it in the Basel III rules. Under this treatment, which was announced by the Reserve Bank of Australia (RBA) and APRA in December 2010, any shortfall between an ADI's holdings of high-quality liquid assets and its Liquidity Coverage Ratio requirement will be able to be met through a Committed Liquidity Facility with the RBA, for a fee payable to the RBA. The availability of such a Facility must, however, be balanced against the overriding objective of the new global liquidity framework of improving the self-reliance of banking institutions in liquidity management and reducing their recourse to their central bank at early signs of stress. For that reason, APRA has stepped up its dialogue with the larger ADIs on the balance sheet adjustments and other measures needed to show they have taken 'all reasonable steps' to improve their self-reliance, before recourse to the Facility to meet the Liquidity Coverage Ratio requirement. ADIs have made a good start in this direction through lengthening the maturity of new wholesale funding and actively seeking more stable funding sources through domestic deposits.

Systemically important banks

The new element in global banking reform is a framework for dealing with domestically systemically important banks (D-SIBs). This framework, developed by the Basel Committee and the Financial Stability Board, responds to the strongly held view of the G-20 Leaders that no financial firm should be 'too big to fail' and that taxpayers should not bear the cost of resolution. The framework builds on, but differs in important respects from, the regime for global systemically important banks (G-SIBs) endorsed by the G-20 Leaders in November 2011.

The G-SIB regime focusses on large, internationally active banks with significant cross-border activities and it addresses the 'too big to fail' issue through higher capital requirements, strengthened supervisory oversight and robust recovery and resolution plans for G-SIBs. No Australian bank is on the current list of G-SIBs. The D-SIB framework recognises that there are many banks that are not significant at the global level but could, if they were to come under stress, have an important impact on their domestic financial system and economy compared to non systemic institutions.

In June 2012, the Basel Committee released a consultative document on its proposed framework for dealing with D-SIBs. The framework requires that D-SIBs have a greater ability to absorb losses as a going concern, but it differs from the prescriptive approach in the G-SIB regime in that it does not specify capital 'buckets' into which a country would fit different D-SIBs. Under the principles-based approach, APRA would be required to establish a methodology for assessing the degree to which banks are systemically important in Australia, publicly disclose information that provides an outline of the methodology employed and ensure that any D-SIB has higher loss absorbency, commensurate with its systemic importance and fully met by common equity.

A final version of the D-SIB framework is now awaiting endorsement by the G-20 Leaders. The framework will come into effect from 1 January 2016.

APRA's crisis management powers

APRA has a relatively robust set of legal powers to enable it to respond effectively to situations of financial distress. These powers were strengthened during the course of the crisis through legislative reforms in 2008, 2009 and 2010. The changes covered various aspects of APRA's preventative directions and failure management powers, including those relating to the appointment of a statutory manager (to an ADI) or a judicial manager (to a general or life insurer), as well as powers relating to its role in administering the two Financial Claims Schemes (for ADIs and general insurers). During 2011/12, as part of an ongoing review of the efficiency and operation of financial sector legislation, APRA worked closely with Treasury to develop proposals to further strengthen APRA's ability to respond effectively to financial distress. The proposals address some remaining gaps and deficiencies in APRA's crisis resolution powers and seek to align these powers more closely with international principles and practice.

The review culminated in the release in September 2012 of a Treasury Consultation Paper, *Strengthening APRA's Crisis Management Powers,* which seeks comments on a range of options to enhance APRA's supervision and resolution powers. The options canvassed in the paper aim to:

- strengthen APRA's crisis management powers in relation to all APRA-regulated industries, including extending APRA's power to appoint a statutory manager to an ADI's authorised non-operating holding company (NOHC) and subsidiaries in a range of distress situations and providing APRA with the option to appoint a statutory manager to a general insurer or life insurer (and to its authorised NOHC and subsidiaries) as an alternative to a judicial manager appointed by the Court;
- provide APRA with direction powers to require superannuation entities to take pre-emptive action to address prudential concerns;

- simplify and harmonise APRA's regulatory powers across the various industry Acts it administers; and
- make a number of technical amendments to enhance the effectiveness of these Acts.

Harmonised prudential standards

General and life insurance capital standards

APRA's reforms to capital standards for the general insurance and life insurance industries are now almost complete, and new prudential standards will come into effect from 1 January 2013. This project, which commenced in 2010 and has involved four rounds of industry consultation on the policy proposals, aims to make the capital standards more risk-sensitive, improve their alignment across regulated industries where appropriate and take account of relevant international developments.

For general insurance, the reforms will ensure that all known material risks, including asset/liability mismatch, asset concentration, insurance concentration and operational risks, are adequately addressed within the capital standards.

For life insurance, the changes are more fundamental. The current dual reporting requirements for solvency and capital adequacy will be simplified and, by introducing the concept of a 'capital base' for life insurers, the capital structure for life insurers will be aligned with that for general insurers and ADIs. This improved alignment of capital requirements across the three industries will also facilitate adoption of APRA's proposed framework for the supervision of conglomerate groups.

Following two earlier rounds of consultation and two quantitative impact studies (QIS), APRA commenced a third round of consultation in December 2011, with the release of a second response to submissions paper and 14 draft prudential standards. This package detailed more specific proposals on APRA's approach to harmonising the definition of capital for insurers with the Basel III definition of capital. The package also provided information on the results of the second QIS and outlined APRA's proposed case-by-case approach for any transition arrangements. A fourth round of consultation with industry commenced in May 2012, with the release of a third response to submissions paper and final versions of most of the capital standards issued in December 2011. Draft prudential standards on the composition of the capital base were also released.

APRA released draft guidance material for consultation in late September 2012 and expects to release the remaining capital standards in final form in October 2012. APRA has also consulted on changes to reporting standards required to implement the reforms, releasing a consultation package in June 2012.

An important component of the guidance material related to the Internal Capital Adequacy Assessment Process (ICAAP). APRA expects that the ICAAP, which includes the management of deviations from the capital target set by the board above minimum prudential requirements, will be developed by an insurer's senior management with input as appropriate from relevant areas and experts. However, the ICAAP is fundamentally the responsibility of the Board: the Board needs to be actively engaged in the development of the ICAAP and its implementation, and must ultimately approve the ICAAP. While many insurers will already be doing much of what would be required in a well-developed ICAAP under their current capital management processes, others will need to make more fundamental changes.

Based on the QIS results, APRA's reforms are likely to increase overall capital requirements across both industries but that increase is expected to be moderated as insurers optimise their business and capital management strategies in response to the revised capital standards. The impact of the reforms is also likely to vary widely between insurers, with some insurers expected to experience reductions in required capital whilst others are expected to face an increase, perhaps material in certain cases. In APRA's assessment, this range of outcomes is consistent with the aim of enhancing the risk-sensitivity of the capital standards; it is also manageable by industry with appropriate case-by-case transition arrangements agreed with APRA.

Supervision of conglomerate groups

During 2011/12, APRA continued to develop its proposed prudential framework for conglomerate ('Level 3') groups. These are groups (containing APRA-regulated institutions) that have material operations in more than one APRA-regulated industry and/or have one or more material entities operating in non-APRA regulated businesses. The objective of this substantial initiative is to better protect the interests of beneficiaries (depositors, policyholders and superannuation fund members) by limiting the risks to APRA-regulated institutions – from contagion, reputation and operational risks in particular – that may arise from that institution's membership of a conglomerate group. The initiative also aims to ensure that both APRA and the group itself have a broader understanding of the financial and operational soundness of the group, irrespective of its structure and variety of operations.

APRA's proposals for the supervision of conglomerate groups were outlined in a discussion paper released in March 2010. The proposals seek to ensure that a conglomerate group holds adequate capital to protect the APRA-regulated institutions from potential contagion and other risks within the group and that the parent entity meets a range of principles-based governance and risk management standards. The proposals, which build on APRA's existing requirements for stand alone institutions (Level 1) and single-industry groups (Level 2), would introduce a complementary layer of prudential requirements that harmonise existing standards and industry-specific supervision frameworks at the group level.

APRA conducted a QIS with potential Level 3 groups during 2010/11 to assess the impact of its capital adequacy proposals. During 2011/12, APRA refined its proposals to take into account the Basel III, general and life insurance, and Stronger Super reforms and engaged closely with potential Level 3 groups on a further analysis of impact. In May 2012, APRA advised industry that the implementation date for this initiative would be deferred to 1 January 2014 so that it would be appropriately sequenced with related reforms to capital standards in the other APRA-regulated industries. APRA is aiming to release a comprehensive consultation package, including draft conglomerate prudential standards, by the end of 2012.

Superannuation

Implementing Stronger Super reforms

In December 2010, the Government announced its Stronger Super reforms to strengthen the governance, integrity and regulatory settings of the superannuation system in Australia. The reforms were a response to the recommendations of the *Review into the governance, efficiency, structure and operations of Australia's superannuation system* (Cooper Review) delivered to the Government in June 2010. The Government announced its decisions on key design aspects of the Stronger Super reforms in September 2011.

The Stronger Super reforms envisage a strengthening of trustee duties, the establishment of a new superannuation product ('MySuper') and the streamlining of superannuation transactions ('SuperStream'). MySuper is intended to be a simple, cost-effective superannuation product that will take the place of existing default products; it will have a basic set of product features designed to aid comparability between products and reduce costs. SuperStream is intended to make the processing of superannuation transactions easier, cheaper and faster, provide better information to trustees, employers and fund members, and facilitate consolidation of unnecessary additional superannuation accounts.

Once the Stronger Super reforms were announced, APRA commenced a multi-year project that will result in significant changes to the prudential and reporting framework for superannuation. During 2011/12, APRA spent considerable time consulting with industry on various elements of the reforms and received feedback from a broad range of stakeholders.

Prudential standards

With the enactment of the *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012* in September 2012, APRA has been granted power to make prudential standards in superannuation. This brings superannuation into line with the ADI and insurance industries, where prudential standards are the centrepiece of APRA's prudential framework. APRA's new standards-making power will strengthen the prudential regulation of superannuation trustees and the protection of fund member interests.

APRA's formal consultations on prudential standards began in September 2011 with the release of a discussion paper outlining proposals for prudential standards covering topics common to other APRA-regulated industries as well as topics specific to superannuation. Submissions from a wide range of stakeholders were supportive of APRA's objectives and the broad direction of the proposed prudential standards, including the range of topics.

In April 2012, APRA released its response to submissions on the discussion paper and 11 draft prudential standards. The standards common to other APRA-regulated industries covered governance, fit and proper, outsourcing, business continuity management, risk management, and audit and related matters. The superannuation specific standards covered investment governance, conflicts of interest, defined benefit funding and solvency, operational risk financial requirements, and insurance in superannuation. Again, submissions from a wide range of stakeholders were received; the majority of submissions expressed support for APRA's proposals and sought only minor changes to the provisions in the standards or requested clarity about APRA's intentions and expectations in some areas. A number of the submissions also suggested topics on which it would be desirable for APRA to issue guidance.

APRA expects to finalise the prudential standards in late 2012 with most provisions to come into effect on 1 July 2013. APRA also plans to commence consultations in late 2012 on draft guidance material to support the standards.

Reporting requirements

In response to the growing size and complexity of the industry, and to support implementation of the Stronger Super reforms, APRA plans a substantially enhanced superannuation data collection. APRA previously consulted on proposals for a revised data collection for superannuation in 2009 but put this project on hold pending the Cooper Review and the Government's Stronger Super reforms.

APRA resumed consultations on the revised superannuation data collection with the release of a comprehensive consultation package, including draft reporting forms, in September 2012. It expects to finalise its reporting requirements in early 2013. The proposed requirements implement the transparency and accountability elements of the Stronger Super reforms and also support the implementation of prudential standards, MySuper products and SuperStream. Overall, APRA expects that this new data collection will be of significant benefit to all industry stakeholders by providing greater transparency of investments and costs in superannuation and by enhancing APRA's ability to supervise trustees and funds.

MySuper and eligible rollover funds

Under proposed legislation, APRA is required to authorise Registrable Superannuation Entity (RSE) licensees to offer MySuper products. During 2011/12, APRA consulted on the proposed framework for MySuper authorisation and held a number of seminars, workshops and meetings with RSE licensees and other relevant stakeholders to facilitate the authorisation process. Subject to the passing of legislation, APRA expects to finalise the authorisation requirements in late 2012, with the application process to commence from 1 January 2013.

Similarly, under proposed legislation, an RSE licensee intending to operate an eligible rollover fund from 1 January 2014 must seek authorisation from APRA. In June 2012, APRA consulted on its proposed authorisation framework, which is aligned with the MySuper authorisation process; release of the final framework is expected in late 2012. Subject to the passing of legislation, applications for authorisation of eligible rollover funds can be submitted to APRA from 1 January 2013.

Review of superannuation guidance material

APRA is replacing the former Superannuation Circulars and guidance notes with prudential practice guides, as used in the other industries, to provide guidance material for trustees. Draft prudential practice guides are expected to be released for consultation in two stages, in late 2012 and early 2013. The first stage will focus on the key prudential practice guides that will support the implementation of the new prudential standards and Stronger Super reforms; the second stage will focus on the remaining areas of guidance related to these reforms.

In August 2011, APRA released for consultation two draft prudential practice guides on contribution and benefit accrual standards, and payment standards. This guidance material is separate from APRA's implementation of the Stronger Super reforms and updates the guidance that had been in place prior to commencement of trustee licensing in 2004. The two prudential practice guides were released in final form in April 2012 and took effect immediately upon release.

Authorised deposit-taking institutions

Financial Claims Scheme implementation

APRA has responsibility for administering the Financial Claims Schemes for the ADI and general insurance industries. The Scheme for the ADI industry (also known as the Early Access Facility for Depositors) provides depositors with timely access to, and certainty of repayment of, their deposit funds up to a defined limit. The limit was set at $250,000 per depositor per ADI from 1 February 2012, following a review by the Government. The new limit reflected advice from the Council of Financial Regulators that the limit should be set at a lower level (it was previously $1 million) to reflect the strength of the Australian banking system and its very sound positioning to meet the new Basel III global standards. There were no discernible changes in ADI depositor behaviour as a result of the reduction in the limit.

In its capacity as administrator, APRA has undertaken a number of measures to ensure that the Scheme can be operated effectively in the event of an ADI failure. Following consultation with the ADI industry and other parties, in December 2011 APRA released *Prudential Standard APS 910 Financial Claims Scheme,* which requires locally incorporated ADIs to generate deposit data and other information on a 'single customer view' basis. This is a fundamental requirement for the effective operation of the Scheme since it enables deposit balances to be aggregated across different protected accounts in the name of a single depositor. It is a prerequisite for accurate and prompt payouts.

ADIs will be required to comply with the prudential standard from 1 January 2014 unless, on a case-by-case basis, APRA grants particular ADIs an additional transition period (which cannot extend beyond 31 December 2015).

During 2011/12, APRA also discussed with the ADI industry and other parties some proposed additions to Scheme requirements. These relate mainly to the need for ADIs to be pre-positioned to facilitate prompt payment to, and effective communication with, depositors in the event that the Scheme is invoked. APRA also wishes to be able to regularly test ADIs' ability to comply with all aspects of the prudential standard. An amended prudential standard incorporating these proposals will be released for consultation later in 2012.

Covered bonds

In December 2010, in the context of its *Competitive and Sustainable Banking System package,* the Government announced that the *Banking Act 1959* would be amended to allow ADIs to issue covered bonds. This amendment took effect in October 2011. Reflecting the change, APRA removed a prohibition on ADIs issuing covered bonds from *Prudential Standard APS 120 Securitisation.*

In November 2011, APRA released a discussion paper and draft prudential standard on covered bonds. The objective of this prudential standard is to ensure that ADIs issuing covered bonds appropriately manage the associated risks, including those to which they may become exposed via the covered bond special purpose vehicle (SPV). APRA proposed to require ADIs to identify the assets transferred to a covered bond SPV and whether those assets form part of the cover pool held as collateral against covered bonds, or are held by the covered bond SPV for other purposes. Although submissions argued otherwise, APRA believes it is essential from a prudential perspective that assets not in the cover pool be able to be claimed quickly by the ADI in the event of default, and this claim cannot be made if the assets are not individually identified. Submissions also raised a number of technical issues that were considered in finalising the standard.

The final *Prudential Standard APS 121 Covered Bonds* was released in July 2012 and commenced on 1 August 2012.

General insurance

General insurance Level 2 refinements

APRA proposed a number of refinements to the prudential and reporting framework for general insurance groups (Level 2 groups) in a discussion paper released in May 2011. The proposals made minor amendments to the Level 2 group prudential standards and aligned aspects of the reporting framework between Level 2 groups and individual APRA-regulated general insurers (Level 1 insurers).

The final prudential standards and reporting standards were released in October 2011. The first reporting under the revised framework was for the six-month period ending 31 December 2011.

International peer review

During 2011, APRA contributed to a country peer review of Australia under the FSB *Framework for Strengthening Adherence to International Standards*, which focusses on the implementation of financial sector standards and policies agreed within the FSB. In APRA's case, the peer review concentrated on the initiatives APRA had undertaken in response to the recommendations of the IMF's first Financial Sector Assessment Program (FSAP) review of Australia in 2005/06.

The report of the Peer Review of Australia, published in September 2011, concluded that the FSAP recommendations on ADI supervision had been largely addressed. The report noted that APRA has continued to promote effective risk management practices and strong capital reserves and to closely monitor the adequacy of ADIs' liquidity, and has improved its stress-testing capabilities. The report also noted that the regulatory and supervisory framework for general insurance has been considerably strengthened in recent years and that the introduction of insurance group supervision has enhanced APRA's ability to supervise the foreign subsidiaries of insurers domiciled in Australia.

In addition, the report noted that 'significant and commendable' progress has been made on failure resolution and crisis management, including the development of a crisis management framework, the establishment of the two Financial Claims Schemes and the strengthening of APRA's crisis resolution powers.

During 2011/12, APRA was actively involved in the IMF's second FSAP review of Australia, which focussed on the strength and stability of the Australian financial system and the quality of its regulatory architecture and financial supervision. As part of this review, APRA's supervision of the banking and the general and life insurance industries was evaluated against the Basel Committee's *Core Principles for Effective Banking Supervision* (for banks) and the International Association of Insurance Supervisors' (IAIS) new *Insurance Core Principles*, respectively. The IMF also conducted a macroeconomic stress test of the capacity of the Australian financial system to deal with certain shocks and reviewed Australia's crisis management arrangements, including the operation of the two Financial Claims Schemes. A background paper on Australia's financial stability arrangements, prepared for the FSAP by the Reserve Bank of Australia and APRA, was published in September 2012.

The IMF has yet to present its FSAP report on Australia to its governing body. Preliminary findings are that Australia has a sound and resilient financial system, supported by strong economic fundamentals and policies, intensive supervision and effective systemic oversight, and that there is a high degree of compliance with international standards. However, the IMF also noted that there were structural risks associated with the continued (though declining) use of offshore wholesale funding by the larger ADIs, the high level of household debt and house prices, and the concentration and interconnectedness of the Australian banking system. The IMF also echoed a concern voiced by APRA on a number of occasions that pressure on ADIs to preserve profitability in a slow credit growth environment may encourage greater risk-taking.

