



14 May 2014

To all Authorised Deposit-taking Institutions

Composition of a Level 2 Authorised Deposit-taking Institution (ADI) group

APRA recently reviewed the composition of ADI Level 2 groups. This review highlighted some inconsistencies in the entities that ADIs have included or excluded in their Level 2 groups. Some ADIs have also sought clarification on this matter from APRA. APRA's work in recent years on the potential for contagion within conglomerate groups and the need for robust capital frameworks has also assisted in this review. The purpose of this letter is to assist ADIs to define their Level 2 groups to ensure consistency in approach.

The definition of a Level 2 group is stated in Attachment B of *Prudential Standard APS 001 Definitions* (APS 001). In particular, all subsidiaries in a group headed by an ADI, or a non-operating holding company that heads a Level 2 group, must, unless explicitly excluded by APRA, be included in the Level 2 group.

Paragraph 2 of Attachment B of APS 001 states that:

'Consolidation at Level 2 must cover the global operations of an ADI and its subsidiary entities, as well as other controlled banking entities, securities and other financial entities, except those entities involved in the following business activities:

- (a) insurance (including friendly societies and health funds);*
- (b) acting as manager, responsible entity, approved trustee, trustee or similar role in relation to funds management;*
- (c) non-financial (commercial) operations; and*
- (d) securitisation special purpose vehicles to which assets have been transferred in accordance with the requirements of Prudential Standard APS 120 Securitisation.'*

Unless a subsidiary entity is of a type listed in paragraph 2(a) to (d), it must be included as part of an ADI's Level 2 group. In particular, subsidiary intermediate holding companies are, unless otherwise specified by APRA, part of the ADI Level 2 group regardless of the nature of any activity undertaken by the operating subsidiaries of those holding companies.

The amount to be deducted from Common Equity Tier 1 (CET1) in relation to subsidiaries not included in the Level 2 group is the current value of the investments in those subsidiaries in the accounts of the Level 2 group. This includes investments in the capital of the subsidiary and any other capital support that may be either on- or off-balance sheet.

Any entity within an ADI Level 2 group that forms part of a Level 2 general insurance group, as defined in Attachment D of *Prudential Standard GPS 001 Definitions* (GPS 001), should be considered to be an ‘insurer’ for the purposes of applying the exception contained in paragraph 2(a) of Attachment B of APS 001.

APRA does not currently apply a Level 2 group approach to life insurance companies. APRA is willing to consider an application from ADIs to recognise as an ‘insurer’ for the purposes of paragraph 2(a) of Attachment B of APS 001, selected non-insurance subsidiaries of life insurance companies. APRA may consider an application where the activities of non-life subsidiaries are closely integrated with the provision of life insurance services of parent life insurance companies. Non-operating holding companies of life insurance subsidiaries, however, would need to continue to be included in the ADI Level 2 group.

When APS 001 is next revised, APRA intends to confirm the treatment of entities included in a general insurer’s Level 2 group and of non-life subsidiaries of life insurance companies. APRA would have no objection to the application of these interpretations in the interim by ADIs.

Transition

While most ADIs will not be affected by the clarification of a Level 2 group, APRA is aware that a small number of ADIs currently use debt raised from intermediate holding companies to reduce CET1 deductions within the Level 2 group. The clarification does not restrict an ADI’s external debt arrangements or stop ADIs achieving funding benefits from such arrangements. However, debt raised from intermediate holding companies cannot be used to reduce CET1 deductions within the Level 2 group.

ADIs affected by this clarification may apply to APRA for transition arrangements where there are material capital adjustments. An ADI likely to re-state its Level 2 capital position is requested to inform its responsible supervisor when the relevant calculations are to hand.

Yours sincerely



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