Discussion Paper

Supervision of conglomerate groups
Proposed Level 3 reporting requirements

26 September 2013

Preamble

In March 2010, APRA released a discussion paper that outlined proposals for a Level 3 framework for the supervision of conglomerate groups (Level 3 groups). In December 2012 and May 2013, APRA released two consultation packages that included detailed proposals on the four components of the framework: group governance, risk exposures, risk management and capital adequacy. These proposals were accompanied by draft prudential standards.

This consultation package proposes Level 3 reporting requirements in relation to capital adequacy of Level 3 groups. The package includes two draft reporting standards accompanied by reporting forms and instructions.

Written submissions on this package should be sent to Level3Framework@apra.gov.au by 31 October 2013 and addressed to:

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Contents

Glossary

ADI	An authorised deposit-taking institution under the *Banking Act 1959* (Banking Act)
Additional Tier 1 Capital	Capital instruments that provide loss-absorption but do not satisfy all of the criteria for inclusion in Common Equity Tier 1 Capital
Authorised NOHC	A non-operating holding company authorised under the Banking Act or the *Insurance Act 1973* (Insurance Act) or registered under the *Life Insurance Act 1995* (Life Insurance Act)
APRA	Australian Prudential Regulation Authority
APRA beneficiary	A depositor of an ADI, a policyholder (including policy owner) of a general insurer or life company, or a beneficiary of an RSE
APRA-regulated institution	An ADI, Extended Licensed Entity, general insurer, life company, RSE licensee or authorised NOHC
Common Equity Tier 1 (CET1) Capital	The highest quality component of capital. It is subordinated to all other elements of funding, absorbs losses as and when they occur, has full flexibility of dividend payments and has no maturity date
December 2012 response paper	Response to Submissions, *Supervision of conglomerate groups. 1. Group governance and risk exposures*, December 2012
General insurer	A general insurer authorised under the Insurance Act
ICAAP	Internal Capital Adequacy Assessment Process
ITEs	Intra-group transactions and exposures
Level 1 institution	An individual operating company authorised to undertake activities within a single APRA-regulated industry (ADIs, general insurers, life companies and RSE licensees)
Level 2 group	A consolidated group within a single APRA-regulated industry, headed by an ADI, general insurer or authorised NOHC
Level 3 EC	Eligible capital (EC) held by a Level 3 group that APRA recognises for capital adequacy purposes
Level 3 group	A conglomerate group, containing an APRA-regulated institution, with operations across more than one APRA-regulated industry and/or including material non-APRA-regulated activities
Level 3 Head	An APRA-regulated institution heading a Level 3 group
Level 3 institution	An institution within the Level 3 group

Level 3 PCR	Level 3 Prudential Capital Requirement (PCR), determined as the Level 3 prescribed capital amount plus any Level 3 supervisory adjustment
Level 3 prescribed capital amount	Prescribed capital amount determined in accordance with the quantitative rules as set out in the capital standards, before any Level 3 supervisory adjustment is applied
Level 3 supervisory adjustment	An adjustment that APRA may require to be included in the Level 3 PCR
Life company	A life company, including a friendly society, registered under the Life Insurance Act
March 2010 discussion paper	Discussion Paper, *Supervision of conglomerate groups*, March 2010
May 2013 response paper	Response Paper, *Supervision of conglomerate groups. 2. Risk management and capital adequacy*, May 2013
NOHC	Non-operating holding company
Non-APRA-regulated institution	An institution other than an APRA-regulated institution
ORFR target amount	The operational risk financial requirement (ORFR) target amount determined for RSE licensees in accordance with *Prudential Standard SPS 114 Operational Risk Financial Requirement*
RC	Required capital
RSE	A registrable superannuation entity as defined in the *Superannuation Industry (Supervision) Act 1993* (SIS Act)
RSE licensee	A registrable superannuation entity licensee as defined in the SIS Act
Tier 1 Capital	Capital that provides loss-absorption, comprised of Common Equity Tier 1 Capital and Additional Tier 1 Capital
Tier 2 Capital	Capital instruments that provide loss-absorption but do not satisfy the criteria for Common Equity Tier 1 Capital or Additional Tier 1 Capital