APRA-regulated institutions

	Number			Assets ($ billion)[1]		
	30 Jun 11	30 Jun 12	% change	30 Jun 11	30 Jun 12	% change
ADIs[2]	177	174	-1.7	2,813.4	3,039.9	8.1
Banks	56	66	17.9	2,722.9	2,963.2	8.8
Building societies	10	9	-10.0	26.4	22.1	-16.3
Credit unions	103	92	-10.7	55.8	46.9	-15.9
Other ADIs, including SCCIs	8	7	-12.5	8.3	7.7	-7.2
Representative offices of foreign banks	18	17	-5.6			
General insurers	127	124	-2.4	115.0	118.2	2.8
Life insurers	31	28	-9.7	235.0	237.5	1.1
Friendly societies	14	13	-7.1	6.2	6.1	-1.6
Licensed trustees	225	209	-7.1			
Superannuation entities[3]	4,054	3,675	-9.3	810.6	832.5	2.7
Public offer funds	183	173	-5.5	619.2	644.0	4.0
Non-public offer funds	164	141	-14.0	183.9	180.8	-1.7
Small APRA funds	3,519	3,201	-9.0	2.0	2.0	0.0
Approved deposit funds	95	77	-18.9	0.2	0.1	-50.0
Eligible rollover funds	16	16	0.0	5.3	5.6	5.7
Pooled superannuation trusts[4]	77	67	-13.0	86.8	96.7	11.4
Non-operating holding companies	25	25	0.0			
Total	**4,671**	**4,265**	**-8.7**	**3,980.2**	**4,234.2**	**6.4**

Notes:

1 Asset figures for end-June 2012 are based on most recent returns. Asset figures for end-June 2011 have been revised slightly from APRA's *2011 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 Superannuation entities comprise registered and unregistered entities. From 1 July 2006, all trustees operating APRA-regulated superannuation entities were required to hold an RSE licence and register their superannuation entities with APRA. A small number of unregistered entities are still in the process of winding-up or transferring trusteeship to an RSE licensee. The total for superannuation entities 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 2012, there were 11 such funds.

4 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 clarion call from the G-20 for an increase in the intensity and effectiveness of supervision of financial institutions – the second objective of its global reform agenda – has become loud and clear. A salient lesson from the crisis was that supervisory agencies that were focussed on process rather than on outcomes, on compliance with regulations rather than on forward-looking assessments of risk, fell short of the mark. Global policymakers are now holding supervisors to higher standards. This is evident, in particular, in the revised 'Core Principles' for effective banking and insurance supervision, where the bar against which supervisors are now being assessed under the IMF's Financial Sector Assessment Program (see page 45) has been raised.

In endorsing more effective supervision as a key pillar in global reform initiatives, the G-20 Leaders agreed that 'supervisors should have strong and unambiguous mandates, sufficient independence to act, appropriate resources, and a full suite of tools and powers to proactively identify and address risks, including regular stress testing and early intervention'. APRA is well rated internationally against these requirements.

Effective supervision of a financial institution is a dynamic and multi-layered process, in which three key elements interact. One element is a robust process for bringing together the institutional knowledge, prudential data, market intelligence and financial analysis needed to assess the risk profile of the institution and its risk management capabilities. The second is relevant, timely and accurate prudential data on the institution and its industry, reinforced where it can be by rigorous research. The third and critical element is supervisory talent with the skills and experience to make astute risk assessments, and the confidence to challenge the institution and to intervene when necessary. The interaction of these elements delivers the core 'outcome' of supervision – accurate judgment about the financial soundness of the institution and its ability to withstand stress.

These three elements form the foundation of APRA's risk-based approach to supervision, and they receive considerable attention to ensure that APRA's risk-radar remains sharp, its approach is not mechanical but responsive to changing economic and market circumstances, and its supervision is delivered in a cost-effective way.

APRA's supervisory approach

APRA's supervisory process employs a range of risk analysis techniques designed to probe for points of potential weakness in a regulated institution's operations and risk management defences. Based on this analysis, APRA takes targeted remedial actions where necessary to avert adverse outcomes. APRA's risk-based approach seeks to direct its supervisory resources and attention to those aspects of an institution's operations that pose the greatest risk to its ability to meet its financial promises to its beneficiaries or that could present a threat to the stability of the financial system as a whole. In the absence of a rigorous framework to give it structure, risk-based supervision is merely a slogan. Over the last several years – both before and over the course of the crisis – APRA has invested heavily in improving the structure of its supervisory approach to ensure that its supervisory interventions continue to be well-targeted and effective.

Firstly, following an international review of best practice in prudential supervision, the *APRA Supervision Blueprint* was developed, setting out the governing principles and a strategic direction for the development of supervision practices in APRA. This was published in January 2010.

Secondly, APRA established a dedicated unit, the Supervision Framework Team, to develop and maintain the supervision framework. The Team champions a risk-based approach throughout APRA and reinforces a culture aimed at identifying, refreshing and evolving good supervisory practices.

Thirdly, a revised supervision methodology was rolled-out over 2011/12 that better integrated the various pieces of supervisory analysis undertaken by APRA supervisors and facilitated a more cohesive approach to risk-based planning and response to risk issues. The revised methodology is designed to:

- better align APRA's risk identification, risk assessment and supervisory response processes to improve the currency of its risk-ratings of regulated institutions and encourage supervisors to update risk-ratings and supervisory action plans dynamically;
- strengthen planning and assessment processes around the conduct of detailed on-site reviews, with a focus on the desired outcomes of the review and improved collaboration between supervisors in achieving those outcomes, particularly when delving into more complex areas of operation with the assistance of APRA's specialist risk teams;
- reduce 'administrative noise' and streamline review and approval processes to improve efficiencies and ensure that the level of review and oversight of key supervisory outputs is commensurate with the risk profile of a regulated institution; and
- integrate the assessment of prudential data received by APRA with industry risk data and other institution-specific information to promote the early identification of risks and issues.

These changes were supported by the release of a significantly modernised suite of analytical tools used by supervisors of the general insurance, superannuation and ADI industries. These tools will be extended to the life insurance industry in 2012/13.

The fourth limb of this renewal program is the rebuilding of APRA's systems infrastructure to provide a more robust and efficient IT platform on which to run APRA's supervision processes. This will be a substantial exercise requiring a shift from APRA's current suite of internally built supervisory systems to a new suite of integrated software that will be in line with APRA's overarching IT strategy.

Considerable work went into preparing the ground for these systems changes during 2011/12. The systems architecture was established, a set of detailed business requirements and systems specifications prepared, a delivery schedule and release plan written and a suitably qualified systems integrator selected to assist with the design, build and implementation of the new solution.

The first wave of new systems capabilities to be rolled out in 2012/13 will deliver:

- the integration of APRA's risk assessment and response tools – PAIRS (Probability and Impact Rating System), SOARS (Supervisory Oversight and Response System) and SAPs (Supervisory Action Plans) – into a single system to facilitate greater visibility of risks, issues and supervisory activities, better manage issues to resolution and improve access to supervisory information to assist with the risk-based allocation of supervisory resources;
- improved technology support for APRA's precedents repository to allow better search capabilities and access to prior regulatory decisions made by APRA from a single 'source of truth'; and
- the foundation for a new electronic document and records management system that will support both supervision and other business processes across APRA.

The remainder of the delivery schedule will take place in stages over the next few years so as to reduce implementation risks and better manage the required business transformation. Ultimately, the renewal program will produce significant efficiency gains and sharper supervision processes, with less time spent on maintaining cumbersome legacy systems and more flexible technology support for evolving supervisory practices.

APRA's staffing

APRA has been able to build a strong workforce with the specialised knowledge, capabilities and experience needed to support its risk-based approach to supervision and its substantial prudential policy agenda. Special funding provided by the Government, which ended in 2011/12, enabled APRA to augment its staff resources to cope with demands arising from the crisis. A new four-year funding arrangement from 2012/13 is intended to ensure APRA's continued capacity to supervise the Australian financial system.

At end-June 2012, APRA's total permanent staffing was 591, while the addition of fixed-term and casual employees brought staffing levels to around 606 on a full-time equivalent basis. These numbers are very similar to the previous year. Subdued conditions in the finance industry over 2011/12 tilted the usually tough recruiting environment a little in APRA's favour; turnover fell to its lowest rate in APRA's history and APRA again brought on board a number of high calibre staff. As a consequence, the average supervisory experience of staff in APRA's operational divisions has increased to over eight and a half years, in addition to an average of around six years of relevant industry experience. Each new hire into APRA's supervisory and policy areas since the crisis began, excluding graduates, has brought an average of 11 years of industry experience into APRA.

Age distribution profile - years

	<30 (%)	30-39 (%)	40-49 (%)	50-60 (%)	>60 (%)	Median age
June 2002	32.1	35.1	22.6	9.9	0.2	34
June 2012	19.5	31.7	27.5	18.4	2.9	39

Over the past decade, a major transformation has taken place in APRA's age profile, reflecting both the maturing of the organisation and a conscious policy of hiring more experienced staff. At the same time, APRA remains strongly committed to a graduate intake (which has provided around 13 per cent of APRA's current staff). APRA's median age has increased from 34 to 39 years, which is now in line with the general workforce. Just under 50 per cent of staff are age 40 years and over, whereas in 2002 only one-third of staff were in that age profile.

APRA has maintained a heavy investment 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, with an average annual training expenditure per employee of over $3,500. The greater bulk of APRA's recent investment in training has been targeted at enhancing the analytical skills of frontline supervisors. In conjunction with external facilitators, APRA has built a series of detailed financial analysis training programs covering each of the industries under APRA supervision. As well as teaching the techniques of sound financial analysis, these programs emphasise a forensic approach to the analysis of data and seek to equip supervisors with the capacity to challenge the data for signs of potential vulnerability. A key focus is to ensure that supervisors make the most of the tools at their disposal to identify risks, analyse their significance and ensure that appropriate remedial action is taken where needed. In this context, financial data are reviewed at an institution, peer group and industry level. Further courses are being developed to take skills to a more advanced level.

Other initiatives to improve staff development and retention include career progression, rotations and internal staff transfers, overseas and domestic secondments to regulatory agencies and enhanced recognition and rewarding of performance. Over recent years, APRA has increased its emphasis on developing leaders and managers able to guide change, and support and engage staff. APRA is also well aware of the importance of workplace flexibility as a key to attracting and retaining valued staff, and remains a recognised leader in this area.

APRA's training activities in 2011/12

Training by type (%)	
Internal technical training	60
External training	23
Management training	17
Studies support	
Employees undertaking formal post-graduate studies	103
Key training metrics	
Training spend per employee	$3,547
Training spend as a per cent of base salary (%)	2.8
Per cent of staff provided with training (%)	100
Training sessions per employee	10.4
Training days per employee	4.6
Number of internal classroom courses offered	535

APRA's statistical capabilities

APRA collects a broad range of financial and risk data that are essential input to its supervision of regulated institutions. The data are used by supervisors to assess compliance with prudential standards and, more importantly, to gain a comprehensive understanding of the business and risks of individual institutions. The data also assist APRA's industry-wide analysis and research into emerging risks.

In addition, APRA collects data from regulated and unregulated financial institutions to assist the Reserve Bank of Australia (RBA), the Australian Bureau of Statistics (ABS) and the Australian Securities and Investments Commission (ASIC) to fulfil their roles. Much of the data are shared between agencies to reduce unnecessary reporting burden on institutions.

Since its establishment, APRA has accumulated over a decade's worth of data into a central repository of statistical information on the Australian financial sector. APRA recognises the public value of these statistics and seeks to publish as many of the statistics as are useful, subject to APRA's confidentiality obligations. The statistics inform policymakers, other regulators, market analysts, researchers and senior management of financial institutions.

APRA's current priorities in relation to statistics are to improve the quality of data collected, reduce unnecessary burden on reporting institutions and encourage greater use of the collected data. Improvements have been guided by feedback received in the 2011 APRA Stakeholder Survey.

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 were submitted on time or within one week during 2011/12. With the aim of reducing reporting burdens, while maintaining the collection of high-quality and timely data, APRA introduced a significant number of new data validation rules within APRA's electronic data collection system, Direct to APRA (D2A). These new rules help institutions identify and fix data errors, and explain anomalies, at the time they submit data to APRA; they also ensure that submitted data are immediately fit for use by APRA supervisors, the RBA and ABS. APRA also removed or relaxed a number of other validation rules that were no longer effective at identifying errors.

The considerable reduction in institutions needing to resubmit incorrect data has enabled APRA to step-up its assistance to banks providing the macroeconomic data used by the RBA and ABS in Australia's monetary statistics and financial accounts. The three agencies, led by APRA, participated in workshops hosted by the Australian Bankers' Association to improve banks' understanding of the purpose and use of the macroeconomic data collected and identify areas for improvement in the data collection. APRA shared some of the outcomes of the workshops in an APRA *Insight* article in April 2012. APRA also continued to work with a small number of institutions to ensure that the data they reported were appropriate.

During the year, APRA updated its data collections in line with changes to prudential standards. A revised general insurance data collection incorporating a number of refinements to the prudential and reporting framework for Level 2 insurance groups commenced from 1 July 2011. A revised ADI reporting data collection, giving effect to the Basel 2.5 enhancements to the market risk framework, became effective from 1 January 2012. APRA incorporated the revised reporting requirements into the Government's Standard Business Reporting (SBR) taxonomy, which ensured that the data collections were harmonised with other participating Government agencies and institutions can submit data in the eXtensible Business Reporting Language (XBRL) format. Incorporating data collections into SBR minimises the additional reporting requirements for institutions and allows them to automate their reporting to APRA. APRA also reviewed its data collections for general and life insurers to incorporate the revised capital framework from 1 January 2013. In addition, APRA considered the data it would need to collect and publish to implement the Government's Stronger Super recommendations – in particular, to improve the transparency, comparability and accountability of fees, costs and investment returns, including for MySuper products. A discussion paper on an enhanced superannuation statistics collection was released in September 2012 (see page 43).

During the year, APRA also delivered a number of improvements to its regular statistical publications (now a suite of 15 publications) to encourage the use of data collected and to address common themes in feedback provided by users. APRA brought forward the regular release date of two of the publications, and will continue to work with reporting entities to bring forward the release dates of other publications where possible, given users' desire to receive the data earlier.

APRA released the first edition of the new *Intermediated General Insurance Statistics* publication in March 2012. The publication provides an overview of the business placed by general insurance intermediaries with APRA-regulated general insurers, Lloyd's underwriters and unauthorised foreign insurers (UFIs). The statistics include detailed information about risks placed with UFIs, which are not regulated by APRA. The publication fills a gap in the market for this information and improves the quality of external analysis of intermediated insurance. Policy-makers and regulators are able to monitor insurance business being placed offshore with UFIs, while general insurers, general insurance intermediaries, professional bodies, researchers and the public have access to more information to understand intermediated general insurance.

In March 2012, APRA ceased publication of the *Half Yearly General Insurance Bulletin* and transferred the statistics into other statistical publications. APRA added statistics to the *Quarterly General Insurance Performance Statistics* publication and introduced a new annual publication, *General Insurance Supplementary Statistical Tables*. The statistics transferred to the quarterly publication are now available three months earlier than previously.

APRA also introduced an additional database version of the *Quarterly General Insurance Performance statistics.* APRA continues to publish the PDF and Excel versions of publications, with the additional database version intended to be easily imported into various tools to allow users to conduct more in-depth analysis. APRA had earlier introduced a database version of the *Monthly Banking Statistics.* Each month, this version of the publication incorporates revisions to data submitted by banks after publication. This is a change from APRA's previous practice of consolidating the back issues of the publication once a year and not including revisions. Publishing a time series, as requested by users, will facilitate analysis of the statistics and improve the accuracy and reliability of the data. APRA will continue to work with banks to minimise the need for data revisions.

APRA released the first edition of its revised *Insight* publication in April 2012. Since it was first published in 2001, *Insight* has provided a raft of important statistics, but few significant changes have been made to the types of statistics published. With ongoing enhancements to APRA's data collections, most of the statistics in *Insight* have been incorporated into APRA's suite of statistical publications. APRA is transferring the remaining ADI statistics not already published elsewhere into its statistical publications.

APRA began an upgrade of the National Claims and Policy Database (NCPD) to new hardware and current versions of software. Following industry consultation, APRA determined that data in NCPD reports are non-confidential and it is removing masking from reports during the upgrade. By publishing unmasked data, APRA will increase the usefulness of the NCPD reports and the value of the NCPD data collection. APRA will take steps to protect the privacy of individuals in claims reports but does not expect that this will reduce the usefulness of these reports. The upgrade will also reduce operating support effort and costs for APRA. When the new system goes live in 2012/13, APRA intends to publish detailed reports that will enable contributors and subscribers to analyse the data using risk factors such as industry or occupation group and variations to product or policy coverage.

APRA's research capabilities

APRA has a small research unit that supports APRA's activities by conducting rigorous analysis of issues relating to prudential policy development and supervisory practices. The unit's research is published as working papers on the APRA website, presented at academic and industry conferences, and also often published in academic and international journals.

In 2011/12, the unit focussed its resources on research into aspects of the superannuation and ADI industries. Two superannuation-related working papers were published on the APRA website, one exploring the impact of illiquid investments on fund returns and the other investigating the effect of fund size on fund performance. The first paper was presented at the International Centre for Pension Management Discussion Forum in Toronto and the Netspar International Pension Workshop in Paris. Both papers have also been selected for two future domestic conferences. A third working paper, on the cost of insurance within superannuation funds, was presented at the Colloquium for Superannuation Researchers hosted by the University of New South Wales (UNSW). The unit has also continued to contribute to APRA's preparations for revising its regular data collections under the Stronger Super reforms.

On the ADI front, a paper published last year on the APRA website relating to funds transfer pricing was republished as an Occasional Paper by the Financial Stability Institute of the Bank for International Settlements (BIS) – only the tenth paper so recognised over the past 12 years. A working paper on stochastic stress testing was also presented in Kuala Lumpur at the BIS-hosted Asian Research Network Workshop held for central banks and bank regulators in the region.

The unit's full-time staff is supplemented by up to four PhD candidates whom APRA co-sponsors through the Capital Markets Cooperative Research Centre. APRA also supports other university research relevant to prudential regulation. A four-year Australian Research Council (ARC) Linkage Grant, partly funded by APRA, supports a team of academics from the Centre of Excellence in Population Ageing Research at UNSW to research longevity risk.

APRA also funded three external research teams under its inaugural Research Grants Program. One team has published a paper in *Accounting and Finance* on the strategic underestimation of market risk by large banks. A second team has conducted workshops on its study of the Australian syndicated loan market, which is likely to lead to two journal articles in the current year. The third grant was used to purchase a database that is supporting several studies of the factors relating to Australian banks' decisions to raise wholesale funds.

Chapter five

Cooperation and liaison

APRA's close engagement with other domestic regulatory agencies is a central element in Australia's framework for financial stability, while its other liaison activities – at home and abroad – provide a source of valuable intelligence on the institutions and industries that it regulates. APRA's involvement in all three global standard-setting bodies for prudential regulation ensures that Australia's interests have a 'voice at court' in the development of global regulatory reforms. For these various reasons, APRA attaches high priority to its liaison activities. At the same time, APRA has become more selective in its participation in international bodies given the substantial workload it has been facing in its policy and supervisory activities.

Australia

Australia's framework for financial stability is built on clear mandates for its financial regulatory agencies and effective cooperation and coordination across these agencies, at various levels and degrees of formality. This framework has been tested and strongly affirmed over the course of the global financial crisis.

Three specialist regulatory agencies – APRA, the Australian Securities and Investments Commission (ASIC) and the Reserve Bank of Australia (RBA) – have separate functional responsibilities for oversight of the Australian financial system but shared responsibilities for the stability and integrity of the system. All three agencies are independent statutory authorities. APRA has a close bilateral working relationship with each of ASIC and the RBA as well as with the Australian Treasury, which provides advice to the Government on policy and possible reforms that promote a sound financial system and infrastructure. Since the onset of the crisis, however, the focal point for agency cooperation has been the Council of Financial Regulators, a non-statutory body made up of these four agencies.

The Council, chaired by the Governor of the RBA, operates as a forum for coordination and information exchange between its members on financial policy and regulatory issues. Its objectives are to contribute to the efficiency and effectiveness of regulation and promote stability of the Australian financial system. Over 2011/12, the Council continued its oversight of conditions in global funding markets but it devoted much of its attention to further enhancing Australia's crisis management arrangements and providing advice to the Government on financial market infrastructure.

