



## Prudential Standard 3PS 221

### Aggregate Risk Exposures

#### **Objective and key requirements of this Prudential Standard**

This Prudential Standard requires a Level 3 Head to ensure that an aggregate risk exposure external to the Level 3 group does not expose APRA-regulated institutions within the group to excessive risk.

The ultimate responsibility for the aggregate risk exposure policy of a Level 3 group rests with the Board of its Level 3 Head.

The key requirements of this Prudential Standard are that a Level 3 Head must:

- have a policy for the Level 3 group that deals with the measurement, management and monitoring of, and reporting on, aggregate risk exposures associated with all risk types within the group;
- develop and implement effective systems and processes to manage, monitor and report on aggregate risk exposures; and
- meet minimum requirements with respect to aggregate risk exposures and certain related matters.

**Authority**

1. This Prudential Standard is made under:
  - (a) section 11AF of the *Banking Act 1959* (Banking Act);
  - (b) section 32 of the *Insurance Act 1973* (Insurance Act); and
  - (c) section 230A of the *Life Insurance Act 1995* (Life Insurance Act).

**Application**

2. This Prudential Standard applies to each **Level 3 Head**.
3. This Prudential Standard commences on 1 January 2014.

**Interpretation**

4. Terms that are defined in *Prudential Standard 3PS 001 Definitions* appear in bold the first time they are used in this Prudential Standard.

**Interaction with other prudential standards**

5. The requirements in this Prudential Standard are in addition to the obligations imposed on **APRA-regulated institutions** under other Prudential Standards.

**Aggregate risk exposures**

6. For the purposes of this Prudential Standard, aggregate risk exposures may arise from exposures to individual counterparties, a group of related individual counterparties, a group of counterparties with similar characteristics (e.g. in specific geographical locations or industry sectors) or to particular asset classes (property holdings or other investments) where the exposures have the potential to result in material losses for the **Level 3 group** or an individual APRA-regulated institution in the group. Aggregate risk exposures include both on- and off-balance sheet exposures. Unlimited exposures to any individual counterparty (e.g. a general guarantee of the obligations of a counterparty) are not permitted unless agreed with APRA.
7. For the purposes of this Prudential Standard, when determining aggregate risk exposures the Level 3 Head must ensure that exposures to the **wider conglomerate group** to which the Level 3 group belongs are taken into account.
8. For the purposes of this Prudential Standard, aggregate risk exposures exclude any exposures held, in accordance with written legal agreements, by the Level 3 group on behalf of **third parties** (e.g. custodian arrangements), even if the assets are held in the name of a **Level 3 institution** in the group.

**Responsibilities of a Level 3 Head**

9. A Level 3 Head must have an 'aggregate risk exposures policy' that addresses all material risk exposures associated with the operations undertaken by Level 3 institutions in the Level 3 group. The policy must include systems and procedures to measure, manage, monitor and report on group-wide risks arising from aggregate risk exposures.
10. The management of aggregate risk exposures must be a part of the Level 3 group's risk management framework.

**Responsibilities of the Board of a Level 3 Head**

11. The Board of a Level 3 Head must:
  - (a) approve the aggregate risk exposures policy for the Level 3 group;
  - (b) ensure that adequate systems and controls are in place to identify, measure, aggregate, manage, monitor and report on material risk exposures in the Level 3 group in a timely manner;
  - (c) engage in active oversight, which may be via a Board committee, of the approach to the identification, measurement, management and monitoring of aggregate risk exposures and compliance with the aggregate risk exposures policy, which includes regular reviews of:
    - (i) aggregate risk exposures in the Level 3 group that are financial in nature or which have the capacity to materially affect the operations of the group; and
    - (ii) escalation procedures for aggregate risk exposures which facilitate responses to identified policy breaches between formal reporting cycles;
  - (d) review Board-approved policies and relevant controls for aggregate risk exposures at least annually, to consider and, if appropriate, take action in relation to:
    - (i) ongoing compliance with the aggregate risk exposures policy;
    - (ii) areas in the aggregate risk exposures policy requiring improvement;
    - (iii) deficiencies that have not been adequately addressed within the allocated rectification timeframe; and
    - (iv) material changes or exceptions from established policies that have had an impact on the operations of the policy;
  - (e) ensure that Board-approved policies remain adequate and appropriate for identifying, measuring, aggregating, managing and monitoring Level 3 group risk in relation to risk exposures. Any material change to

established policies must be approved by the Board of the Level 3 Head;  
and

- (f) ensure that those systems and controls are documented and that such documents are provided to APRA on request.