Executive summary

In March 2010, APRA released a discussion paper, *Supervision of conglomerate groups*, outlining its proposed prudential framework for the supervision of such groups (Level 3 framework).[1] The Level 3 framework consists of four components: group governance, risk exposures, risk management and capital adequacy. In December 2012 and May 2013, APRA released two consultation packages covering draft prudential standards relating to these four components.[2]

This consultation package proposes Level 3 reporting requirements in relation to the capital adequacy of Level 3 groups. Specifically, APRA proposes two reporting standards and associated quarterly reporting forms. The two standards are:

- *Reporting Standard 3RS 110.0 Level 3 Prescribed Capital Amount*; and
- *Reporting Standard 3RS 111.0 Level 3 Eligible Capital*.

At this stage, APRA does not propose standardised reporting requirements for the other three components of the Level 3 framework. It is envisaged that APRA supervisors of Level 3 groups will determine appropriate bespoke reporting requirements for these components that reflect the Level 3 groups' own internal reporting framework.

APRA currently proposes that there be no Level 3 statistical publications.

Level 3 groups will be requried to comply with the standards under the Level 3 framework by 1 January 2015. In the final quarter of 2013, APRA intends to publish the final Level 3 prudential standards and also release for consultation a set of prudential practice guides and consequential amendments to other prudential standards to give effect to the Level 3 framework. APRA intends to release final reporting standards, forms and instructions during the first quarter of 2014. Collection of data is proposed to commence with the first reporting period ending after 1 January 2015, although APRA will require groups to submit an unaudited trial return based on 31 December 2014 data.

1 http://www.apra.gov.au/CrossIndustry/Consultations/Pages/Supervision-of-conglomerate-groups-2010.aspx.

2 http://www.apra.gov.au/CrossIndustry/Consultations/Pages/Supervision-of-conglomerate-groups-2012.aspx and http://www.apra.gov.au/CrossIndustry/Consultations/Pages/Supervision-of-conglomerate-groups-May-2013.aspx.

Chapter 1 – General reporting requirements

1.1 Background

In March 2010, APRA released a discussion paper, *Supervision of conglomerate groups*, outlining its proposed prudential framework for the supervision of such groups (Level 3 framework). Conglomerate groups (Level 3 groups) are groups containing at least one APRA-regulated institution, that perform material activities across more than one APRA-regulated industry and/or in one or more non-APRA-regulated industries. The framework is designed to complement APRA's existing industry-based Level 1 and Level 2 frameworks. At the same time, the Level 3 framework will provide common measures and tools through which group-wide risk profiles and supervisory assessments can be made.

Two consultation packages released in December 2012 and May 2013 set out detailed proposals relating to the four components of the Level 3 framework: group governance, risk exposures, risk management and capital adequacy. In relation to capital adequacy, APRA proposed that a Level 3 group must have sufficient capital such that the ability of its APRA-regulated institutions to meet their obligations to APRA beneficiaries is not adversely impacted by risks emanating from non-APRA-regulated institutions in the group.

This consultation package proposes Level 3 reporting requirements relating to a Level 3 group's capital adequacy. These requirements are imposed on the Level 3 Head, which will be responsible for the submission of the completed reporting forms.

1.2 Reporting forms

APRA proposes two reporting standards relating to the capital adequacy component of the Level 3 framework:

- *Reporting Standard 3RS 110.0 Level 3 Prescribed Capital Amount* (3RS 110); and
- *Reporting Standard 3RS 111.0 Level 3 Eligible Capital* (3RS 111).

APRA further proposes two associated quarterly reporting forms:

- *Reporting Form 3RF 110.0 Level 3 Prescribed Capital Amount* (3RF 110); and
- *Reporting Form 3RF 111.0 Level 3 Eligible Capital* (3RF 111).