The Council's work on crisis management included a review of crisis resolution funding arrangements and a refinement of ADI crisis resolution coordination procedures. These procedures are also aimed at ensuring coordinated and effective public communications in a crisis. The Council continued to work closely with the New Zealand Treasury and the Reserve Bank of New Zealand (RBNZ) on Trans-Tasman crisis management arrangements (see page 65). In September 2011, in response to the Council's recommendations from its review of the design of the Financial Claims Scheme for ADIs, the Government announced a number of changes to the Scheme. These included a lowering of the Scheme limit from $1 million to $250,000 per depositor per ADI, with effect from 1 February 2012.

The Council's work on financial market infrastructure has had two main strands. The first relates to the issue of central clearing of over-the-counter (OTC) derivatives transacted in Australia's financial markets. This is in response to the substantial reforms in this area underway in many offshore jurisdictions and to the G-20 commitment to see all standardised OTC derivatives transactions centrally cleared by the end of 2012. The Council published a discussion paper on this topic in June 2011 and, following industry consultation, the Government released a consultation paper on the implementation of a framework for Australia's G-20 OTC derivatives commitments in April 2012. The second strand is developing proposals for changing the regulation of financial market infrastructures in Australia to strengthen regulators' ability to provide effective oversight and manage risks to stability and market integrity. The Council's recommendations to the Government in this area were published in March 2012. APRA has participated in two Council working groups on financial market infrastructure, as well as two on crisis management arrangements.

The Council's active work program since the crisis began has not replaced APRA's bilateral relationships with the other agencies. These relationships are based in each case on a Memorandum of Understanding (MoU) and a structured coordination process involving meetings between staff at different operational levels, from agency heads down; however, much of the regular contact occurs via informal as well as formal channels. Both channels have worked well over the years.

APRA's formal channel for its dealings with the RBA is the RBA/APRA Coordination Committee. Over 2011/12, the Committee discussed a range of policy, market, institutional and technical developments. The Basel III reforms featured prominently, along with APRA's revised capital requirements for life and general insurers, and conglomerate supervision. Other main topics included the sovereign debt crisis in Europe, global and domestic liquidity conditions and progress in the Australian banking system on funding structures. Contingency and recovery planning, crisis simulation and stress-testing work were also discussed.

The main formal channels between APRA and ASIC are regulatory liaison meetings and deterrence liaison meetings. The former meetings focus on policy issues or operational supervision matters concerning industries and institutions regulated by both agencies; they are also a forum for discussion on practical supervision outcomes arising out of changes to legislative and administrative procedures. The latter meetings discuss broad enforcement-related issues, coordinate specific actions related to jointly regulated institutions and discuss cases identified by one agency that may have relevance to the other. Following the failure of Trio Capital (see Chapter 2) and the recommendations of the Parliamentary Joint Committee, APRA is making improvements to the framework for information sharing with ASIC and other agencies, such as the Australian Taxation Office (ATO) and the Australian Federal Police. During 2011/12, broad issues under discussion between APRA and ASIC included risk management systems and other matters for entities that are jointly regulated, and the Government's Stronger Super proposals.

As one of the main mechanisms for joint consultation with industry, the APRA Members and ASIC Commissioners meet annually with the Finance Industry Council of Australia (FICA), an umbrella body for a number of finance industry associations, to discuss significant regulatory and other issues facing the industry. Such liaison allows the two regulatory agencies to brief industry on their current priorities and to identify and test industry concerns. FICA comprises the Australian Bankers' Association, Abacus – Australian Mutuals, the Australian Finance Conference, the Australian Financial Markets Association, the Australian Securitisation Forum, the Financial Services Council and the Insurance Council of Australia.

APRA's strong working relationship with Treasury was particularly constructive in 2011/12, when key legislative initiatives relevant to APRA's powers and responsibilities were being developed. These initiatives related to crisis management, a review of the Acts under which APRA operates and the Government's Stronger Super reforms. Since the announcement of these latter reforms in December 2010, APRA officials have participated actively in the Treasury's consultation with industry and have assisted Parliament by appearing before a number of hearings on the reforms. Another important area of coordination included the natural disaster insurance 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, the Financial Stability Board and the Basel Committee and the International Association of Insurance Supervisors.

APRA also interacts with a number of other Australian agencies. APRA and the Australian Transaction Reports and Analysis Centre (AUSTRAC) coordinate activities through the AUSTRAC/APRA Coordination Committee, which meets to update each agency on relevant regulatory developments and to share findings from supervisory activities. Referrals on specific regulatory matters and exchanges of information between the agencies are conducted using protocols established to meet relevant legislative requirements. To avoid duplication and minimise burden, there is also regular communication at the working level on visit schedules to jointly regulated institutions.

APRA has a longstanding commitment to cooperation with the ATO on superannuation matters. Regular consultation takes place across a range of superannuation administration and policy issues, including the Stronger Super reforms, ATO rulings, determinations and interpretative decisions and APRA prudential practice guides on the application of superannuation legislation, illegal early access to superannuation benefits, limited recourse borrowing arrangements and the public register of superannuation funds maintained by the ATO. The regular interaction between APRA and ATO staff (including data interchange on superannuation matters) is augmented by quarterly 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 sub-committee 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 for its supervisory functions and worked closely with PHIAC in relation to the review of the latter's compliance with the Insurance Core Principles by the International Monetary Fund (IMF) in the context of its Financial Sector Assessment Program. In this context, APRA and PHIAC consulted on input to assessments by and discussions with the IMF on the regulation of private health insurers in Australia. PHIAC also accessed APRA's training and development programs during the year and was provided with assistance to develop its cost recovery function. The two agencies regularly exchange information on jointly supervised institutions and discuss common industry issues. A new MoU between the two agencies was signed in December 2010 and reviewed in 2011 with no changes.

APRA liaises regularly with the Motor Accidents Authority of New South Wales (MAA) and the Motor Accident Insurance Commission of Queensland (MAIC). These State regulatory bodies administer compulsory third-party (CTP) motor vehicle insurance schemes in these states. The MAA and MAIC provide APRA with scheme information and consult with APRA on the financial condition of the CTP insurance providers; in turn, APRA provides both agencies with solvency data on these providers. APRA also keeps these agencies informed of policy developments in the prudential supervision of general insurers. During the year, APRA's MoU with the MAA was updated. APRA also liaises with WorkCover State authorities on prudential matters relevant to workers' compensation insurance.

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 Ian Laughlin is a member of the Council. APRA also contributed to the AASB's work on reporting by superannuation funds.

APRA is a permanent member of the Banking and Finance Sector Group (BFSG). Established under the Government's Trusted Information Sharing Network, the 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. The BFSG is an important forum for strengthening the resilience of the banking and finance sector and further streamlining business and government coordination in disasters. During 2011/12, the main area of interest was business and government communication, taking into account lessons on information-sharing and electronic security learnt from the responses to recent natural disasters.

In addition to its meetings with FICA, APRA liaises directly with a number of industry organisations including the Australian Bankers' Association, Abacus – Australian Mutuals, the Australian Finance Conference, the Australian Payments Clearing Association, the Financial Services Council, the Insurance Council of Australia, the Association of Superannuation Funds of Australia, the Corporate Superannuation Association and the Australian Institute of Superannuation Trustees. APRA also liaises with professional associations and institutes such as those for accountants, actuaries, administrators, auditors, company directors, compliance professionals, financial planners, risk managers and trustees. Such liaison may be at multiple levels throughout these organisations and APRA's own staff are actively involved in various committees and taskforces of some of the professional associations. APRA's regional offices also have wide-ranging liaison programs with regional offices of ASIC, industry bodies and professional associations.

The actuarial profession has for many years played a key role in financial management and prudent risk management, both formally through statutory roles and also in an advisory capacity, in the general insurance, life insurance and superannuation industries. APRA has regular dialogue with the Institute of Actuaries of Australia (IAAust) and the profession generally. During 2011/12, the principal topics of interest in discussions have been APRA's proposals to update its prudential capital requirements for life and general insurers, and the role and responsibilities of appointed actuaries in reviewing the adequacy and effectiveness of the risk management framework of insurers. APRA also liaises regularly with life insurance Appointed Actuaries as a group and, during the year, it initiated similar meetings with general insurance Appointed Actuaries. It also liaised with other groups of individuals who undertake statutory roles under the various Acts that APRA administers.

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 financial institutions with cross-border operations. The second is its participation in international groups and fora that, amongst other roles, have carriage of global reform initiatives being pursued by the Leaders of the G-20. Unlike some of its overseas counterparts, APRA does not have a separate unit that participates in such groups. Rather, APRA spreads the involvement across a range of experienced staff. In addition to information sharing on policy matters, the involvement of staff with supervision experience in particular allows APRA to inject supervisory knowledge and practical considerations into the global debate. Importantly, it also has the advantage, when reforms are being implemented, that APRA's senior supervisors have a strong understanding of the policy imperatives and detailed discussions behind the reforms.

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. Since the global financial crisis began, the drive for stronger global regulatory cooperation has centred on supervisory colleges, which are multilateral working groups of relevant supervisors and central banks formed to enhance the supervision of each of the largest international banking and insurance groups. APRA participates in several of these colleges and has established its own colleges for a number of large, internationally active financial institutions headquartered in Australia. During 2011/12, it hosted two of these colleges, involving 14 participants from overseas regulatory agencies. APRA now has formal bilateral information sharing arrangements with 23 overseas regulatory agencies, following the signing in 2011/12 of MoUs with the Financial Supervisory Commission/Financial Supervisory Service of Korea, the Banking Control Commission of Lebanon and the Bank of Indonesia. Other arrangements remain under discussion, some of which will facilitate the activities of supervisory colleges. APRA is also one of 32 signatories to the multilateral MoU put in place by the International Association of Insurance Supervisors (IAIS) and provides staff resources to assist the IAIS in the validation of applications from other jurisdictions.

The traditional direct link of most importance to APRA is that with the RBNZ, the prudential supervisor of banks and insurance companies in New Zealand. The importance flows from the high degree of interconnectedness between the Australian and New Zealand financial systems. APRA has a strong cooperative working relationship with the RBNZ on a range of supervisory issues. There is regular liaison on matters relating to the supervision of the major Australian banks, including regular information exchange and coordination of supervisory activities where appropriate. Cooperation has extended to the supervision of insurance, as the RBNZ takes on its new role in this area; an APRA officer was seconded to the RBNZ for much of the year to help build its insurance supervision team and processes.

Over recent years, APRA and the RBNZ, together with other members of the Trans-Tasman Council on Banking Supervision (the RBA and the Australian and New Zealand Treasuries), have given high priority to the detection of emerging stress in trans-Tasman banks. Considerable work has gone into the development of a structured approach to the handling of any episode of trans-Tasman financial distress. In this context, the Trans-Tasman Council agencies, together with ASIC, have entered into a Memorandum of Cooperation on Trans-Tasman Bank Distress Management. The Memorandum sets out high-level principles to which agencies will have regard when faced with financial distress involving banks with significant operations in Australia and New Zealand.

The Memorandum represents a non-binding understanding on how cooperation will be promoted in respect of all stages of crisis resolution, including problem identification, information sharing, systemic impact analysis, assessment of response options, implementation of measures to resolve a crisis and public communications. Notwithstanding this Memorandum, the Trans-Tasman Council agencies recognise that the exact nature of any response by the respective governments and their agencies will always depend on the specifics of a particular situation. In the first instance, both countries will look to the private sector for solutions to financial distress affecting trans-Tasman banking groups.

In 2011/12, the Trans-Tasman Council agencies and ASIC carried out a bank crisis simulation exercise in order to test the effectiveness of multi-agency coordination in a crisis. The exercise focussed on different areas of trans-Tasman coordination including information exchange, diagnostic work, formulation of a resolution and managing communications. It was part of a routine periodic testing of crisis resolution arrangements and provided helpful guidance on the means by which trans-Tasman coordination on crisis resolution can be further enhanced. These lessons will be drawn on in future work on cross-border crisis resolution.

APRA's participation in global reform initiatives is mainly through its involvement in global standard-setting bodies and in other fora. These include:

- **Basel Committee on Banking Supervision.** APRA has been a member of the Basel Committee on Banking Supervision, the global standard setting body for bank regulation and supervision, since 2009. The RBA is also a member and the APRA Chairman represents Australia on prudential supervision matters. The primary focus of the Basel Committee over the past year has been the implementation of new global regulatory standards on bank capital adequacy and liquidity (Basel III), which are discussed elsewhere in this *Report*, and a substantial revision to the Core Principles for Effective Banking Supervision. The Basel Committee has also been involved in the development of additional policy measures for systemically important banks whose failure would have significant cross-border repercussions (so-called G-SIBs) or impacts on the domestic economy (D-SIBs).

  APRA is also represented on the Basel Committee's three key sub-committees: the Policy Development Group, the Standards Implementation Group and the Accounting Task Force. The Policy Development Group identifies and reviews emerging prudential issues and develops policies to promote strong prudential standards. Its work program during 2011/12 covered Basel III implementation issues, banks' exposures to central counterparties and 'trading book' capital requirements. The Group was also involved in producing updated guidance on the management of foreign exchange settlement risk.

The Standards Implementation Group shares information and promotes consistency in the implementation of Basel Committee standards and guidance. Its main priority in 2011/12, which will continue over 2012/13, was assessing the progress of Basel Committee members in adopting Basel III in line with the agreed rules text and timetables. The Group also developed principles for effective risk data aggregation and risk reporting, and has been reviewing and benchmarking the adequacy of operational risk capital charges. APRA hosted a meeting of the Group in November 2011.

The Accounting Task Force engages with accounting and auditing standard-setters to help ensure that global accounting and auditing standards and practices promote sound risk management at banks, support market discipline through transparency, and reinforce the safety and soundness of the banking system. In 2011/12, it remained closely involved in the ongoing convergence process between the International Accounting Standards Board and the Financial Accounting Standards Board, with a particular interest in the development of a provisioning approach based on expected loss. In addition, the Accounting Task Force continued to analyse the implications for bank balance sheets of the interaction between changes to capital and accounting standards, and developed enhanced guidance for supervisors for assessing the effectiveness of the internal audit function in banks.

In addition, APRA is 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 Basel III reforms – the Definition of Capital Sub-group, the Working Group on Liquidity and the QIS Working Group, which is monitoring the impact of the reforms through semi-annual quantitative impact studies during the transition to Basel III. APRA was a member of the Core Principles Group (now disbanded), established to review and assess the need for changes to the Basel Committee's *Core Principles,* and is a member of the Operational Risk Sub-group of the Standards Implementation Group, which investigates issues related to the management and measurement of operational risk. During 2011/12, the bulk of the sub-group's work has been a review of the adequacy of the standardised approaches for calculating operational risk capital charges. APRA hosted a meeting of the sub-group in January 2012.

APRA also participated in the Cross-border Bank Resolution Group, which undertook a survey of members' policies, legal frameworks and allocation of responsibilities for the resolution of failed banks. In July 2011, following that survey, the Group published a report on progress being made on cross-border bank resolution and identified areas where further work is needed. The report contributed to the development of the Financial Stability Board's *Key Attributes of Effective Resolution Regimes for Financial Institutions,* a new international standard on financial crisis resolution published in November 2011.

A senior executive of APRA took up a secondment to the Basel Committee, as Secretary General, in the latter part of 2011. The Secretary General heads up the Secretariat of the Committee.

- **International Association of Insurance Supervisors (IAIS).** The main objectives of the IAIS are to promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders, and to contribute to global financial stability. APRA is represented on the IAIS Executive Committee (at APRA Member level) and Technical Committee; it is also an active participant on the Financial Stability Committee, established in response to the global financial crisis, and on a number of sub-committees most relevant to APRA's supervisory mandate and the Australian insurance industry.

  Over recent years, APRA has been closely involved with a key IAIS initiative to develop a common framework ('ComFrame') for the supervision of internationally active insurance groups, and it has led a number of drafting groups. APRA is in a strong position to contribute to this work, as it has had a group supervision framework for general insurance since 2009. An important area of work for the Financial Stability Committee has been responding to G-20 and Financial Stability Board requests in relation to systemically important financial institutions. APRA has contributed to the IAIS draft methodology for use in determining whether an insurer or insurance group has systemic importance.

  APRA has also continued its involvement in the Accounting and Auditing Issues, Solvency and Actuarial Issues, Insurance Groups and Cross-sectoral Issues, and Reinsurance sub-committees. While much of this work has been related to the development of ComFrame, other more general developments have also been progressed under the aegis of each sub-committee. APRA hosted two IAIS sub-committee/working group meetings in 2011/12.

- **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 Commissions (IOSCO).

  The Joint Forum focusses on issues relating to financial conglomerates and other issues that are common to, or have cross-sectoral implications for, the banking, insurance and securities sectors. During 2011/12, the Joint Forum completed a review of its *Principles for the Supervision of Financial Conglomerates*. APRA has significant supervisory experience in this area and was an active contributor to the review. The *Principles* are directly relevant to APRA's development of a prudential framework for conglomerate groups (Level 3 framework). Other workstreams reported on intra-group support measures and commenced investigations into disclosure at point of sale, mortgage insurance and longevity risk.

- **International Organisation of Pension Supervisors (IOPS).** IOPS is an independent body representing agencies involved in the supervision of private pension arrangements. Its objectives are to be the global standard-setting body for pensions supervision, to promote international cooperation on pension supervisory issues and to provide a global forum for policy dialogue and exchange of information on these matters.

APRA has been on the board of IOPS since its foundation and is a member of the Technical Committee. In late 2011, the APRA Deputy Chairman was re-elected President of IOPS for a third two-year term. During 2011/12, the work of IOPS included development and publication of further working papers in the Effective Supervision series and the release, jointly with the OECD, of a good practice guide on pension funds' use of alternative investments and derivatives. Following the launch of the IOPS 'toolkit' for risk-based supervision of pension funds in 2010, an APRA staff member was seconded to the IOPS Secretariat during 2011 to assist in the development of further guidance and a practical case study on risk-based supervision. The case study has been used in a series of IOPS workshops held in various regions to demonstrate these supervision techniques.

- **OECD Insurance and Private Pensions Committee (IPPC).** APRA is represented on the IPPC, which focusses 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 2011/12, the IPPC and WPPP published their work on policy options to strengthen retirement income adequacy in defined-contribution pension schemes. Work was commenced on a series of studies covering the management of longevity risk, analysis of long-term investment options, the communication of risk to defined-contribution members, the adequacy of retirement savings in OECD countries, insurance for catastrophic risk and disaster risk management. The IPCC and WPPP also considered how the level and quality of insurance and pension statistics collections could be improved and undertook accession reviews of and engagement with a number of countries seeking to join the OECD.
- **International Association of Deposit Insurers (IADI).** IADI is responsible 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 particular, APRA's membership of IADI has provided access to targeted training on deposit insurance systems and the ability to contribute to policy developments on deposit insurance and resolution of banking institutions. IADI's core mission is to share developments and best practice in deposit insurance with all countries. In that spirit, APRA has developed bilateral relationships with the most experienced IADI members.
- **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. In 2011/12, ICURN published its *Guiding Principles for Effective Prudential Supervision of Cooperative Financial Institutions.* It continues to work closely with the World Council of Credit Unions in assisting the development of supervisory systems and approaches in developing countries. ICURN is governed by a steering committee of representatives from six regions around the world and APRA is currently the representative for the Asia-Pacific region.