### **The aggregate risk exposures policy**

12. The aggregate risk exposures policy for a Level 3 group must:

- (a) be conceptually sound, consistently implemented, transparent and capable of independent review and validation;
- (b) be sufficiently comprehensive to capture all material aggregate risk exposures;
- (c) consider the impact of material changes in macroeconomic conditions, including foreign exchange rates, interest rates and inflation; and
- (d) clearly articulate the responsibilities, compliance obligations and reporting relationships that are subject to periodic review.

13. The aggregate risk exposures policy must include:

- (a) exposure limits for the Level 3 group to:
  - (i) various types of counterparties;
  - (ii) an individual counterparty or group of related counterparties;
  - (iii) individual industry sectors;
  - (iv) geographical locations;
  - (v) financial products, including risk transfer products;
  - (vi) specific funding sources;
  - (vii) various asset classes such as equities, property holdings and other investments;
  - (viii) various market risks such as interest rate, foreign exchange and commodities; and
  - (ix) any other material risk exposures

that cover asset and liability exposures and which are commensurate with the Level 3 group's capital, its risk appetite and profile, and the nature, scale and complexity of the group's business;

- (b) operational risk limits for the Level 3 group to:
  - (i) service providers;

- (ii) outsourcing;
  - (iii) business continuity management; and
  - (iv) any other operational risk exposures;
- (c) the circumstances in which the above limits may be exceeded and the authority required for approving such excesses;
- (d) a description of the procedures for identifying, aggregating, reviewing, controlling and reporting risk exposures within the Level 3 group, including risk mitigation strategies. This must include:
- (i) a clear statement of the responsibilities and compliance obligations of **senior management** of the Level 3 group, any relevant Board committee and the Board of the Level 3 Head in relation to the monitoring and management of aggregate risk exposures;
  - (ii) thresholds and procedures for Board reporting in both formal reporting cycles and outside formal reporting cycles in relation to material changes requiring escalation; and
  - (iii) a timetable for a regular review of the reports by the Board of the Level 3 Head; and
- (e) a timetable for the regular review of the operation of the policy by senior management of the Level 3 group to consider and, if appropriate, take action in relation to:
- (i) ongoing compliance with the aggregate risk exposures policy, systems and procedures;
  - (ii) areas in the aggregate risk exposures policy, systems and procedures requiring improvement;
  - (iii) deficiencies that have not been adequately addressed within the allocated rectification timeframe; and
  - (iv) material changes or exceptions from established policies that have had an impact on the operations of the policy.
14. A Level 3 Head must conduct stress testing and scenario analysis of the Level 3 group's aggregate risk exposures to assess the impact of changes in market conditions or key risk factors on the group's risk profile and earnings arising from those aggregate risk exposures.

### **Internal reporting systems**

15. A Level 3 Head must develop and maintain reporting systems in relation to aggregate risk exposures across the Level 3 group.
16. Reports on aggregate risk exposures must be provided to APRA on request.

## Limits and approvals

17. If, in APRA's view, the Level 3 group is exposed to a significant level of aggregate risk exposure, APRA may apply a Level 3 supervisory adjustment.<sup>1</sup> In determining any supervisory adjustment, APRA may take account of:
- (a) whether the Level 3 group has been acting in a manner that is consistent with the group's policy on aggregate risk exposures;
  - (b) the number of exposures, their individual size and nature;
  - (c) the characteristics of the Level 3 group, including the nature of its business and the experience of its management; and
  - (d) other relevant factors to be considered on a case-by-case basis.
18. APRA may also require a Level 3 Head to reduce the Level 3 group's level of aggregate risk exposure. Where, in APRA's opinion, the Level 3 group is exposed to a significant level of aggregate risk exposure in specific risks, APRA may require that the Level 3 group does not increase the relevant risk exposures.
19. APRA may by written notice to a Level 3 Head impose limits on the Level 3 group's aggregate risk exposure and, at APRA's discretion, may determine how a Level 3 Head must calculate the aggregate risk exposure of the group.

## Notification requirements

20. A Level 3 Head must notify APRA immediately of any significant breach of the requirements of this Prudential Standard or the Board-approved aggregate risk exposures policy, including remedial actions taken or planned to deal with the breach.

## Adjustments and exclusions

21. APRA may, by notice in writing to a Level 3 Head, adjust or exclude a specific prudential requirement in this Prudential Standard in relation to the Level 3 Head.<sup>2</sup>

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<sup>1</sup> A Level 3 supervisory adjustment is an adjustment that APRA may require to the Level 3 capital adequacy requirement.

<sup>2</sup> Refer to subsection 11AF(2) of the Banking Act, subsection 32(3D) of the Insurance Act and subsection 230A(4) of the Life Insurance Act.