The forms report the Level 3 prescribed capital amount and the Level 3 Eligible Capital (Level 3 EC) in accordance with the requirements set out in *Prudential Standard 3PS 110 Capital Adequacy* (3PS 110) and *Prudential Standard 3PS 111 Capital Adequacy: Measurement of Capital* (3PS 111).

1.3 Frequency, due date and audit requirements

1.3.1 Frequency of collection

APRA proposes that forms 3RF 110 and 3RF 111 be collected on a quarterly basis. Certain inputs, in particular in relation to form 3RF 110, are already collected quarterly on a Level 1 or Level 2 basis. However, certain Level 1 and Level 2 inputs proposed to be reported at Level 3 are currently collected on a less frequent basis. Specifically:

- general insurance Level 2 groups are currently only required to submit relevant information to APRA on a half yearly basis, including the specific inputs required at Level 3, namely their prescribed capital amount, Additional Tier 1 Capital and Tier 2 Capital; and
- registrable superannuation entity (RSE) licensees are currently only required to submit to APRA on an annual basis their operational risk financial requirement (ORFR) target amount and the ORFR reserves held by each RSE for whom the RSE licensee has been appointed as trustee.

APRA considers that quarterly collection of the proposed Level 3 reporting forms is essential to the adequate supervision of Level 3 groups. For Level 3 purposes general insurance Level 2 groups and RSE licensees that are members of a Level 3 group will need to provide information on a quarterly basis. APRA does not consider this to be a significant new requirement as general insurance Level 2 groups and RSE licensees are already required to actively monitor their respective requirements. *Prudential Standard GPS 110 Capital Adequacy* requires a general insurance Level 2 group to have an Internal Capital Adequacy Assessment Process (ICAAP) that includes adequate policies, procedures, systems, controls and personnel to identify, measure, monitor and manage the risks arising from the group's activities on a continuous basis, and the capital held against such risks. *Prudential Standard SPS 114 Operational Risk Financial Requirement* requires an RSE licensee to review the appropriateness of its ORFR target amount and tolerance limit following any material change to the operational risks identified in its risk management framework or the size, business mix and complexity of an RSE within its business operations and hence would be monitoring the ORFR target amount on a more frequent basis. APRA therefore expects that the requested information would be readily available on a quarterly basis for Level 3 groups. Further, Level 3 groups have over 12 months to prepare for these reporting requirements.

1.3.2 Due date

The proposed data collections will have a due date of 28 calendar days after the end of the quarter. This aligns with APRA's intention, across all its regulated industries, to set reporting due dates on a calendar day basis rather than a business day basis. Four weeks (28 calendar days) after the reference period is now the reporting due date for APRA's quarterly data collections, and some ADI data collections that have longer reporting due dates will be brought into alignment in 2013/2014.

1.3.3 Audit requirements

APRA proposes that the data collections be subject to audit requirements as set out in *Prudential Standard 3PS 310 Audit and Related Matters* (3PS 310). The information provided by a Level 3 Head must be the product of systems, procedures and internal controls that have been reviewed and tested by the appointed auditor. In accordance with 3PS 310, responsibilities of the appointed auditor include reporting simultaneously to APRA and the Board of the Level 3 Head (or Board Audit Committee), within three months of the end of the financial year of the Level 3 Head[3], on matters relating to APRA data collections.

APRA emphasises that the audit requirements set out in 3RS 110 and 3RS 111 also apply to the general insurance Level 2 group and RSE licensee information identified in section 1.3.1 that is currently collected on a less frequent basis.

1.4 Statistical publications

APRA publishes a suite of statistical publications that provide regular updates on the financial performance of the four APRA-regulated industries, such as the Quarterly Industry Performance Statistics, the annual ADI Points of Presence and various annual industry Bulletins. APRA currently proposes, however, that there be no Level 3 statistical publications. There are only a limited number of Level 3 groups and the heterogeneous nature of these groups does not readily lend itself to standardised statistical publications. If in the future APRA considers that statistical publications may be warranted, it would consult on any proposals relating to such publications.