Although APRA is not a member agency of the Financial Stability Board (FSB) – Australia is represented by the RBA and Treasury – it contributed to the work of the FSB in the year under review. This included participation as the lead Australian resolution authority in an FSB survey on deposit insurance issues. An APRA staff member was appointed to an FSB panel of experts on crisis resolution to assist in coordinating an FSB peer review on matters relating to financial crisis management. Australia will participate in this review in 2012/13. In addition, an APRA staff member participates in the Compensation Monitoring Contact Group of the FSB. This group is responsible for sharing and promoting good practice in implementation of the FSB's *Principles for Sound Compensation Practices*, monitoring and reporting on national implementation of the *Principles*, and establishing and maintaining a process to ensure consistency of their application (including a bilateral complaint-handling process to address specific level playing field concerns raised by regulated financial institutions).

APRA meets annually with integrated supervisory agencies from a range of countries to discuss matters of common interest. The theme of the 14th conference in June 2012 was an integrated perspective on recent regulatory reforms. The main topics discussed were bank capital and liquidity versus insurance solvency initiatives, conflicts of policy in relation to economic and financial matters, and the 'shadow' finance industry.

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 2011/12, its main focus continued to be the implications of global regulatory reforms for countries in the region. EMEAP also facilitates a number of training initiatives to which APRA provides speakers from time to time.

Technical assistance

APRA supports the deepening of institutional capacity among its Asian and Pacific regulatory counterparts through a series of tailored technical assistance programs, principally funded by Australian Agency for International Development (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. APRA's technical assistance activities aim primarily at building relationships with its regional counterparts through the sharing of supervisory skills and experience.

In Asia, APRA's engagement is primarily focussed on technical assistance activities with Indonesia, although it is not limited to that country. APRA has been engaged with Bapepam-LK, Indonesia's integrated regulator of securities markets and non-bank financial institutions, for the past seven 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 and is also assisting Bapepam-LK's Insurance Bureau to develop a risk-rating model. APRA's capacity-building engagement with Bank Indonesia, the banking supervisor, continued in 2011/12, with two Bank Indonesia interns placed within APRA's frontline supervisory divisions for a period of six months. This was the fourth instalment of a longer-term engagement between APRA and Bank Indonesia that began in 2006. Other visits from Bank Indonesia staff focussed on adapting regulatory tools and assisting with the development of its risk-based bank rating guidance, which applies similar philosophy and methodology to APRA's PAIRS/SOARS framework. In total, APRA hosted 20 interns from Indonesia during the past year.

The Indonesian Government is planning to integrate the supervision of banking, non-bank financial institutions and securities markets into a single financial supervisory agency (OJK) by the end of 2013. Towards this aim, APRA hosted several visits by Indonesian officials in 2011/12 to review Australia's regulatory framework and how APRA itself was established.

APRA's assistance to Bapepam-LK and Bank Indonesia has been funded by a multi-year initiative under the auspices of the Government Partnership Fund II (GPF II).

In the Pacific, APRA administers two distinct but complementary projects under the auspices of the Government's multilateral Public 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 2011/12, APRA supervisors undertook three on-site training programs in Fiji, two in Papua New Guinea and one in Vanuatu; these programs ranged across banking and other credit providers, insurance and provident funds. The Pacific Prudential Regulator Internship Project places staff from Pacific prudential regulators within APRA's frontline supervisory divisions for a period of up to three months to learn about prudential supervision techniques. In 2011/12, this project placed one participant from the Bank of Papua New Guinea in APRA's office in Melbourne.

In August 2011, an external review of APRA's Pacific technical assistance program confirmed that Pacific partner jurisdictions uniformly value the program, which through its hands on components in particular was seen as filling a useful training gap. The program was found to be clearly in line with AusAID requirements of demonstrated relevance to both Australian government and partner government development priorities and very effective in meeting the program's short-term and intermediate objectives, which include raising levels of understanding about and capacity to deliver risk-based supervision and promoting Pacific regulatory networks. The program was also considered to represent good value for money, give attention to sustainability and gender equality, and to have a well-considered approach to capacity development.

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 training workshops. APRA is also a member of:

- the Asian Forum of Insurance Regulators;
- 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.

Given the importance of Australian banks within the South Pacific, APRA has been invited to join the annual meeting of South Pacific Central Bank Governors. The 2011 meeting was held in Samoa.

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, the APEC Financial Regulatory Training Initiative and the ASEAN Insurance Training and Research Institute (AITRI). During 2011/12, APRA provided two speakers to conferences organised by the Financial Stability Institute, which are often co-hosted with other regional bodies, and one speaker to programs organised by each of the APEC Study Centre and AITRI. APRA values the opportunity to develop the skills of its staff, as both participants and speakers in such programs.

During the year, APRA hosted just over 100 international delegations from regulatory agencies, central banks, multilateral organisations, industry bodies and private sector organisations. Approximately half of the delegations were from developing countries and just under one-fifth from China. Delegation visits from South Korea and Indonesia were also prominent. Areas of interest were wide-ranging and included APRA's functions and operations, Australia's 'twin peaks' approach to regulatory arrangements and the challenges of establishing an integrated prudential regulator, prudential policy developments, risk-based supervision, Australia's handling of the global financial crisis and superannuation prudential policy and supervisory practice. In addition, there were a number of 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 incurred in implementing and enhancing the prudential framework in Australia and in its ongoing supervisory and enforcement activities. APRA's income derives mostly from annual levies on its supervised entities.

APRA's expenditure

APRA's total operating expenditure in 2011/12 was $121.1 million compared with the (adjusted) budget of $116.9 million. The overrun reflected the impact of the lower 10-year government bond rate on the valuation of employee liabilities, as well as higher expenditure on enforcement related matters. Following the transfer of the early release of benefits function to the Department of Human Services in November 2011, APRA's expenditure and income budgets for 2011/12 were reduced by $2.7 million.

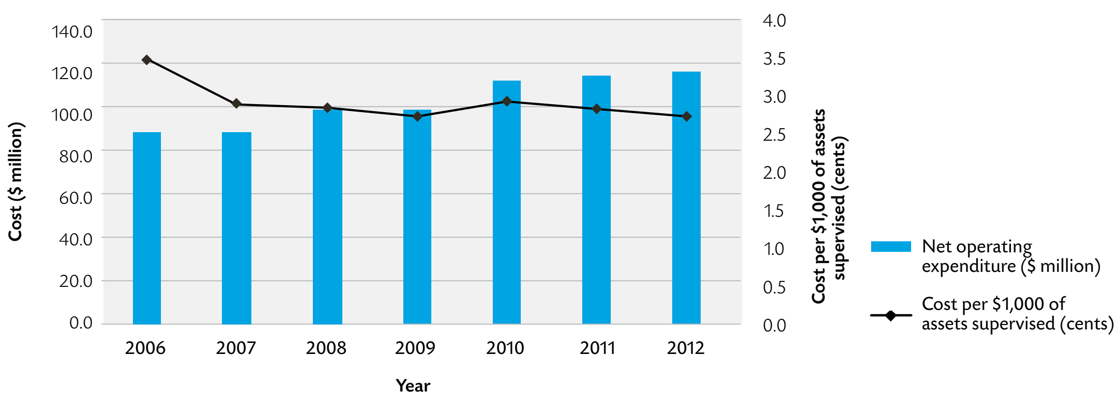
Following a build-up in supervisory numbers and capacity in the early stages of the global financial crisis, APRA's operating expenditure has remained fairly stable over the past three years. Further, relative to the value of assets supervised by APRA, costs have remained at about three cents per $1,000 of assets supervised.

APRA's income

APRA's total income in 2011/12 was $118.6 million compared with the (adjusted) budget of $113.1 million.

In addition to levies collected from supervised institutions, APRA's income includes interest earnings, fees for services and miscellaneous cost recoveries. Also included in 2011/12 revenue was the final $9.0 million instalment of a Special Appropriation from the Government to deal with the global financial crisis. In total, an additional $45.5 million was provided between 2008/09 and 2011/12 for this purpose.

APRA's costs



Levies are raised according to the *Financial Institutions Supervisory Levies Collection Act 1998* and seven other Acts applying to the regulated industries. Prior to the beginning of each financial year, and after consultation with industry, 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 and small APRA superannuation funds that are levied at a flat rate. The levies collected by APRA also cover some costs of ASIC, the ATO and, following the transfer of the early release of superannuation benefits function, the Department of Human Services. 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 agencies in 2011/12 were $131.0 million compared with the budget of $127.8 million. The $3.2 million over-collection of levies will be refunded to industry in 2012/13.

Reserves

APRA had an operating deficit from ordinary activities of $2.5 million in 2011/12, which was funded out of retained surpluses. As a consequence, total reserves decreased to $28.7 million. Included in this amount is a $6.0 million Contingency Enforcement Fund, which is available to be used for large unexpected investigation and enforcement activities, and an Asset Revaluation Reserve of $6.5 million.

Business planning

In August 2012, APRA launched its 2012-15 Strategic Plan, which consolidated progress under its previous strategic plan in an environment of continued uncertainties about global economic prospects and persistent bouts of turbulence in global financial markets. The Plan does not involve any major change in APRA's strategic direction but gives priority to successfully implementing major prudential policy reforms across the ADI, insurance and superannuation industries and to the continued development of APRA's supervisory capabilities. The Plan places strong emphasis on the importance of active supervision built on a solid base of understanding and knowledge of APRA-regulated institutions and industries.

The Plan articulates APRA's long-term strategy to achieve its mission and realise its vision. It also identifies four strategic objectives and the initiatives APRA will undertake to meet them. The objectives are to:

- ensure APRA's prudential framework is robust, empower supervisors and sets expectations of prudent behaviour by regulated institutions and their boards;
- supervise institutions with timely, risk-based, considered action;
- develop robust organisational processes and infrastructure to effectively support APRA's core functions; and
- have highly skilled and engaged people, guided and supported by strong leaders.

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. The Plan itself will be reviewed each year in light of developments in APRA's operating environment.

Supervisory performance

Notwithstanding the increasing focus globally on the performance of supervisory agencies, useful objective indicators of supervisory intensity and effectiveness are proving elusive. For its part, APRA publishes information from two different sources to provide broad quantitative indicators of its supervisory performance. These sources are APRA's 'transition matrices' and data on financial failures and losses to beneficiaries.

Transition matrices track the migration of institutions between the four supervision stances in APRA's Supervisory Oversight and Response System (SOARS), which guides supervisors in responding to identified risks. 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's goal is that institutions in Oversight take appropriate action that would see them return to Normal in due course. However, some institutions may remain in Oversight indefinitely if their business plans or risk appetite makes that appropriate; APRA's strategy with such institutions is close monitoring and communication. APRA's expectation is that an institution in Mandated Improvement will take immediate and appropriate action that would, in a short timeframe, see it returning to an improved supervision stance or moving to Restructure. APRA does not expect institutions to be permanently classified as 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 five years, almost half of the institutions in Normal and Oversight remained in that stance. A significant percentage of the remainder of Oversight institutions either improved or exited the industry in an orderly manner. Around half of the institutions in Mandated Improvement have exited the industry while the others remained where they were or have moved towards an improved supervision stance. The majority of institutions in Restructure have remained in that stance, with all others exiting the industry.

SOARS matrix (2007/12)
(%)

From/to	Normal	Oversight	Mandated Improvement	Restructure	Exit
Normal	46	19	0	0	34
Oversight	23	47	1	1	28
Mandated Improvement	12	18	24	0	47
Restructure	0	0	0	60	40

Over the past nine years, a total of 222 institutions have been in Mandated Improvement and/or Restructure (of which 10 institutions moved through both SOARS categories). Of that total, 54 institutions have improved stance to Normal or Oversight, 20 have remained in their SOARS category , 142 have exited without loss to beneficiaries and six institutions have failed (four of which moved through both Mandated Improvement and Restructure during that time). While it is not possible to compare these outcomes with what would have happened had APRA not intervened, the overall 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 (2003/12)

Current stance	Total
Normal	23
Oversight	28
Mandated Improvement	10
Restructure	2
Exit	109
Failure	5
Total	**177**

Entities in Restructure (2003/12)

Current stance	Total
Normal	0
Oversight	3
Mandated Improvement	0
Restructure	10
Exit	37
Failure	5
Total	**55**

At end-June 2012, around 56 per cent of institutions were in the Normal stance, 41 per cent in Oversight, one per cent in Mandated Improvement and two per cent in Restructure. This distribution has shown little change over the year.

The second set of quantitative indicators of supervisory performance is linked to financial failures and losses to beneficiaries. APRA publishes two headline performance 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 99.91 per cent and the annual MPR, which is dominated by the losses associated with HIH Insurance, has averaged 99.96 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	4	11	4,473	887,172	99.91	100.00
2000	3	308	4,407	993,369	99.93	99.97
2001	8	5,341 [4]	4,350	1,043,111	99.82	99.49
2002	6	140	3,803	1,009,373	99.84	99.99
2003	5	19	3,252	1,068,081	99.85	100.00
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	2	965	2,232,254	99.90	100.00
2011	4	55	898	2,469,585	99.55	100.00
2012	0	0	827	2,660,234	100.00	100.00

1 In the case of superannuation, failures refer to the number of funds affected and include failures due to employer sponsors.

2 The number of institutions excludes Small APRA Funds, representative offices of foreign banks and non-operating holding companies.

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 $4,234.2 billion at end-June 2012.

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

There must be at least three and no more than five Members of APRA, as specified in Part 3 of the *Australian Prudential Regulation Authority Act 1998*. In practice, there are three full-time Members and they comprise APRA's Executive Group. The Executive Group is responsible and accountable for the operation and performance of APRA.

APRA has responsibility for regulating institutions in the financial sector and for 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 also acts as a national statistical agency for the Australian financial system and is 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 2011 to 30 June 2012

	Meetings	Attended
John Laker	19	19
Ross Jones	19	18
Ian Laughlin	19	17

Details on APRA Members are provided on pages 86-87 of this *Report*.

Risk management in APRA

Risk Management and Audit Committee

APRA's Risk Management and Audit Committee provides independent assurance and assistance to APRA's Executive Group on APRA's risk management policies and practices, internal control and compliance frameworks and its external accountabilities.

The Committee comprises an external chair, 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, the APRA Secretary and representatives of the Australian National Audit Office. The Chairman of APRA may attend by invitation.

During 2011/12, the Committee met five times and at those meetings all audit reports were reviewed. The Committee approved the Risk Management and Internal Audit annual plans and monitored the operation of APRA's Enterprise Risk Management Framework. At the August 2012 meeting, the Committee made an attestation to the APRA Chairman that reliance could be placed on APRA's systems and controls applied in preparing the annual accounts.

The members of the Committee in 2011/12 were:

Mr W Peter Day
LLB (Hons), MBA, FCPA, FCA, FTIA, FAICD

Chair

Mr Day was appointed for a five-year term in 2008 and assumed the role of Chair of the Committee from 1 September 2010. He is Chairman of Orbital Corporation Limited and a non-executive director of Ansell Limited, Centro Retail Australia and SAI Global Limited. He also serves on 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.

Ms Fiona Bennett
BA (Hons), FCA, FAICD, FAIM
External member

Ms Bennett was appointed for a three-year term on 1 January 2011. She is a non-executive director of two ASX listed companies - Hills Holdings Limited and Boom Logistics Limited - and a number of other entities including Alfred Health and the Legal Services Board (Victoria).

During her executive career, Fiona held senior executive positions at BHP Billiton Limited and Coles Group Limited, and has been Chief Financial Officer at several organisations in the health sector.

Mr Ian Laughlin
APRA Member

Mr Keith Chapman
Executive General Manager
– Diversified Institutions Division

Attendance at Risk Management and Audit Committee meetings from 1 July 2011 to 30 June 2012

	Meetings	Attended
Peter Day	5	5
Fiona Bennett	5	5
Ian Laughlin	5	5
Keith Chapman	5	5

Risk Management and Internal Audit unit

Independent of APRA's management structure, the Risk Management and Internal Audit unit plays an important role in APRA's governance, assurance and compliance framework through a detailed and planned approach to the monitoring and assessment of risks and the review of APRA's systems, controls and processes. The unit 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.

APRA's Enterprise Risk Management Framework is central to risk management in APRA and to the work of the unit. The Framework was implemented in 2009/10 for the identification, monitoring and management of risk within APRA, and is subject to ongoing enhancement. An 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. Risks are reassessed on a regular basis. The unit provides APRA's Executive Group and its Risk Management and Audit Committee with consolidated risk reports on a quarterly basis. The Framework was strengthened in 2011/12 through the capture of APRA's risk appetite in a formal statement that articulates the level and nature of risk APRA is willing to accept in pursuit of its vision, mission and associated strategic objectives.

Each year, following consultation with APRA management and staff and an assessment of APRA's strategies and risks, a broad ranging and robust program of internal audits is developed and subsequently approved by the Executive Group and endorsed by the Risk Management and Audit Committee. The program 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 on a quarterly basis, 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 in line with Government requirements is in place. All audits undertaken by the unit assess whether potential fraud exposures are appropriately addressed by APRA's processes and controls. There were no incidents of internal fraud reported for the year. Compulsory annual online fraud awareness training is delivered to all staff and APRA management makes formal six-monthly attestations on any fraud identified and actions taken.

APRA has a range of external accountabilities and, to ensure compliance, a comprehensive APRA-wide compliance framework based upon the relevant Australian Standard has been put in place. The responsibility for monitoring and ongoing development of this framework is with the Secretary.

Other governance matters

The *Statutory Report* on page 151 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. He is also a director of the Centre for International Finance and Regulation. 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 in 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 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 is APRA's representative on the Executive Committee of the International Association of Insurance Supervisors and on the Financial Reporting Council. 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 2012 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
Chairman
21 August 2012

Mr K. Ross Jones
Deputy Chairman
21 August 2012

Mr Ian Laughlin
Member
21 August 2012

Mr Steve Matthews
Chief Financial Officer
21 August 2012

Chapter eight

Financial statements

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Notes

Statement of comprehensive income
for the year ended 30 June 2012

	Notes	2012 $'000	2011 $'000
Expenses			
Employee benefits	4A	**89,812**	82,175
Supplier expenses	4B	**26,053**	31,785
Depreciation and amortisation	4C	**5,131**	4,193
Finance costs	4D	**97**	103
Write-down and impairment of assets	4E	**–**	53
Losses from asset disposals	4F	**26**	40
Total expenses		**121,119**	118,349
Less:			
Own-source income			
Own-source revenue			
Rendering of services	5A	**4,212**	3,757
Rental income	5B	**11**	9
Other revenue	5C	**568**	727
Total own-source revenue		**4,791**	4,493
Gains			
Other gains	5D	**128**	125
Total gains		**128**	125
Total own-source income		**4,919**	4,618
Net cost of services		**116,200**	113,731
Revenue from Government	5E	**113,730**	102,634
Operating surplus/(deficit)		**(2,470)**	(11,097)
Other comprehensive income			
Changes in asset revaluation reserves	6A	**(170)**	2,828
Total other comprehensive income		**(170)**	2,828
Total comprehensive income/(loss)		**(2,640)**	(8,269)

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

Balance sheet
as at 30 June 2012

	Notes	2012 $'000	2011 $'000
Assets			
Financial assets			
Cash	7A	**1,739**	1,579
Trade and other receivables	7B	**46,561**	44,010
Total financial assets		**48,300**	45,589
Non-financial assets			
Property, plant and equipment	8A,B	**5,823**	6,164
Intangibles	8C,D	**12,717**	11,622
Other non-financial assets	8E	**1,964**	2,028
Total non-financial assets		**20,504**	19,814
Total assets		**68,804**	65,403
Liabilities			
Payables			
Suppliers	9A	**373**	388
Unearned fees and charges	9B	**1,036**	1,133
Other payables	9C	**3,826**	4,394
Total payables		**5,235**	5,915
Provisions			
Employee provisions	10A	**32,000**	26,135
Other provisions	10B	**2,881**	2,025
Total provisions		**34,881**	28,160
Total liabilities		**40,116**	34,075
Net assets		**28,688**	31,328
Equity			
Contributed equity		**7,469**	7,469
Reserves		**12,467**	12,637
Retained surpluses		**8,752**	11,222
Total equity		**28,688**	31,328

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

Statement of changes in equity
for the year ended 30 June 2012

	Retained surpluses		Asset revaluation reserve		Contingency Enforcement Fund		Contributed equity/capital		Total equity	
	2012 $'000	2011 $'000	**2012 $'000**	2011 $'000	**2012 $'000**	2011 $'000	**2012 $'000**	2011 $'000	**2012 $'000**	2011 $'000
Opening balance										
Balance carried forward from previous period	**11,222**	22,319	**6,637**	3,809	**6,000**	6,000	**7,469**	6,012	**31,328**	38,140
Adjusted opening balance	**11,222**	22,319	**6,637**	3,809	**6,000**	6,000	**7,469**	6,012	**31,328**	38,140
Comprehensive income										
Other comprehensive income	**–**	–	**(170)**	2,828	**–**	–	**–**	–	**(170)**	2,828
Surplus/(deficit) for the period	**(2,470)**	(11,097)	**–**	–	**–**	–	**–**	–	**(2,470)**	(11,097)
Total comprehensive income	**(2,470)**	(11,097)	**(170)**	2,828	**–**	–	**–**	–	**(2,640)**	(8,269)
Contributions by owners										
Equity injection - appropriations	**–**	–	**–**	–	**–**	–	**–**	1,457	**–**	1,457
Sub-total: transactions with owners	**–**	–	**–**	–	**–**	–	**–**	1,457	**–**	1,457
Closing balance as at 30 June	**8,752**	11,222	**6,467**	6,637	**6,000**	6,000	**7,469**	7,469	**28,688**	31,328

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

Statement of cash flows
for the year ended 30 June 2012

	Notes	2012 $'000	2011 $'000
Operating activities			
Cash received			
Appropriations		**119,151**	118,751
Rendering of services		**5,023**	4,686
Rental income		**11**	9
Net GST received		**2,508**	2,995
Other		**568**	727
Total cash received		**127,261**	127,168
Cash used			
Employees		**(83,584)**	(80,736)
Suppliers		**(30,589)**	(34,064)
Section 31 receipts transferred to Official Public Account (OPA)		**(8,110)**	(8,417)
Total cash used		**(122,283)**	(123,217)
Net cash from/(used by) operating activities	12	**4,978**	3,951
Investing activities			
Cash used			
Purchase of property, plant and equipment		**(640)**	(191)
Purchase/development of software intangibles		**(4,178)**	(4,708)
Total cash used		**(4,818)**	(4,899)
Net cash/(used by) investing activities		**(4,818)**	(4,899)
Financing activities			
Cash received			
Contributed equity – capital injections		**–**	1,457
Total cash received		**–**	1,457
Net cash from financing activities		**–**	1,457
Net increase/(decrease) in cash held		**160**	509
Cash at the beginning of the reporting period		**1,579**	1,070
Cash at the end of the reporting period	7A	**1,739**	1,579

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

Schedule of commitments
as at 30 June 2012

	2012 $'000	2011 $'000
By type[1]		
Commitments receivable		
Net GST recoverable on commitments	**(2,519)**	(984)
Total commitments receivable	**(2,519)**	(984)
Commitments payable		
Operating leases	**27,712**	10,825
Total commitments payable	**27,712**	10,825
Net commitments by type	**25,193**	9,841
By maturity		
Commitments receivable		
Net GST recoverable on commitments		
One year or less	**(600)**	(657)
From one to five years	**(1,919)**	(327)
Total net GST recoverable on commitments	**(2,519)**	(984)
Commitments payable		
Operating lease commitments		
One year or less	**6,598**	7,229
From one to five years	**21,114**	3,596
Total operating lease commitments	**27,712**	10,825
Net commitments by maturity	**25,193**	9,841

Leases for office accommodation	Lease payments in Sydney (except for one level) and Perth are subject to prevailing market rates. Leases for all other offices are subject to fixed annual increments. Office leases, with current expiry dates shown in brackets, are current for space in Adelaide (2012), Perth (2014), Canberra (2015), Melbourne (2016), Sydney (2016) and Brisbane (2018).

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 2012

	2012 $'000	2011 $'000
Contingent assets		
Claims for damages or costs	–	–
Total contingent assets	–	–
Contingent liabilities		
Claims for damages or costs	–	–
Total contingent liabilities	–	–
Net contingent assets (liabilities)	–	–

Details of each class of contingent assets and liabilities, including those not included above because they cannot be quantified or are remote, are disclosed in Note 13: *Contingent assets and liabilities.*

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

Administered schedule of comprehensive income
for the year ended 30 June 2012

	Notes	2012 $'000	2011 $'000
Expenses			
Supervisory Levy waivers	19	959	615
Total expenses administered on behalf of Government		959	615
Less:			
Income			
Taxation/levy revenue			
Financial Institutions Supervisory Levies	20A	131,949	116,382
Financial Assistance Levy	20B	20	54,925
Total taxation/levy revenue		131,969	171,307
Net cost of (contribution by) services		131,969	171,307
Total comprehensive income administered on behalf of Government		131,010	170,692

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

Administered schedule of assets and liabilities
as at 30 June 2012

	Notes	2012 $'000	2011 $'000
Assets			
Financial assets			
Receivables	21	**2,201**	54,555
Total assets administered on behalf of Government		**2,201**	54,555
Liabilities			
Liabilities administered on behalf of Government		**–**	–
Total liabilities administered on behalf of Government		**–**	–
Net assets administered on behalf of Government		**2,201**	54,555

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

Administered reconciliation schedule
as at 30 June 2012

	2012 $'000	2011 $'000
Opening administered assets less administered liabilities as at 1 July	**54,555**	38
Plus: Administered income	**131,969**	171,308
Less: Administered expenses	**(959)**	(615)
Administered transfers to/from Australian Government:		
Plus: Appropriation transfers from Official Public Account	**22**	75
Less: Transfers to Official Public Account	**(183,386)**	(116,251)
Closing administered assets less administered liabilities as at 30 June	**2,201**	54,555

Administered statement of cash flows
for the year ended 30 June 2012

	Notes	**2012 $'000**	2011 $'000
Operating activities			
Cash received			
Financial Institutions Supervisory Levies			
Financial Assistance Levy		**131,028**	115,857
Total cash received		**52,358**	395
		183,386	116,252
Cash used			
Refunds for overpayment of Supervisory Levies		**(21)**	(75)
Refunds for overpayment of Financial Assistance Levy		**(1)**	–
Total cash used		**(22)**	(75)
Net cash flows from operating activities	22	**183,364**	116,177
Net increase in cash held		**183,364**	116,177
Cash at the beginning of the reporting period		**–**	–
Cash from Official Public Account for:			
– APRA Special Account: Supervisory Levies		**21**	–
– Section 28 FMA Act refund appropriations: Supervisory Levies		**–**	75
– Section 28 FMA Act refund appropriations: Financial Assistance Levy		**1**	–
		22	75
Cash to Official Public Account for:			
– Financial Institutions Supervisory Levies		**(131,028)**	(115,857)
– Financial Assistance Levy		**(52,358)**	(395)
		(183,386)	(116,252)
Cash at the end of the reporting period		**–**	–

APRA administers the collection of Financial Institutions Supervisory Levies and Financial Assistance Levies on behalf of the Government. While the revenues from Financial Institutions Supervisory Levies are in part used to fund the operations of APRA, they are not directly available to APRA for its own purposes. The revenues from the Financial Assistance Levy are not available to APRA for its own purposes. All administered collections are remitted to the Official Public Account. Transactions and balances relating to levies are reported in Note 20: *Administered income*.

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

Administered schedule of commitments
for the year ended 30 June 2012

APRA had no administered commitments as at balance date.

Administered schedule of contingencies
for the year ended 30 June 2012

APRA had no administered contingencies as at balance date.

Notes to and forming part of the financial statements
for the year ended 30 June 2012

Note 1: Summary of significant accounting policies

1.1 Objectives of Australian Prudential Regulation Authority (APRA)

The role of 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 interests of depositors, policyholders and superannuation fund members. In carrying out its 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 focusses 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 from 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 2011; 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 alternative treatment is specifically required by an accounting standard or the FMOs, assets and liabilities are recognised in the *Balance sheet* when and only when it is probable that future economic benefits will flow to APRA or a future sacrifice of economic benefits will be required and the amounts of the assets or liabilities can be reliably measured. 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.

Note 1: Summary of significant accounting policies (Continued)

1.3 Significant accounting judgements and estimates

In the process of applying the accounting policies listed in this note, APRA has made the following judgements 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 2011.

No accounting assumptions and estimates have been identified that have a significant risk of causing a material adjustment to the 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 2012 and is satisfied that they reflect the fair value.

1.4 Changes in Australian Accounting Standards

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 effect on APRA or are 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.

1.5 Revenue

Revenue 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 from Government 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.

Notes to and forming part of the financial statements
for the year ended 30 June 2012

Note 1: Summary of significant accounting policies (Continued)

Other revenue

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 APRA.

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. Collectability of debts is reviewed at balance date. Allowances are made when collectability of the debt is no longer probable.

Parental leave payments scheme

Amounts received under the Parental Leave Payments Scheme not yet paid to employees are presented gross as cash and a liability (payable) by APRA.

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 or losses from disposal of 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.

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 the 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 long-term employee benefits 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.

Note 1: Summary of significant accounting policies (Continued)

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 and long service 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 those employees affected that it will carry out the terminations.

Superannuation

Certain employees of APRA are members of the Commonwealth Superannuation Scheme (CSS) and the Public Sector Superannuation Scheme (PSS). The CSS and PSS are defined benefit schemes for the Australian Government. 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. This liability is reported in the Department of Finance and Deregulation's administered schedules and notes. APRA makes employer contributions to the employees' superannuation scheme at rates determined by an actuary to be sufficient to meet the current cost to the Government of the superannuation entitlement 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.

The liability for superannuation recognised at the balance date represents outstanding contributions for the remaining days following the last payroll in June 2012.

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.

Notes to and forming part of the financial statements
for the year ended 30 June 2012

Note 1: Summary of significant accounting policies (Continued)

1.10 Cash

Cash includes cash on hand and cash at bank.

1.11 Financial assets

APRA classifies its financial assets as loans and 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 'payables'. Financial liabilities are recognised and derecognised upon trade date. 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).

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

1.13 Contingent assets and contingent liabilities

Contingent assets and contingent liabilities 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 an asset or liability, or represent an asset or liability in respect of which the 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.

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.

Note 1: Summary of significant accounting policies (Continued)

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 2010/11).

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 in the *Statement of comprehensive income*. Revaluation decrements for a class of assets are recognised directly in the *Statement of comprehensive income* except to the extent that they reversed 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

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 depreciated on a straight-line basis over the lesser of the estimated useful life of the improvements or the unexpired period of the lease.

Notes to and forming part of the financial statements
for the year ended 30 June 2012

Note 1: Summary of significant accounting policies (Continued)

Depreciation rates (useful lives), residual values 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	2012	2011
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 were assessed for impairment at the balance date. 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 amortisation 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 (2010/11: lesser of five years or assessed useful life).

All software assets were assessed for indications of impairment as at 30 June 2012.

1.17 Taxation

APRA is exempt from all forms of taxation except Fringe Benefits Tax (FBT) and the Goods and Services Tax (GST).

Revenues, expenses and assets are recognised net of GST except where the amount of GST incurred is not recoverable from the Australian Taxation Office. Receivables and payables are recognised inclusive of GST.

Note 1: Summary of significant accounting policies (Continued)

1.18 Reporting of administered activities

Administered revenues, expenses, assets, liabilities and cash flows are disclosed in the *Administered schedules* 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 (OPA)

Revenue collected by APRA for use by the Government rather than by APRA is administered revenue. Collections are transferred to the 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 the 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 statement of cash flows* and in the *Administered statement of cash flow reconciliation* in Note 22.

Revenue

All administered revenues relate to the ordinary activities performed by APRA on behalf of the 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 (including the Financial Assistance Levy) is recognised on an accrual basis, in line with the Minister's regulations and determinations. 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 waivers of levy debts are recognised at the time of approval by delegated APRA officials.

Waivers of levies under the *Financial Institutions Supervisory Levies Collection Act 1998* are shown at Note 27, 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.

Contingent assets and liabilities

There were no administered contingent assets or liabilities in 2012 or in 2011.

Note 2: Events after the balance sheet date

There were no significant events occurring after the balance sheet date that have the potential to significantly affect the ongoing structure or financial activities of APRA.

Notes to and forming part of the financial statements
for the year ended 30 June 2012

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:

	2012 $'000	2011 $'000
Table 1: Summary		
Current year levies and penalties (see Note 20A, Table 1)	**131,949**	116,382
Less: Waivers and doubtful debts (see Note 19)	**(959)**	(615)
Net current year levies and penalties (see Table 2 below)	**130,990**	115,767
Less: Amount retained in the CRF (see Table 3 below)	**(30,610)**	(26,100)
Total	**100,380**	89,667
Table 2: Net current year levies and penalties by levy type		
Superannuation funds	**46,315**	37,198
Authorised deposit-taking institutions	**45,650**	42,004
Life insurers and friendly societies	**12,777**	11,429
General insurers	**26,248**	25,136
Total	**130,990**	115,767
Table 3: Amounts retained in the CRF by levy type[1]		
Superannuation funds	**(20,710)**	(16,700)
Authorised deposit-taking institutions	**(4,100)**	(3,800)
Life insurers and friendly societies	**(2,100)**	(2,300)
General insurers	**(3,700)**	(3,300)
Total	**(30,610)**	(26,100)
Table 4: Amounts of levy payable to APRA under the APRA Special Appropriation by levy type		
Superannuation funds	**25,605**	20,498
Authorised deposit-taking institutions	**41,550**	38,204
Life insurers and friendly societies	**10,677**	9,129
General insurers	**22,548**	21,836
Total	**100,380**	89,667

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

Note 4: Expenses

	2012 $'000	2011 $'000
Note 4A: Employee benefits		
Salaries and wages	**70,297**	67,241
Superannuation	**7,395**	7,044
Leave and other entitlements	**11,413**	7,586
Separation and redundancies	**528**	5
Other employee benefits	**179**	299
Total employee benefits	**89,812**	82,175
Note 4B: Supplier expenses		
Goods and services		
Consultants	**2,123**	4,816
Contractors	**886**	2,638
Travel-related expenses	**2,952**	3,737
Operational expenses	**11,163**	11,359
Training and conference expenses	**1,841**	2,044
Other professional services	**62**	67
Total goods and services	**19,027**	24,661
Goods and services are made up of:		
Provision of goods – external parties	**2,583**	2,800
Rendering of services – related entities	**2,921**	2,340
Rendering of services – external parties	**13,523**	19,521
Total goods and services	**19,027**	24,661
Other supplier expenses		
Operating lease rentals – external parties:		
– minimum lease payments	**6,779**	6,911
Workers' compensation premiums	**247**	213
Total other supplier expenses	**7,026**	7,124
Total supplier expenses	**26,053**	31,785

Notes to and forming part of the financial statements
for the year ended 30 June 2012

Note 4: Expenses (Continued)

	2012 $'000	2011 $'000
Note 4C: Depreciation and amortisation		
Depreciation:		
Computer hardware	**648**	756
Leasehold improvements	**1,399**	1,301
Total depreciation	**2,047**	2,057
Amortisation:		
Intangibles – computer software	**3,084**	2,136
Total amortisation	**3,084**	2,136
Total depreciation and amortisation	**5,131**	4,193
Note 4D: Finance costs		
Unwinding of discount	**97**	103
Total finance costs	**97**	103
Note 4E: Write-down and impairment of assets		
Asset write-downs and impairments from:		
Impairment of internally developed software	**–**	53
Total write-down and impairment of assets	**–**	53
Note 4F: Losses from asset sales/disposals		
Computer hardware:		
Proceeds from sale	**(2)**	–
Carrying value of assets disposed	**28**	40
Total losses from asset sales/disposals	**26**	40

Note 5: Income

	2012 $'000	2011 $'000
Note 5A: Rendering of services		
Rendering of services – government entities	**1,580**	1,512
Rendering of services – external entities	**2,632**	2,245
Total rendering of services	**4,212**	3,757
Note 5B: Rental income		
Rental income	**11**	9
Total rental income	**11**	9
Note 5C: Other revenue		
Licence fees from finance sector entities	**285**	465
Superannuation trustee applications	**60**	20
Fees from foreign bank representative offices	**85**	75
Recoveries from RBA for scholarship	**19**	23
Other	**119**	144
Total other revenue	**568**	727
Note 5D: Other gains		
Resources received free of charge	**128**	125
Total other gains	**128**	125
Note 5E: Revenue from Government		
Appropriations:		
Special Appropriations	**100,380**	89,667
Departmental outputs	**13,349**	12,967
Total revenue from Government	**113,730**	102,634

Notes to and forming part of the financial statements
for the year ended 30 June 2012

Note 6: Other comprehensive income

	2012 $'000	2011 $'000
Note 6A: Changes in asset revaluation reserve		
Net asset revaluation	–	2,641
Make good revaluation	170	187
	170	2,828

Note 7: Financial assets

	2012 $'000	2011 $'000
Note 7A: Cash		
APRA official bank accounts	1,737	1,577
Cash on hand	2	2
Total cash and cash equivalents	1,739	1,579
Note 7B: Trade and other receivables		
Goods and services:		
Goods and services – related entities	203	45
Goods and services – external parties	2,501	2,641
Total receivables for goods and services	2,704	2,686
Appropriations receivable:		
For existing outputs	938	929
Special Appropriations	9	29
APRA Special Account	42,815	40,179
Total appropriations receivable	43,762	41,137
Other receivables:		
GST receivable from the Australian Taxation Office	47	144
Other	48	47
Total other receivables	95	191
Total trade and other receivables (gross)	46,561	44,014
Less: impairment allowance account:		
Appropriations receivable	–	(4)
Total impairment allowance account	–	(4)
Total trade and other receivables (net)	46,561	44,010

Note 7: Financial assets (Continued)

Note 7B: Trade and other receivables (Continued)

	2012 $'000	2011 $'000
Receivables are expected to be recovered in:		
No more than 12 months	**46,555**	44,010
More than 12 months	**6**	–
Total trade and other receivables (net)	**46,561**	44,010
Receivables are aged as follows:		
Not overdue	**46,509**	43,941
Overdue by:		
– 0 to 30 days	**1**	10
– 31 to 60 days	**10**	9
– 61 to 90 days	**2**	9
– more than 90 days	**39**	45
Total receivables (gross)	**46,561**	44,014
The impairment allowance account is aged as follows:		
– more than 90 days	**–**	(4)
Total impairment allowance account	**–**	(4)

Reconciliation of the impairment allowance account

Movements in relation to 2012	Other receivables $'000	Total $'000
Opening balance	**(4)**	**(4)**
Amounts written off	**4**	**4**
Closing balance	**–**	**–**

Notes to and forming part of the financial statements
for the year ended 30 June 2012

Note 7: Financial assets (Continued)

Note 7B: Trade and other receivables (Continued)

Movements in relation to 2011	Other receivables $'000	Total $'000
Opening balance	(6)	(6)
Amounts written off	6	6
Increase recognised in net surplus	(4)	(4)
Closing balance	**(4)**	**(4)**

Note 8: Non-financial assets

	2012 $'000	2011 $'000
Note 8A: Property, plant and equipment		
Computer hardware and office equipment		
– fair value	**1,382**	1,060
– accumulated depreciation	**(583)**	–
Total computer hardware and office equipment	**799**	1,060
Leasehold improvements		
– fair value	**7,717**	6,491
– accumulated depreciation	**(2,693)**	(1,387)
Total leasehold improvements	**5,024**	5,104
Total property, plant and equipment	**5,823**	6,164

No property, plant or equipment is expected to be sold or disposed of within the next 12 months.