3 For non-disclosing entities the relevant period is four months.

1.5 Data collections relating to other items

APRA does not propose a standardised data collection via 'Direct to APRA' ('D2A') for the capital shortfall assessment required by Level 3 groups. The capital shortfall assessment will be included in the Level 3 ICAAP and 3PS 110 requires the Level 3 Head on an annual basis to provide APRA with a report on the implementation of the Level 3 group's ICAAP.

At this stage, APRA also does not propose standardised reporting requirements for the other three components of the Level 3 framework, including aggregate risk exposures and intra-group transactions and exposures (ITEs). Following implementation of the Level 3 framework, however, APRA may reconsider the appropriateness of reporting requirements relating to a Level 3 group's aggregate risk exposures and ITEs.

APRA envisages that supervisors of Level 3 groups will determine appropriate bespoke reporting requirements. These are likely to follow Level 3 groups' own internal reporting frameworks.

1.6 Timetable

Level 3 groups will be required to comply with the standards under the Level 3 framework by 1 January 2015. In the final quarter of 2013, APRA intends to publish the final Level 3 prudential standards and also release for consultation a set of prudential practice guides and consequential amendments to other prudential standards to give effect to the Level 3 framework.

APRA intends to release final reporting standards, forms and instructions during the first quarter of 2014. Collection of data is proposed to commence with the first reporting period ending after 1 January 2015, although APRA will require groups to submit an unaudited trial return based on 31 December 2014 data.

Chapter 2 – The reporting forms

This chapter discusses the proposed Level 3 reporting forms. The forms reflect the requirements set out in draft 3PS 110 and 3PS 111 that were released for consultation in May 2013 and therefore do not incorporate feedback received from stakeholders on that consultation package. APRA does not expect that its response to submissions will require material changes to the determination of Level 3 EC and the Level 3 prescribed capital amount. The forms will be updated to reflect the final versions of the prudential standards following their expected release in the final quarter of 2013. The draft forms do, however, reflect certain adjustments that APRA intends to make to the final versions of 3PS 110 and 3PS 111. These changes, which are highlighted in Sections 2.1 and 2.2, are included to provide stakeholders with an opportunity for comment prior to the finalisation of the prudential standards.

2.1 Form 3RF 110 Level 3 Prescribed Capital Amount

Level 3 Heads will be required to use reporting form 3RF 110 to report the Level 3 prescribed capital amount, which together with the Level 3 supervisory adjustment, if any, determines the Level 3 Prudential Capital Requirement (Level 3 PCR).

The Level 3 prescribed capital amount to be reported in 3RF 110 is determined in accordance with the requirements set out in draft 3PS 110 except for one change that APRA intends to incorporate in the final 3PS 110. To prevent an inappropriate increase in Level 3 surplus as a result of internal capital arrangements, 3RF 110 excludes from the required capital (RC) calculations for the ADI, GI and LI blocks any Additional Tier 1 Capital and Tier 2 Capital held by other Level 3 institutions in the Level 3 group. For example, a life company could issue Additional Tier 1 Capital to the Level 3 Head, which funds this with senior debt. Without an adjustment this could reduce the LI block's RC and thereby increase the Level 3 group's surplus through capital upgrading. Another example would be where the Level 3 Head would fund such capital by issuing ordinary shares. Without an adjustment this would increase the group's Level 3 EC and simultaneously reduce the LI block's RC as the capital is effectively double counted.

The adjustment set out in the previous paragraph excludes capital instruments held by the Level 3 group on behalf of third parties such as superannuation fund members. Furthermore, APRA may determine that part or all of the capital instruments held by other Level 3 institutions in the group are to be excluded from this adjustment.

A Level 3 group is also required to report in 3RF 110, the ten largest ITEs for the ADI, GI and LI blocks. These are based on the reduction in the block's RC due to the ITE. All ITEs in a block must be reported if there are fewer than ten. Where a block contains multiple institutions that do not form a Level 2 group, the group must report the largest ten ITEs across all institutions in the block rather than per institution. For each ITE, the group must also report the counterparty and the change in RC as appropriate, and provide a brief description of the nature of the ITE.