Revaluations of non-financial assets

Revaluations are conducted in accordance with the revaluation policy stated in Note 1.15. The latest revaluation was undertaken by an independent valuer in May 2011.

Note 8: Non-financial assets (Continued)

Note 8B: Reconciliation of the opening and closing balances of property, plant and equipment – 2012

	Computer hardware and office equipment $'000	Leasehold improvements $'000	Total $'000
As at 1 July 2011			
Gross book value	**1,060**	**6,491**	**7,551**
Accumulated depreciation	–	(1,387)	(1,387)
Net book value 1 July 2011	**1,060**	**5,104**	**6,164**
Additions:			
By purchase	398	242	640
By capital incentive or additional make good provision	–	1,094	1,094
Depreciation expense	(648)	(1,399)	(2,047)
Disposals:			
Write-off (at cost)	(76)	(110)	(186)
Write-off (accumulated depreciation)	65	93	158
Net book value 30 June 2012	**799**	**5,024**	**5,823**
Net book value as of 30 June 2012 represented by:			
Gross book value	**1,382**	**7,717**	**9,099**
Accumulated depreciation	**(583)**	**(2,693)**	**(3,276)**
Net book value 30 June 2012	**799**	**5,024**	**5,823**

Notes to and forming part of the financial statements
for the year ended 30 June 2012

Note 8: Non-financial assets (Continued)

Note 8B: Reconciliation of the opening and closing balances of property, plant and equipment – 2011

	Computer hardware and office equipment $'000	Leasehold improvements $'000	Total $'000
As at 1 July 2010			
Gross book value	**4,727**	**6,696**	**11,423**
Accumulated depreciation	(3,027)	(2,997)	(6,024)
Net book value 1 July 2010	**1,700**	**3,699**	**5,399**
Additions:			
By purchase	191	–	191
Revaluations and impairments recognised in other comprehensive income	(65)	2,706	2,641
Depreciation expense	(756)	(1,301)	(2,057)
Disposals:			
Write-off (at cost)	(311)	(19)	(330)
Write-off (accumulated depreciation)	301	19	320
Net book value 30 June 2011	**1,060**	**5,104**	**6,164**
Net book value as of 30 June 2011 represented by:			
Gross book value	**1,060**	**6,491**	**7,551**
Accumulated depreciation	**–**	**(1,387)**	**(1,387)**
Net book value 30 June 2011	**1,060**	**5,104**	**6,164**

Note 8C: Intangibles

	2012 $'000	2011 $'000
Computer software:		
– internally developed – in progress	**3,375**	4,258
– internally developed – in use	**18,076**	13,950
– purchased – in progress	**–**	64
– purchased – in use	**6,501**	5,865
– accumulated amortisation	**(15,235)**	(12,515)
Total computer software	**12,717**	11,622
Total intangibles	**12,717**	11,622

No intangibles are expected to be sold or disposed of within the next 12 months.

Note 8: Non-financial assets (Continued)

Note 8D: Reconciliation of the opening and closing balances of intangibles – 2012

	Computer software internally developed $'000	Computer software purchased $'000	Total $'000
As at 1 July 2011			
Gross book value	**18,208**	**5,929**	**24,137**
Accumulated amortisation	(8,425)	(4,090)	(12,515)
Net book value 1 July 2011	**9,783**	**1,839**	**11,622**
Additions:			
By purchase	–	625	625
Internally developed	3,553	–	3,553
Amortisation	(2,354)	(729)	(3,083)
Disposals:			
Write-off (at cost)	(310)	(53)	(363)
Write-off (accumulated amortisation)	310	53	363
Net book value 30 June 2012	**10,982**	**1,735**	**12,717**
Net book value as of 30 June 2012 represented by:			
Gross book value	**21,451**	**6,501**	**27,952**
Accumulated amortisation	**(10,469)**	**(4,766)**	**(15,235)**
	10,982	**1,735**	**12,717**

Notes to and forming part of the financial statements
for the year ended 30 June 2012

Note 8: Non-financial assets (Continued)

Note 8D: Reconciliation of the opening and closing balances of intangibles – 2011

	Computer software internally developed $'000	Computer software purchased $'000	Total $'000
As at 1 July 2010			
Gross book value	**14,213**	**5,432**	**19,645**
Accumulated amortisation	(7,016)	(3,496)	(10,512)
Net book value 1 July 2010	**7,197**	**1,936**	**9,133**
Additions:			
By purchase	–	659	659
Internally developed	4,049	–	4,049
Impairments of internally developed software	(53)	–	(53)
Amortisation	(1,410)	(726)	(2,136)
Disposals:			
Write-off (at cost)	–	(163)	(163)
Write-off (accumulated amortisation)	–	133	133
Net book value 30 June 2011	**9,783**	**1,839**	**11,622**
Net book value as of 30 June 2011 represented by:			
Gross book value	**18,208**	**5,929**	**24,137**
Accumulated amortisation and impairment	**(8,425)**	**(4,090)**	**(12,515)**
	9,783	**1,839**	**11,622**

Note 8E: Other non-financial assets

	2012 $'000	2011 $'000
Prepayments	**1,964**	2,028
Total other non-financial assets	**1,964**	2,028
Total other non-financial assets are expected to be recovered in:		
– less than 12 months	**1,917**	1,944
– more than 12 months	**47**	84
Total other non-financial assets	**1,964**	2,028

Note 9: Payables

	2012 $'000	2011 $'000
Note 9A: Suppliers		
Operating lease rentals	**373**	388
Total supplier payables	**373**	388

Operating lease rentals payable relate to external parties and are expected to be settled in less than 12 months.

	2012 $'000	2011 $'000
Note 9B: Unearned fees and charges		
Unearned revenue	**1,036**	1,133
Total unearned fees and charges	**1,036**	1,133

Unearned fees and charges are expected to be settled in less than 12 months.

	2012 $'000	2011 $'000
Note 9C: Other payables		
Accrued expenses	**995**	2,289
Salaries and wages	**2,279**	1,917
Lease incentives	**552**	188
Total other payables	**3,826**	4,394
Other payables are expected to be settled in:		
– less than 12 months	**3,383**	4,242
– more than 12 months	**443**	152
Total other payables	**3,826**	4,394

Notes to and forming part of the financial statements
for the year ended 30 June 2012

Note 10: Provisions

	2012 $'000	2011 $'000
Note 10A: Employee provisions		
Leave	**26,953**	21,520
Bonus	**4,693**	4,534
Other	**354**	81
Total employee provisions	**32,000**	26,135
Employee provisions are expected to be settled in:		
– less than 12 months	**26,155**	21,334
– more than 12 months	**5,845**	4,801
Total employee provisions	**32,000**	26,135
Note 10B: Other provisions		
Provisions for make good	**2,881**	2,025
Total other provisions	**2,881**	2,025
Other provisions are expected to be settled in:		
– less than 12 months	**44**	117
– more than 12 months	**2,837**	1,908
Total other provisions	**2,881**	2,025

Reconciliation of other provisions	Provision for make good $'000	Total $'000
Carrying amount 1 July 2011	2,025	2,025
Additional provisions made	89	89
Amounts used	(110)	(110)
Unwinding of discount or change in rate	877	877
Closing balance 30 June 2012	**2,881**	**2,881**

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.

Note 11: Restructuring

	2012 $'000
Note 11A: Departmental restructuring	
Income	
Recognised by the receiving entity	2,710
Recognised by the losing entity - APRA	1,355
Total Income	4,065
Expenses	
Recognised by the receiving entity	2,710
Recognised by the losing entity - APRA	1,355
Total Expenses	4,065
Assets relinquished	
Cash paid (performance bonuses transferred to DHS)	178
Office equipment	6
Total assets relinquished	184
Liabilities relinquished	
Performance bonuses to staff transferred to DHS	178
Total liabilities relinquished	178
Net assets/(liabilities) relinquished	6

1 Responsibility for the early release of superannuation benefits on compassionate grounds was transferred to the Department of Human Services (DHS) from November 2011. To reflect this transfer, APRA's Special Appropriation was reduced by $2.71 million.

2 APRA transferred $216,720 in accrued annual and long service leave to DHS in 2010/11.

Note 11B: Administered restructuring

There was no administered restructuring in 2011/12.

Notes to and forming part of the financial statements
for the year ended 30 June 2012

Note 12: Statement of cash flows reconciliation

	2012 $'000	2011 $'000
Reconciliation of cash and cash equivalents as per *Balance sheet* to *Statement of cash flows*		
Cash as per		
Statement of cash flows	**1,739**	1,579
Balance sheet	**1,739**	1,579
Difference	**–**	–
Reconciliation of net cost of services to net cash from operating activities		
Net cost of services	**(116,200)**	(113,731)
Add: revenue from Government	**113,730**	102,634
Adjustments for non-cash items		
Depreciation/amortisation	**5,131**	4,193
Loss on disposal of assets	**26**	40
Impairment of internally developed software	**–**	53
Make good	**(868)**	187
Lease incentives	**(395)**	–
Change in assets/liabilities		
(Increase)/decrease in net receivables	**(2,551)**	8,829
Decrease in other non-financial assets	**64**	146
Increase in employee provisions	**5,865**	1,010
Increase/(decrease) in supplier payables	**(15)**	60
(Decrease) in unearned fees and charges	**(97)**	(585)
Increase/(decrease) in other payables	**(568)**	1,308
Increase/(decrease) in other provisions	**856**	(193)
Net cash from/(used by) operating activities	**4,978**	3,951

Note 13: Contingent assets and liabilities

	Claims for damages or costs	
	2012	2011
	$'000	$'000
Contingent assets		
Balance from previous period	**–**	–
New contingent assets recognised	**–**	–
Expired	**–**	–
Total contingent assets	**–**	–
Contingent liabilities		
Balance from previous period	**–**	–
New contingent liabilities recognised	**–**	–
Obligations expired	**–**	–
Total contingent liabilities	**–**	–
Net contingent assets/(liabilities)	**–**	–

Quantifiable contingencies

APRA has no quantifiable contingencies as at balance date.

Unquantifiable contingencies

At 30 June 2012, APRA had one workplace relations claim. The costs that might be incurred relate mainly to legal counsel and those associated with any legal proceedings. It is not possible to estimate the amount of any eventual payments that may be required in relation to this claim and therefore no amount has been included in the schedule of contingencies.

Significant remote contingencies

APRA has no significant remote contingencies as at balance date.

Notes to and forming part of the financial statements
for the year ended 30 June 2012

Note 14: Remuneration of APRA Members

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 2011/12 was Chairman $800,000 (2010/11: $646,710); Deputy Chairman $640,000 (2010/11: $541,120); and Member $600,200 (2010/11: $514,750). 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.

	2012	2011
The remuneration of APRA Members, measured in terms of the cost to APRA, is shown in the relevant remuneration bands:		
$510,000 to $539,999	**–**	1
$540,000 to $569,999	**–**	1
$600,000 to $629,999	**1**	–
$660,000 to $689,999	**1**	1
$900,000 to $929,999	**1**	–
Total	**3**	3
Total remuneration of APRA Members	**$2,223,959**	$1,745,596

Note 15: Remuneration of senior executives

	2012 $	2011 $
Note 15A: Remuneration expenses for senior executives[1]		
Short-term employee benefits:		
Salary (including annual leave)	**6,918,998**	6,548,279
Movement in annual leave provision	**125,739**	27,266
Performance bonus	**413,601**	392,907
Allowances	**2,508**	3,175
Total short-term employee benefits	**7,460,846**	6,971,627
Post-employment benefits:		
Superannuation	**766,986**	800,745
Total post-employment benefits	**766,986**	800,745
Other long-term benefits:		
Long-service leave accrued	**817,801**	235,489
Total other long-term benefits	**817,801**	235,489
Total	**9,045,633**	8,007,861

1 Note 15A was prepared on an accrual basis (therefore the performance bonus expenses disclosed above may differ from the cash 'Bonus paid' in Note 15B). Note 15A excludes acting arrangements and part-year service where total remuneration expensed for a senior executive was less than $150,000.

Notes to and forming part of the financial statements
for the year ended 30 June 2012

Note 15: Remuneration of senior executives (Continued)

Note 15B: Average annual reportable remuneration paid to senior executives during the reporting period

	2012					
Average annual reportable remuneration[1]	Senior Executives No.	Reportable salary[2] $	Contributed superannuation[3] $	Reportable allowances[4] $	Bonus paid[5]	Total[6] $
Total remuneration (including part-time arrangements):						
Less than $150,000	**3**	**88,268**	**14,120**	**–**	**–**	**102,388**
$150,000 to $179,999	**2**	**132,488**	**29,768**	**–**	**10,174**	**172,430**
$240,000 to $269,999	**7**	**218,170**	**27,058**	**–**	**12,242**	**257,470**
$270,000 to $299,999	**13**	**235,028**	**36,375**	**–**	**11,614**	**283,017**
$300,000 to $329,999	**1**	**234,417**	**48,724**	**–**	**18,373**	**301,514**
$360,000 to $389,999	**1**	**283,090**	**50,000**	**–**	**38,935**	**372,025**
$390,000 to $419,999	**2**	**332,982**	**65,793**	**258**	**14,664**	**413,697**
$420,000 to $449,999	**1**	**376,226**	**35,274**	**1,992**	**15,709**	**429,201**
Total	**30**					

	2011					
Average annual reportable remuneration[1]	Senior Executives No.	Reportable salary[2] $	Contributed superannuation[3] $	Reportable allowances[4] $	Bonus paid[5]	Total[6] $
Total remuneration (including part-time arrangements):						
Less than $150,000	2	107,610	27,488	–	6,953	142,051
$150,000 to $179,999	1	164,021	14,672	–	–	178,693
$180,000 to $209,999	2	159,878	41,983	83	408	202,352
$240,000 to $269,999	10	212,493	35,905	–	7,842	256,240
$270,000 to $299,999	8	233,447	32,941	–	15,993	282,381
$300,000 to $329,999	1	243,535	50,723	–	18,103	312,361
$390,000 to $419,999	3	324,605	63,870	1,003	18,324	407,802
$420,000 to $449,999	1	348,048	72,880	–	25,872	446,800
Total	28					

Note 15: Remuneration of senior executives (Continued)

1 This table reports on senior executives who received remuneration during the reporting period. Each row is an averaged figure based on headcount for individuals in the band.

2 Reportable salary includes the following:

(a) gross payments (less any bonuses paid, which are separated out and disclosed in the 'bonus paid' column);

(b) reportable fringe benefits (at the net amount prior to 'grossing up' to account for tax benefits); and

(c) exempt foreign employment income.

3 'Contributed superannuation' is the average actual superannuation contributions paid to senior executives in that reportable remuneration band during the reporting period, including any salary sacrificed amounts.

4 'Reportable allowances' are the average actual allowances paid as per the 'total allowances' line on individuals' payment summaries.

5 'Bonus paid' represents average actual bonuses paid during the reporting period in that reportable remuneration band. The 'bonus paid' within a particular band may vary between financial years due to various factors such as individuals commencing with or leaving APRA during the financial year.

6 Various salary sacrifice arrangements are available to senior executives including superannuation, motor vehicle and expense payment fringe benefits. Salary sacrifice benefits are reported in the 'reportable salary' column, excluding salary sacrificed superannuation, which is reported in the 'contributed superannuation' column.

Senior executives have the following leave entitlements:

- annual leave 20 days (2010/11: 20 days) each full year worked (pro-rata for part-time senior executives);
- unlimited personal leave; and
- long service leave (LSL) in accordance with *Long Service Leave (Commonwealth Employees) Act 1976*.

Notes to and forming part of the financial statements
for the year ended 30 June 2012

Note 15: Remuneration of senior executives (Continued)

Note 15C: Other highly paid staff

Average annual reportable remuneration[1,2]	Staff No.	Reportable salary $	Contributed superannuation $	Reportable allowances $	Bonus paid	Total $
	2012					
Total remuneration (including part-time arrangements):						
$150,000 to $179,999	**86**	**134,987**	**20,301**	**58**	**8,746**	**164,092**
$180,000 to $209,999	**45**	**162,131**	**23,117**	**57**	**9,874**	**195,179**
$210,000 to $239,999	**29**	**179,527**	**29,153**	**–**	**13,496**	**222,176**
$240,000 to $269,999	**6**	**197,942**	**39,019**	**162**	**12,803**	**249,926**
Total	**166**					

Average annual reportable remuneration[1,2]	Staff No.	Reportable salary $	Contributed superannuation $	Reportable allowances $	Bonus paid	Total $
	2011					
Total remuneration (including part-time arrangements):						
$150,000 to $179,999	69	133,184	21,439	70	9,878	164,571
$180,000 to $209,999	49	159,619	25,136	51	9,767	194,573
$210,000 to $239,999	14	177,345	33,323	–	15,169	225,837
$240,000 to $269,999	4	186,595	44,810	–	12,908	244,313
$300,000 to $329,999	1	226,787	47,418	–	29,277	303,482
Total	137					

1 This table reports staff:
(a) who were employed by APRA during the reporting period;
(b) whose reportable remuneration was $150,000 or more for the financial period; and
(c) were not required to be disclosed in Notes 15A or 15B.
Each row is an averaged figure based on headcount for individuals in the band.

2 Disclosures for other highly paid staff in Note15C are aligned with disclosures for senior executives in Note 15B.

Note 16: Remuneration of auditors

	2012 $'000	2011 $'000
Financial statement audit services were provided free of charge to APRA in 2011/12.		
Fair value of the services provided by:		
The Australian National Audit Office	**128**	125
Total	**128**	125

No other services were provided by the auditors of the financial statements.