APRA emphasises that the ITEs on which the group must report in 3RF 110 are of a more limited scope than the internal ITE reports required under *Prudential Standard 3PS 222 Intra-group Transactions and Exposures* (3PS 222). ITEs in 3RF 110 are specifically limited to changes in a block's RC, whereas ITEs for the purposes of 3PS 222 reflect all exposures of a Level 3 institution to another Level 3 institution within the same Level 3 group.

Due to the free-form manner in which groups may determine the internal capital allocations for the Funds Management and Other Activities blocks, APRA proposes to limit standardised data collection regarding the internal capital allocations to two inputs for each block: the amount for Level 3 institutions determined to be operationally separated or separable, and the amount for Level 3 institutions not determined to be operationally separated or separable. APRA may request supporting documentation or require *ad hoc* reporting in relation to a Level 3 group's internal capital allocations; this will be determined on a case-by-case basis.

Finally, 3RF 110 requires a Level 3 group to report its Level 3 EC determined in accordance with 3RF 111 in order to derive the group's capital in excess of its Level 3 prescribed capital amount.

2.2 Form 3RF 111 Level 3 Eligible Capital

Level 3 Heads will be required to use reporting form 3RF 111 to report their Level 3 EC. This form is structurally similar to reporting forms *ARF 110 Capital Adequacy*, *GRF 112 Determination of Capital Base* and *LRF 112 Determination of Capital Base*.

Level 3 EC is to be reported in 3RF 111 in accordance with the requirements set out in draft 3PS 111, except for two changes as follows that APRA intends to include in the final 3PS 111. The first change relates to general insurance technical provisions in surplus or deficit of those required by *Prudential Standard GPS 320 Actuarial and Related Matters*. Where there is no general insurance Level 2 group, this item must be determined as the aggregate for all Level 1 general insurers and equivalent overseas general insurers in the Level 3 group. If there is more than one standalone general insurer, 3RF 111 requires the group to report the necessary adjustment to the aggregate technical provisions to reflect the impact of consolidating the Level 1 general insurers and overseas equivalent general insurers, notably consolidation adjustments for intra-group transactions and diversification benefits in risk margins.

The second change relates to the regulatory adjustment for assets under a fixed or floating charge. This adjustment is based on a similar adjustment in *Prudential Standard GPS 112 Capital Adequacy: Measurement of Capital* (GPS 112) and *Prudential Standard LPS 112 Capital Adequacy: Measurement of Capital*. However, GPS 112 exempts from this adjustment the international business of general insurance Level 2 groups. This exemption was inadvertently omitted from 3PS 111 and APRA proposes to align the Level 3 framework with GPS 112 by exempting the international business of general insurance Level 2 groups. APRA further proposes to extend this exemption to equivalent overseas general insurers included in the GI block on a standalone basis.

Chapter 3 – Cost-benefit analysis information

To improve the quality of regulation, the Australian Government requires all proposals to undergo a preliminary assessment to establish whether it is likely that there will be business compliance costs. In order to perform a comprehensive cost-benefit analysis, APRA welcomes information from interested parties on the financial impact of the proposed reporting requirements. These costs could include the impact on balance sheets, profit and loss, and capital.

As part of the consultation process, APRA also requests respondents to provide an assessment of the compliance impact of the proposed changes. Given that APRA's proposed requirements may impose some compliance and implementation costs, respondents may also indicate whether there are any other requirements that should be improved or removed to reduce compliance costs. In doing so, please explain what they are and why they need to be improved or removed.

Respondents are requested to use the Business Cost Calculator (BCC) to estimate costs to ensure that the data supplied to APRA can be aggregated and used in an industry-wide assessment. APRA would appreciate being provided with the input to the BCC as well as the final result. The BCC can be accessed at www.finance.gov.au/obpr/bcc/index.html.

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