Notes to and forming part of the financial statements
for the year ended 30 June 2012

Note 17: Financial instruments

	Notes	2012 $'000	2011 $'000

Note 17A: Categories of financial instruments

	Notes	2012 $'000	2011 $'000
Financial assets			
Loans and receivables:			
Cash		**1,739**	1,579
Trade receivables		**2,704**	2,686
Carrying amount of financial assets	18	**4,443**	4,265
Financial liabilities			
At amortised cost:			
Suppliers		**373**	388
Other payables		**3,274**	4,206
Carrying amount of financial liabilities		**3,647**	4,594

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

Note 17B: Credit risk

APRA's maximum exposure to credit risk at the reporting date is the carrying amount of the trade receivables reported in the *Balance sheet.* 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 2012 $'000	Not past due nor impaired 2011 $'000	Past due or impaired 2012 $'000	Past due or impaired 2011 $'000
Cash	**1,739**	1,579	**–**	–
Trade receivables	**2,652**	2,626	**52**	60
Total	**4,391**	4,205	**52**	60

Note 17: Financial instruments

Note 17B: Credit risk (Continued)

Ageing of financial assets that were past due but not impaired for 2012

	0 to 30 days $'000	31 to 60 days $'000	61 to 90 days $'000	90+ days $'000	Total $'000
Trade receivables	1	10	2	39	52
Total	**1**	**10**	**2**	**39**	**52**

Ageing of financial assets that were past due but not impaired for 2011

	0 to 30 days $'000	31 to 60 days $'000	61 to 90 days $'000	90+ days $'000	Total $'000
Trade receivables	2	8	9	41	60
Total	**2**	**8**	**9**	**41**	**60**

Note 17C: Liquidity risk

APRA is funded annually by appropriations from Government based on the actual cost of regulation of 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 17D: Market risk

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

Notes to and forming part of the financial statements
for the year ended 30 June 2012

Note 18: Financial assets reconciliation

	Notes	2012 $'000	2011 $'000
Financial assets			
Total financial assets as per balance sheet		**48,300**	45,589
Less: non-financial instrument components:			
Other GST receivable		**95**	191
Appropriation receivable		**43,762**	41,137
Impairment allowance		**–**	(4)
Total non-financial instrument components		**43,857**	41,324
Total financial assets as per financial instruments note	17	**4,443**	4,265

Note 19: Administered expenses

	2012 $'000	2011 $'000
Note 19: Waivers		
Supervisory Levy waivers	**963**	616
Impairment allowance adjustment	**(4)**	(1)
Total waivers	**959**	615
Levies and late payment penalties waived by levy type		
Superannuation funds	**890**	511
General insurers	**19**	102
Other	**50**	2
Total	**959**	615

Note 20: Administered income

	2012 $'000	2011 $'000
Revenue		
Taxation revenue		
Note 20A: Financial Institutions Supervisory Levies		
Current year levies and penalties (see Table 1)	**131,949**	116,382
Total Financial Institutions Supervisory Levies	**131,949**	116,382

Table 1: Financial Institutions Supervisory Levies revenue by type

	2012 $'000	2011 $'000
Levy:		
Superannuation funds	**46,984**	37,658
Authorised deposit-taking institutions	**45,695**	42,006
Life insurers and friendly societies	**12,783**	11,429
General insurers	**26,267**	25,233
Total levies	**131,729**	116,326
Late payment penalties:		
Superannuation funds	**220**	56
Total late payment penalties	**220**	56
Total current year levies and penalties	**131,949**	116,382

Note 20B: Financial Assistance Levy

	2012 $'000	2011 $'000
Current year levies	**–**	54,925
Total Financial Assistance Levy	**–**	54,925
Late payment penalties	**20**	–
Total late payment penalties	**20**	–
Total current year levies and penalties	**20**	54,925

Notes to and forming part of the financial statements
for the year ended 30 June 2012

Note 21: Administered financial assets

	2012 $'000	2011 $'000
Financial assets		
Receivables		
Financial Institutions Supervisory Levies	9	29
Financial Assistance Levy	2,192	54,530
Total receivables (gross)	2,201	54,559
Less: impairment allowance account		
Supervisory Levies	–	(4)
Total receivables (net)	2,201	54,555
Receivables were aged as follows:		
Not overdue	9	54,546
Overdue by:		
- 0 to 30 days	–	8
- 31 to 60 days	–	1
- more than 90 days	2,192	4
Total receivables (gross)	2,201	54,559
The impairment allowance account is aged as follows:		
- more than 90 days	–	(4)
Total impairment allowance account	–	(4)

Reconciliation of the impairment allowance account:

Movements in relation to 2012	Receivables $'000	Total $'000
Opening balance	(4)	(4)
Amounts written off	4	4
Closing balance	–	–

Movements in relation to 2011	Receivables $'000	Total $'000
Opening balance	(6)	(6)
Amounts written off	6	6
(Increase) recognised in net surplus	(4)	(4)
Closing balance	(4)	(4)

Note 22: Administered statement of cash flows reconciliation

	2012 $'000	2011 $'000
Reconciliation of cash as per *Administered schedule of assets and liabilities* to *Administered statement of cash flows*		
Cash as per:		
Administered statement of cash flows	–	–
Administered schedule of assets and liabilities	–	–
Difference	–	–
Reconciliation of net cost of services to net cash from operating activities:		
Net cost of services	**131,010**	170,692
Changes in assets / liabilities		
(Increase) / decrease in net receivables	**52,354**	(54,515)
Net cash from operating activities	**183,364**	116,177

Notes to and forming part of the financial statements
for the year ended 30 June 2012

Note 23: Administered – financial instruments

	Notes	2012 $'000	2011 $'000
Note 23A: Categories of financial instruments			
Financial assets			
Loans and receivables:			
Receivables	24	**2,201**	54,559
Carrying amount of financial assets		**2,201**	54,559

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

Note 23B: Credit risk

The maximum exposure to credit risk at the reporting date is the carrying amount of levy receivable as recognised in the *Administered schedule of assets and liabilities*. There is no significant exposure 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 2012 $'000	Not past due nor impaired 2011 $'000	Past due or impaired 2012 $'000	Past due or impaired 2011 $'000
Receivables	**9**	54,546	**2,192**	13
Total	**9**	54,546	**2,192**	13

Note 23: Administered – financial instruments (Continued)

Note 23B: Credit risk (Continued)

Ageing of financial assets that were past due but not impaired for 2012

	0 to 30 days $'000	31 to 60 days $'000	61 to 90 days $'000	90+ days $'000	Total $'000
Receivable	–	–	–	2,192	2,192
Total	–	–	–	2,192	2,192

Ageing of financial assets that were past due but not impaired for 2011

	0 to 30 days $'000	31 to 60 days $'000	61 to 90 days $'000	90+ days $'000	Total $'000
Receivable	8	1	–	4	13
Total	8	1	–	4	13

Note 23C: Liquidity risk

There are no administered financial liabilities and therefore there is no exposure to any liquidity risk.

Note 23D: Market risk

There is no exposure to any form of currency risk, interest rate risk or other price risk.

Notes to and forming part of the financial statements
for the year ended 30 June 2012

Note 24: Administered financial assets reconciliation

	Notes	2012 $'000	2011 $'000
Financial assets			
Total financial assets as per *Administered schedule of assets and liabilities*		**2,201**	54,555
Less: non-financial instrument components			
Impairment allowance		**–**	(4)
Total non-financial instrument components		**–**	(4)
Total financial assets as per financial instruments note	23	**2,201**	54,559

Note 25: Appropriations

Table A: Annual appropriations ('recoverable GST exclusive')

	2012 Appropriations					
	Appropriation Act		*FMA Act*			
	Annual Appropriation $'000	Appropriations reduced $'000	Section 31 $'000	Total appropriation $'000	Appropriation applied in 2012 (current and prior years) $'000	Variance[1] $'000
Departmental						
Ordinary annual services	**13,289**	**–**	**8,110**	**21,399**	**21,390**	**9**
Other services						
Equity	**–**	**–**	**–**	**–**	**–**	**–**
Total departmental	**13,289**	**–**	**8,110**	**21,399**	**21,390**	**9**
Administered						
Other services						
New administered outcomes	**–**	**–**	**–**	**–**	**–**	**–**
Total administered	**–**	**–**	**–**	**–**	**–**	**–**

	2011 Appropriations					
	Appropriation Act		*FMA Act*			
	Annual Appropriation $'000	Appropriations reduced $'000	Section 31 $'000	Total appropriation $'000	Appropriation applied in 2011 (current and prior years) $'000	Variance[1] $'000
Departmental						
Ordinary annual services	12,575	–	8,417	20,992	20,786	206
Other services						
Equity	1,457	–	–	1,457	1,457	–
Total departmental	**14,032**	**–**	**8,417**	**22,449**	**22,243**	**206**
Administered						
Other services						
New administered outcomes	–	–	–	–	–	–
Total administered	**–**	**–**	**–**	**–**	**–**	**–**

1 The variance between the total appropriation and the appropriation applied is made up of the prior year appropriation receivable applied in the current year less the current year appropriation receivable.

Notes to and forming part of the financial statements
for the year ended 30 June 2012

Note 25: Appropriations (Continued)

Table B: Unspent departmental annual appropriations ('recoverable GST exclusive')

Authority	2012 $'000	2011 $'000
Departmental		
Appropriation Act (No. 1) 2011/12	**938**	–
Appropriation Act (No. 1) 2010/11	**–**	929
Appropriation Act (No. 2) 2010/11	**–**	1,457
Appropriation Act (No. 2) 2009/10	**–**	30
Appropriation Act (No. 3) 2009/10	**–**	60
Total	**938**	2,476

Table C: Special appropriations ('recoverable GST exclusive')

			Appropriation applied	
Authority	Type	Purpose	2012 $'000	2011 $'000
Australian Prudential Regulation Authority Act 1998 – section 50, Departmental	Unlimited	To provide an appropriation for levy money received that exceeds the amount determined by the Minister under section 50(1) of the *Australian Prudential Regulation Act 1998*.	**100,397**	89,682
Financial Management and Accountability Act 1997 – section 28, Administered	Refund	To provide an appropriation for the repayment of overpaid levies and incorrect deposits received by APRA.	**1**	75
Total			**100,398**	89,757

Table D: Reduction in administered items ('recoverable GST exclusive')

There were no reductions of administered items in 2012 or in 2011.

Note 26: Special Accounts

	APRA Special Account (Departmental)[1]		Financial Claims Scheme Special Account (Administered)[2]		Lloyd's Deposit Trust Special Account (Special Public Money)[3]		Services for Other Entities and Trust Moneys (Special Public Money)[4]	
	2012 $'000	2011 $'000	**2012 $'000**	2011 $'000	**2012 $'000**	2011 $'000	**2012 $'000**	2011 $'000
Balance brought forward from previous period	**41,756**	49,530	**1,451**	1,524	**2,000**	2,000	**–**	–
Increases:								
Departmental								
Special appropriation for reporting period	**100,397**	89,682	**–**	–	**–**	–	**–**	–
Appropriation Act No.1	**21,390**	20,063	**–**	–	**–**	–	**–**	–
Appropriation Act No.2	**–**	1,457	**–**	–	**–**	–	**–**	–
Appropriation Act No.3	**–**	723	**–**	–	**–**	–	**–**	–
Total departmental increases	**121,787**	111,925	**–**	–	**–**	–	**–**	–
Administered								
Special appropriation for reporting period	**–**	–	**200**	–	**–**	–	**–**	–
Total administered increases	**–**	–	**200**	–	**–**	–	**–**	–
Available for payments	**163,543**	161,455	**1,651**	1,524	**2,000**	2,000	**–**	–
Decreases:								
Departmental								
Payments made - employees	**(83,584)**	(80,736)	**–**	–	**–**	–	**–**	–
Payments made - suppliers	**(30,589)**	(34,064)	**–**	–	**–**	–	**–**	–
Payments made - purchase assets	**(4,818)**	(4,899)						
Total departmental decreases	**(118,991)**	(119,699)	**–**	–	**–**	–	**–**	–
Administered								
Repayments made from the Special Account	**–**	–	**(1,358)**	(73)	**–**	–	**–**	–
Total administered decreases	**–**	–	**(1,358)**	(73)	**–**	–	**–**	–
Total balance carried to the next period	**44,552**	41,756	**293**	1,451	**2,000**	2,000	**–**	–

Notes to and forming part of the financial statements
for the year ended 30 June 2012

Note 26: Special Accounts (Continued)

1 Appropriation: *Financial Management and Accountability Act 1997,* section 21.
Establishing Instrument: *Australian Prudential Regulation Authority Act 1998,* section 52.
Purpose: To pay the costs and other obligations incurred by APRA in the performance of its functions or the exercise of its powers; to pay any remuneration or allowances payable to persons appointed or engaged under the APRA Act; and to make any other payments that APRA is authorised or required to make under the APRA Act or any other law of the Commonwealth.

2 Appropriation: *Financial Management and Accountability Act 1997,* section 21.
Establishing Instrument: *Australian Prudential Regulation Authority Act 1998,* section 54A.
Purpose: To meet account-holders' entitlements under Subdivision C (Payment of account-holders with declared ADI) of Division 2AA of Part II of the *Banking Act 1959;* meet persons' entitlements under Division 3 (Early payment of claims) of Part VC of the *Insurance Act 1973*; pay APRA's agents or delegates amounts equal to the entitlements the agents or delegates meet on APRA's behalf or in the performance of APRA's delegated functions; and repayment of principal, interest and other costs connected with the borrowings under Division 2 of the APRA Act.

3 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.*
Responsibility for the administration of the Lloyd's Deposit Trust Special Account was transferred from the Department of Treasury to APRA with effect from 26 May 2008. The market valuation as at 30 June 2012 for Lloyd's inscribed stock is $2,078,380 (2011: $2,078,740).

4 Appropriation: *Financial Management and Accountability Act 1997,* section 20.
Establishing Instrument: *Financial Management and Accountability 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.

Note 27: Compensation and debt relief

	2012 $'000	2011 $'000
Compensation and debt relief - Departmental		
Nil payments were made during the reporting period (2011: Nil payments made).	–	–
Compensation and debt relief - Administered		
31 waivers of amounts owing to the Government were made pursuant to section 12 of the *Financial Institutions Supervisory Levies Collection Act 1998* (2011: 144 waivers).	**958,856**	614,598

No other debt relief was made during the reporting period (2011: Nil payments made).

Notes to and forming part of the financial statements
for the year ended 30 June 2012

Note 28: Assets held in trust

Monetary assets
Lloyd's inscribed stock is held by APRA in trust. Responsibility for the administration of the Lloyd's Deposit Trust Special Account was transferred from the Department of Treasury to APRA with effect from 26 May 2008. The purpose is to disburse amounts in accordance with section 92Q of the *Insurance Act 1973*.

Non-monetary assets
APRA has no non-monetary assets held in trust.

	2012 $'000	2011 $'000
Lloyd's inscribed stock		
Total amount held at the beginning of the reporting period	**2,000**	2,000
Receipts	**130**	115
Payments	**(130)**	(115)
Total amount held at the end of the reporting period	**2,000**	2,000
Total	**2,000**	2,000

The market valuation as at 30 June 2012 for Lloyd's inscribed stock is $2,078,380 (2011: $2,078,740).

Note 29: Reporting of outcomes

Note 29A: 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.

	2012 $'000	2011 $'000	2012 $'000	2011 $'000
	Outcome 1		Total	
Departmental				
Expenses	**121,119**	118,349	**121,119**	118,349
Own-source income	**4,919**	4,618	**4,919**	4,618
Administered				
Expenses	**959**	615	**959**	615
Own-source income	**131,969**	171,307	**131,969**	171,307
Net cost/(contribution) of outcome delivery	**(14,810)**	(56,961)	**(14,810)**	(56,961)

Notes to and forming part of the financial statements
for the year ended 30 June 2012

Note 30: Competitive neutrality and cost recovery

	2012 $'000	2011 $'000
Receipts Subject to Cost Recovery Policy		
Other cost recovery arrangements		
Statistical information provided to RBA	**493**	250
Statistical information provided to ABS	**323**	442
Assessment of models-based capital adequacy requirements for ADIs - Basel II	**2,100**	2,200
Total receipts subject to cost recovery policy	**2,916**	2,892

Note 31: Compliance with statutory conditions for payments from the Consolidated Revenue Fund

Section 83 of the Constitution provides that no amount may be paid out of the Consolidated Revenue Fund except under an appropriation made by law. The Department of Finance and Deregulation provided information to all agencies in 2011 regarding the need for risk assessments in relation to compliance with statutory conditions on payments from Special Appropriations, including Special Accounts.

During 2011/12, APRA reviewed its exposure to risks of not complying with statutory conditions on payments from appropriations. The review involved:

- identifying each Special Appropriation and Special Account;
- determining the risk of non-compliance by assessing the difficulty of administering the statutory conditions and assessing the extent to which existing payment systems and processes satisfy those conditions;
- determining procedures to confirm risk assessments in medium risk cases and to quantify the extent of non-compliance, if any, in higher risk situations;
- obtaining legal advice as appropriate to resolve questions of potential non-compliance; and
- considering legislative or procedural changes to reduce the risk of non-compliance in the future to an acceptably low level.

APRA's appropriations involving statutory conditions for payment comprise:

- APRA Special Appropriations;
- refunds of receipts (s28 FMA);
- APRA Special Account;
- Financial Claims Scheme Special Account;
- Lloyd's Deposit Trust Special Account; and
- Services for Other Entities and Trust Moneys (Special Public Money) Account.

As at 30 June 2012, the review had been completed in respect of all appropriations with statutory conditions for payment.

The review identified no issues of compliance with Section 83.

Australian National Audit Office

INDEPENDENT AUDITOR'S REPORT

To the Minister for Financial Services and Superannuation

I have audited the accompanying financial statements of the Australian Prudential Regulation Authority for the year ended 30 June 2012, which comprise: a Statement by the Members and Chief Financial Officer; Statement of Comprehensive Income; Balance Sheet; Statement of Changes in Equity; Statement of Cash Flows; Schedule of Commitments; Schedule of Contingencies; Administered Schedule of Comprehensive Income; Administered Schedule of Assets and Liabilities; Administered Reconciliation Schedule; Administered Statement of Cash Flows; Administered Schedule of Commitments; Administered Schedule of Contingencies and Notes comprising a Summary of Significant Accounting Policies and other explanatory information.

Chairman's Responsibility for the Financial Statements

The Chairman of the Australian Prudential Regulation Authority is responsible for the preparation of financial statements that give a true and fair view in accordance with the Finance Minister's Orders made under the *Financial Management and Accountability Act 1997*, including the Australian Accounting Standards, and for such internal control as is necessary to enable the preparation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

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 about 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 considers internal control relevant to the Australian Prudential Regulation Authority's preparation of the financial statements that give a true and fair view 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 Australian Prudential Regulation

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Authority's internal control. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of accounting estimates made by the Chairman of the Australian Prudential Regulation Authority, 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 my audit, I have followed the independence requirements of the Australian National Audit Office, which incorporate the requirements of the Australian accounting profession.

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 2012 and of 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

21 August 2012

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 Act 1991* and *Work Health and Safety Act 2011;*
- *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*;
- the number of times during the year that APRA determined, under subsection 13(1) of the *Financial Sector (Collection of Data) Act 2001,* a reporting standard that is not a legislative instrument; 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 2011/12. 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]. Payments totaling $1,358,137 were made from the Financial Claims Scheme Special Account in 2011/12 to satisfy claims against the general insurer.

APRA did not determine any reporting standards under subsection 13(1) of the *Financial Sector (Collection of Data) Act 2001* during 2011/12 that were not legislative instruments.

APRA did not exercise its powers under Part 15 of the RSA Act in 2011/12.

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
A13 of 2011	01/07/2011	Regulation 9.29
A15 of 2011	03/08/2011	Regulation 6.34
A16 of 2011	29/07/2011	Section 93(4)
A17 of 2011	21/12/2011	Regulation 6.34
A18 of 2011	21/12/2011	Regulation 6.37
A19 of 2011	21/12/2011	Regulation 6.37
A20 of 2011	21/12/2011	Section 93(1)
A1 of 2012	03/01/2012	Regulation 9.29(1)
A2 of 2012	03/02/2012	Regulation 7.04(3)
A3 of 2012	11/05/2012	Regulation 6.18(3)
A4 of 2012	29/06/2012	Regulation 9.04D
A5 of 2012	29/06/2012	Regulation 9.29(1)(B)
A6 of 2012	28/06/2012	Regulation 9.04D(3)
A7 of 2012	29/06/2012	Regulations 9.29D(1) and 9.30(2)

Modification declaration number – particular entity	Date	Provision of SIS regulations modified
A9 of 2011	07/07/2011	Regulation 6.17(2)(a)(i)
A10 of 2011	22/08/2011	Regulation 6.17(2)(a)(i)
A11 of 2011	27/09/2011	Regulation 1.03
A12 of 2011	07/11/2011	Regulation 6.17(2)(a)(i)
A13 of 2011	28/11/2011	Regulations 6.20A, 6.21, 7A.03J, 7A.03K, 7A.12 and 7A.13
A14 of 2011	20/12/2011	Regulation 6.17(2)(a)(i)
A1 of 2012	24/01/2012	Regulation 6.17(2)(a)(i)
A2 of 2012	21/02/2012	Regulation 6.17(2)(a)(i)
A3 of 2012	29/03/2012	Section 89(2)
A6 of 2012	16/06/2012	Regulation 9.25
A8 of 2012	28/06/2012	Regulation 1.07(D)(1)(d)
A9 of 2012	29/06/2012	Section 89(2)

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, printer cartridges and office furniture; and staff awareness on environmental issues.

APRA has an Environmental Issues Subgroup (EIS) that examines environmental issues in APRA's day-to-day operations referred to it by staff, as well as areas where APRA could further reduce wastage and carbon emissions. During 2011/12, the EIS was active in encouraging recycling, continuing to provide education about environmental alternatives and promoting the recycling of mobile phones.

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

EEO staff data – staff diversity as at 30 June 2012*

Level	Female	Male	ATSI	NESB1	NESB2	PWD
Level 1	18	12	0	9	0	0
Level 2	71	30	0	17	0	1
Level 3	77	85	0	57	3	1
Level 4	79	147	1	47	2	2
Senior	20	78	0	9	2	2
Executive	1	6	0	1	0	0
Total	**266**	**358**	**1**	**140**	**7**	**6**

* Includes permanent and fixed-term staff but excludes casuals.

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

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

Workplace diversity program report

APRA has maintained an innovative approach to meeting its responsibilities under the EEO Act through a comprehensive workplace diversity strategy across the organisation. APRA fosters an inclusive and flexible workplace 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.

APRA encourages staff to balance their work and personal commitments through offering a range of flexible work arrangements, such as coreless variable hours, a compressed working 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 and adoption leave, two weeks paid partner's leave and a 'Keeping-in-Touch' program that allows women to stay connected while on maternity leave. APRA partners with a service provider to provide support to staff who have dependants and require care arrangements, whether for children or senior dependants. 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.

APRA is a member of Diversity Council Australia, an independent, not-for-profit diversity adviser to business, and partners with it on a number of diversity initiatives to ensure that APRA stays current and consistent with industry benchmarks. Diversity Council Australia also provides APRA's Staff Consultative Group and selected human resources staff with specialist training to perform the important role of Contact Officers. APRA's Contact Officers are available to provide confidential and impartial assistance to any staff with workplace diversity concerns at APRA.

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 2011/12, APRA dealt with 98 applications for access to documents under the FOI Act and one application for internal review. Of the 98, two were on hand at the beginning of the period and the other 96 were new applications. Five applicants disagreed with APRA's decision on access to documents and applied to the Information Commissioner for review under Part VII of the FOI Act. The Commissioner decided not to undertake a review for one of these applications and has yet to determine the remaining four applications. The Commissioner also affirmed a decision made by APRA in 2010/11.

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

Granted in full	15
Granted in part	13
Access refused	43
Withdrawn	16
Transferred to another agency	0
On hand at 30 June 2012	11
Total	**98**

Charges collected were $589 and the estimated cost of handling initial FOI requests and internal review requests in 2011/12 was approximately $58,756.

Information Publication Scheme

APRA is required to publish certain information on its website as part of the Information Publication Scheme. This includes information about its structure, functions and statutory appointments; 'operational information' that guides its decisions or recommendations that affect members of the public; and information about how the public can comment on its prudential policy proposals. The requirement, in Part II of the FOI Act, has replaced the former requirement to publish a Section 8 statement in the annual report.

APRA's information publication plan shows the information APRA publishes in accordance with these Scheme requirements and is accessible from the APRA website.

Occupational Health and Safety Act 1991 (OHS Act) and *Work Health and Safety Act 2011* (WHS Act)

The WHS Act replaced the OHS Act from 1 January 2012. APRA is reporting under the OHS Act for the first six months of 2011/12 and under the WHS Act for the second six months.

Details of investigations and other matters as prescribed

In compliance with reporting obligations under section 74 of the OHS Act and Schedule 2, Part 4 of the WHS 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

APRA has been working to ensure that the following areas comply with the new WHS Act: terms and training of health and safety representatives; policies and guidelines; terms of reference of the Work Health and Safety Committee; education of staff about roles and responsibilities under the new legislation; and resolution procedures for work health and safety issues.

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

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

During 2011/12, a new online ergonomic assessment tool was fully implemented across APRA. This tool helps to identify any health and safety risk with respect to desk-based work through a short online survey completed by staff. Workstation assessments carried out after completion of the survey revealed that only minimal modifications to desk-based work were required in most instances.

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. Two new First-Aid Officers were trained in 2011/12.

Comprehensive health assessments continue to be 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 'cardiac risk assessment' 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 2011/12, 43 per cent of staff accepted this offer compared with 45 per cent the previous year.

WHS 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 WHS Committee with four staff and four management representatives.

The WHS 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, four incidents were notified to APRA, none of which required a report to Comcare under section 68 of the OHS Act or under Part 3 of the WHS 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 the amounts paid to advertising agencies, market research and media advertising organisations. In 2011/12, APRA paid $116,237 to Adcorp Australia Ltd for recruitment advertising. APRA conducted no advertising campaigns during 2011/12.

Agency resources and expenses by outcome

See pages 164-165.

Auditor-General's activities

The Australian National Audit Office (ANAO) undertook the required statutory financial audit of APRA for 2011/12. APRA was included as a respondent to two performance audits. The first was on the *Administration of Grant Reporting Obligations.* APRA has updated its website as a result of this report. The second was on the *Development and Approval of Grant Program Guidelines.* APRA supported the recommendations of the report and noted that its grant program is modest.

Collective Agreements and common law contracts

As at 30 June 2012, 534 staff were covered by the collective *APRA Employment Agreement*, *2011*. One hundred and two senior staff were covered by common law agreements.

All staff are appointed under the *APRA Act 1998*. 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 2012 were:

Level 4	$115,024 – $191,672
Level 3	$80,600 - $134,264
Level 2	$54,912 - $91,520
Level 1	$38,272 - $63,752

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, reporting and data collection procedures and processes are in place; and
- APRA has taken all reasonable measures to minimise the incidence of fraud and to investigate and recover the proceeds of fraud.

Commonwealth Ombudsman

In 2011/12, the Commonwealth Ombudsman did not commence any new investigations into APRA's conduct. There were three outstanding investigations from 2010/11 related to applications for the early release of superannuation benefits. With the transfer of the early release function to the Department of Human Services from 1 November 2011, these applications will be reported on by the Department of Human Services.

Commonwealth Procurement Guidelines

The *APRA Chairman's Finance Instructions and Finance 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 2011/12, 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 Finance Policies*, and associated operational procedures, include specific provisions on consultants.

APRA engages consultants where it lacks specialist expertise or when independent research, review or assessment is required. Consultants are typically engaged to investigate or diagnose a defined issue or problem; carry out defined reviews or evaluations; or provide independent advice, information or creative solutions to assist in APRA's decision-making.

Prior to engaging consultants, APRA takes into account the skills and resources required for the task, the skills and resources available in-house, and the cost-effectiveness of engaging external expertise. The decision to engage a consultant is made in accordance with the FMA Act and related regulations, including the *Commonwealth Procurement Guidelines*, and with internal policies.

During 2011/12, APRA entered into 35 new consultancy contracts involving total actual expenditure of $1.06 million. In addition, 13 ongoing consultancy contracts were active during the year, involving total actual expenditure of $2.05 million. Total expenditure on consultancies in 2011/12 was $3.11 million, including $0.99 million of capitalised expenses.

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 2011/12, APRA fully met the requirements of the Office of Best Practice Regulation (OBPR) for Regulation Impact Statements on new legislative instruments (one in number). In addition, APRA completed 14 preliminary assessments for other regulations made or tabled during this period, for which the OBPR advised that further regulation analysis was required in one matter.

Courts and tribunals

Over 2011/12, there were no judicial decisions that had or may have a significant effect on APRA's operations.

The section of this *Report* headed *APRA's supervisory activities in 2011/12* contains details of court and tribunal decisions relating to enforcement action taken by APRA during the year.

Executive and consultative committees from 1 July 2011 to 30 June 2012

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 recognition, 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.

Licensing Group

This Group, 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.

Work Health and Safety Committee

This Committee, which includes both staff and management representatives, focusses 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 overarching 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) Cooperative Actuarial Scholarship;
- Australian Research Council Linkage Grants with UNSW and the 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 recipients is on APRA's website at www.apra.gov.au/AboutAPRA/WorkingAtAPRA/Pages/briangray-scholarship-program.aspx. Information on other grants awarded by APRA is available on APRA's website at www.apra.gov.au/AboutAPRA/Pages/grants-and-scholarships.aspx.

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 2011/12, APRA's total expenditure on external legal advice and litigation services was $2.50 million (including GST).

National Disability Strategy

Since 1994, Commonwealth departments and agencies have reported on their performance as policy adviser, purchaser, employer, regulator and provider under the Commonwealth Disability Strategy. In 2007/08, reporting on the employer role was transferred to the Australian Public Service Commission's State of the Service Report and the APS Statistical Bulletin. These reports are available at www.apsc.gov.au. From 2010/11, APRA is no longer required to report on its performance under these various roles.

The Commonwealth Disability Strategy has been overtaken by a new National Disability Strategy that sets out a 10-year national policy framework for improving life for Australians with disability, their families and carers. A high-level report to track progress of people with disability will be produced by the Standing Council on Community, Housing and Disability Services for the Council of Australian Governments and will be available at www.fahcsia.gov.au. The Social Inclusion Measurement and Reporting Strategy agreed by the Government in December 2009 will also include some reporting on disability matters in the regular *How Australia is Faring* report and, if appropriate, in strategic change indicators in APRA's annual reports. More detail on social inclusion matters can be found at www.socialinclusion.gov.au.

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, 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.

APRA also 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 this Act is included in its Human Resources Policy Manual and Code of Conduct. 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.

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 2011/12, APRA Members and officers made themselves available for public hearings before the:

- Senate Economics Legislation Committee (sitting as Senate Estimates) on 20 October 2011, 16 February 2012 and 29 May 2012;
- House of Representatives Standing Committee on Social Policy and Legal Affairs in its inquiry into the operation of the insurance industry during disaster events on 24 November 2011;
- Parliamentary Joint Committee on Corporations and Financial Services in its inquiry into the collapse of Trio Capital on 30 August 2011, 6 September 2011 and 4 April 2012; and
- Parliamentary Joint Committee on Corporations and Financial Services in its inquiry into Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011 on 2 March 2012.

In August 2011, APRA made a submission to the Parliamentary Joint Committee on Corporations and Financial Services inquiry into the collapse of Trio Capital.

In May 2012, APRA also made a submission to the Senate Economics References Committee's inquiry into the effects if the global financial crisis on the Australian banking sector.

Transcripts of APRA's appearances before, and copies of its submissions to, parliamentary committees may be downloaded from the Parliament of Australia's website www.aph.gov.au.

Performance pay

APRA has a performance bonus system, designed in consultation with staff and management and covering all employees. For 2011/12, the aggregate bonus pool was $4.69 million. Under deferred bonus arrangements introduced in the APRA Employment Agreement, 2011/12 bonuses will be paid in December 2012 to eligible staff still in APRA's employ at that date.

Privacy Commission

There were no investigations by the Privacy Commissioner under section 40 of the *Privacy Act 1988* during 2011/12. No reports were served under section 30 of the Act. The Privacy Commissioner made no determinations under section 52, nor did APRA seek any under section 73.

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 Group
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, Deputy Prime Minister and Treasurer of the Commonwealth of Australia, has portfolio responsibility for APRA.

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

Staff statistics

Staff by location and full-time/part-time as at 30 June 2012*

Location	Full-time	Part-time	Total
Adelaide	5	1	6
Brisbane	14	1	15
Canberra	3	0	3
Melbourne	62	7	69
Perth	3	2	5
Sydney	486	40	526
Total	**573**	**51**	**624**

Staff by division and full-time/part-time as at 30 June 2012*

Division	Full-time	Part-time	Total
Corporate	111	12	123
Diversified Institutions	116	5	121
Policy, Research and Statistics	89	11	100
Specialised Institutions	134	10	144
Supervisory Support	123	13	136
Total	**573**	**51**	**624**

* Includes permanent and fixed-term staff but excludes casuals.

Full-time equivalent (FTE) staff strength as at 30 June 2012

Permanent	590.6
Fixed-term	14.0
Casual	1.6
Total	**606.3**

Agency resources and expenses by outcome

Under the *Requirements for annual reports for departments, executive agencies and FMA Act bodies*, issued by the Department of Prime Minister and Cabinet, APRA must provide information outlining it's various funding sources during the financial year and total expenses for each Agency outcome. To this end, APRA's Agency Resource Statement and Expenses by Outcome Statement for 2011/12 are set out below.

Agency Resource Statement

		Actual available appropriation $'000	Payments made $'000	Balance remaining $'000
		(a)	(b)	(a) – (b)
Ordinary annual services[1]				
Departmental appropriation		22,328	21,390	938
Total		**22,328**	**21,390**	**938**
Total ordinary annual services	**A**	**22,328**	**21,390**	
Special Accounts				
Opening balance		41,756		
Appropriation receipts		21,390		
Non-appropriation receipts		100,397		
Payments made			118,991	
Total Special Account	**B**	**163,543**	**118,991**	**44,552**
Total resources and payments				
A+B		185,871	140,381	
Less appropriations drawn from annual or special appropriations above and credited to special accounts		21,390	21,390	
Total net resourcing and payments for APRA		**164,481**	**118,991**	

1 This combines Appropriation Bill (No.1) 2011/12, and relevant prior and current year receipts from independent sources.

Expenses by Outcome Statement

Outcome 1: Enhanced public confidence in Australia's financial institutions through a framework of prudential regulation which balances financial safety and efficiency, competition, contestability and competitive neutrality.	Budget $'000	Actual expenses $'000	Variation $'000
	(a)	(b)	(a) – (b)
Program 1.1: Australian Prudential Regulation Authority			
Departmental expenses			
Departmental appropriation[1]	17,868	17,868	–
Special Accounts	95,211	95,211	–
Expenses not requiring appropriation in the budget year	3,823	8,040	(4,217)
Total expenses for Outcome 1	**116,902**	**121,119**	**(4,217)**
	2010/11	**2011/12**	
Average staffing level (number)	619	606	12

1 Departmental appropriation combines 'Ordinary annual services (Appropriation Bill No. 1)' and 'Revenue from independent sources'.

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*.

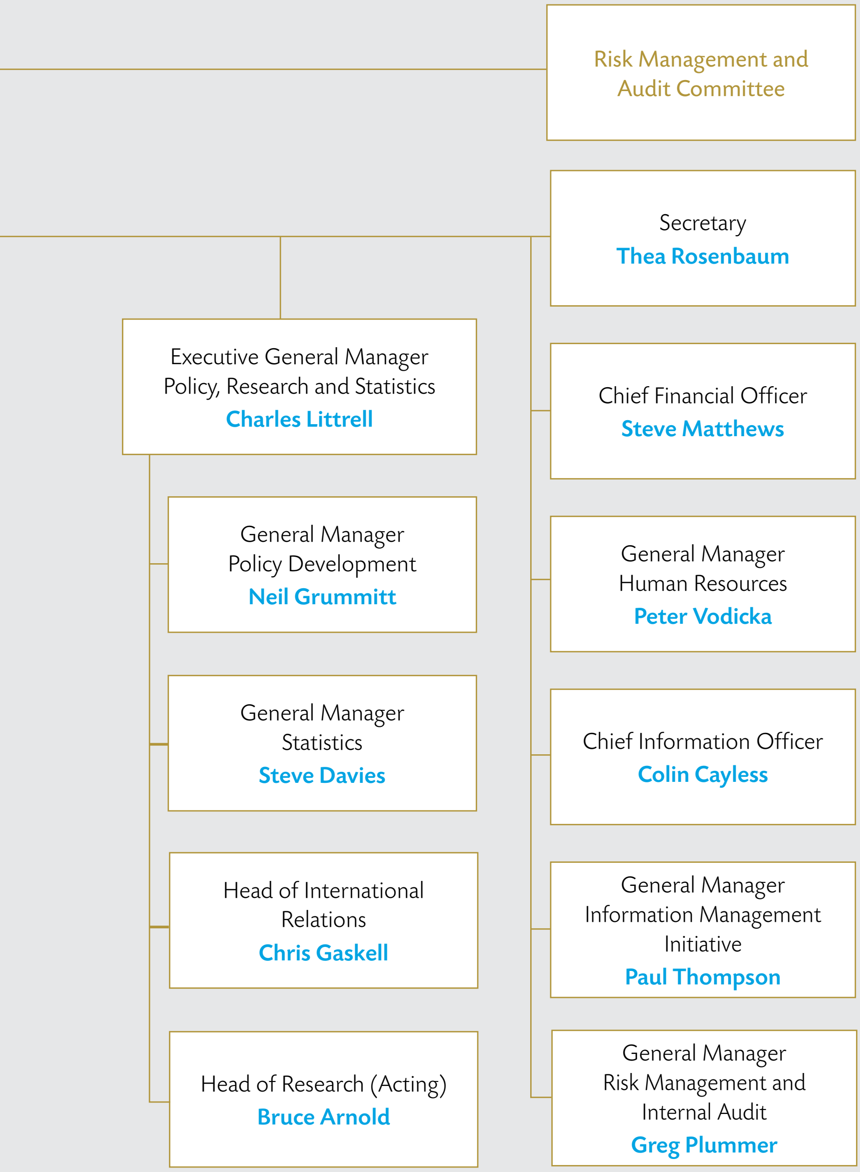
Part of *Report*	Description	Location or applicability
	Letter of transmittal	Page 2
	Table of contents	Page 3
	Index	Pages 172-173
	Glossary	Pages 170-171
	Contact officer(s)	Page 174
	Internet home page address and internet address for report	Page 174
Review by Chairman		Chapter 1
Overview of Authority	Overview	Chapter 7
	Role and functions	Page 1. Chapters 2-5
	Organisational structure	Pages 168-169
	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	Chapters 2-5
	Trend information	Chapters 2-5
	Performance against service charter customer service standards	Not applicable
	Discussion and analysis of the Authority's financial performance	Chapter 6
	Discussion of any significant changes from prior year, from budget or anticipated to have a significant impact on future operations	Not applicable
	Authority's resource statement and summary resource tables by outcomes	Chapter 9
	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	Compliance with the *Commonwealth Fraud Control Guidelines*	Chapter 7
	Statement of the main corporate governance practices in place	Chapter 9
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

Part of *Report*	Description	Location or applicability
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 and common law contracts	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
Financial statements		Chapter 8
Other information	Occupational health and safety (section 74 of the *Occupational Health and Safety Act 1991*) and Schedule 2 Part 4 of the *Work Health and Safety Act 2011*	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 E*nvironment Protection and Biodiversity Conservation Act 1999*)	Chapter 9
	Grant programs	Chapter 9
	Correction of material errors in previous annual report	Not applicable
	Information Publication Scheme statement	Chapter 9

Executive Group

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

- Executive General Manager
  Diversified Institutions
  Keith Chapman
  - General Manager
    Branch 1
    Robyn McMahon
  - General Manager
    Branch 2
    Heidi Richards
  - General Manager
    Branch 3
    Adrian Rees
  - General Manager
    Branch 4
    Harvey Crapp
- Executive General Manager
  Specialised Institutions
  Brandon Khoo
  - General Manager
    Central Region
    Nigel Boik
  - 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
  Helen Rowell
  - General Manager
    Industry Technical Services
    Puay Sim
  - General Manager
    AMIRS[1]
    Greg Brunner
  - General Manager
    CORS[2]
    Pat Brennan
  - 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
ACCC	Australian Competition and Consumer Commission
ADI	Authorised deposit-taking institution
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
CoFR	Council of Financial Regulators
CRF	Consolidated Revenue Fund
D2A	Direct to APRA
EAFD	Early Access Facility for Depositors
EEO	Equal Employment Opportunity
FCS	Financial Claims Scheme
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
IAAust	Institute of Actuaries of Australia
IAIS	International Association of Insurance Supervisors

IASB	International Accounting Standards Board
IMF	International Monetary Fund
IOPS	International Organisation of Pension Supervisors
IOSCO	International Organisation of Securities Commissions
MoU	Memorandum of Understanding
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
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
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

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