



5 July 2013

Mr Neil Grummitt
General Manager, Policy Development
Policy, Research and Statistics
Australian Prudential Regulation Authority
GPO Box 9836
SYDNEY NSW 2001

Dear Mr Grummitt

Harmonising Cross-Industry Risk Management Requirements

The Australian Financial Markets Association (AFMA) welcomes the opportunity to comment on APRA's *Harmonising cross-industry risk management requirements* Discussion Paper (the Discussion Paper), the draft Risk Management Prudential Standard (CPS 220), and the draft Governance Prudential Standard (CPS 510). Effective risk management systems within Authorised Deposit-taking Institutions (ADI) are critical to the effective management and mitigation of risks, and we support APRA's work in enhancing the prudential requirements as they apply to regulated institutions. We also support APRA's work in consolidating cross-industry prudential standards where relevant, and agree that harmonising risk management prudential standards provides for a more streamlined regulatory framework.

Whilst we are supportive of the principles underpinning the proposed reforms, we are concerned that draft CPS 220 does not provide enough clarity around requirements for foreign ADIs. The approach taken in draft CPS 220, with the focus on the role of the Board, the independence of the Chief Risk Officer, and the establishment of a Board Risk Committee, while clearly relevant to locally incorporated ADIs, is less so for foreign ADIs.

The need for foreign ADIs to operate within the global governance framework of their parent is recognised in CPS 510 and the prudential regulatory framework more generally. For this reason the role of the Senior Officer Outside Australia (SOOA) was previously introduced to undertake an equivalent role of an Australian domestic board, which now seems to contradict the independence sought in this jurisdiction by the proposed standard. There is a risk that the requirements in draft CPS 220 will be inconsistent with other prudential standards in relation to their application to foreign ADIs.

Australian Financial Markets Association

ABN 69 793 968 987

Level 3, Plaza Building, 95 Pitt Street GPO Box 3655 Sydney NSW 2001

Tel: +612 9776 7955 Fax: +61 2 9776 4488

Email: info@afma.com.au Web: www.afma.com.au

We note APRA's advice that the requirements to apply to foreign ADIs, including the intended role of the SOOA, will be clarified in the final standard. The future role of the SOOA, and the relevance of this role going forward, would be crucial to our members' approach to complying with the standard. We are concerned that there will be insufficient opportunity for members to provide feedback, or time to adapt to the new requirements. As such, we strongly recommend that APRA provide, at a minimum, an extended period of time for implementation.

The remainder of our submission cover issues for clarification that members have raised.

Role of the Board

Draft CPS 220 indicates that the Board is ultimately responsible for a regulated institution's risk management framework. The issues this creates for foreign bank branches, which by design do not have a Board but a SOOA, have already been noted. We suggest that CPS 220 should be clarified so that the longstanding requirement for foreign ADIs to have a SOOA in place of a Board is preserved.

In relation to the Board Risk Committee, draft CPS 510 specifically excludes foreign ADIs from the requirement to establish such a committee. Clarification on how draft CPS 220 interacts with draft CPS 510 is required, as at present there is an inconsistency between the two standards. In line with our comments in relation to the role of the Board, we suggest that CPS 220 is clarified so that there is no requirement for foreign ADIs to establish a Board Risk Committee.

Risk Management Framework

Draft CPS 220 states that an APRA regulated institution must have a risk appetite, risk management strategy and business plan as part of its overall risk management framework. In many global banks, these will be set at a global, regional or divisional level in accordance with the requirements of the home regulator (which may be similar to what APRA requires).

Clarification on APRA's expectations in relation to how these requirements apply to foreign ADIs is required, particularly around APRA's view on the use of global governance and risk management frameworks for the purpose of complying with CPS 220. Given the integrated nature of business and governance arrangements for foreign bank branches and their parent, it would not only be difficult but detrimental for branches to establish a risk management framework separate from their parent. As such, we suggest that APRA clarify that foreign ADIs should seek to leverage off the global or regional risk management framework, but where required, local supplements should address additional CPS 220 requirements not already covered.

Draft CPS 220 also requires regulated institutions' risk management framework to include an Internal Capital Adequacy Assessment Process (ICAAP) (paragraph 24 (f)). We note that footnote 5 refers to APS 110 Capital Adequacy, which itself exempts foreign ADIs at paragraph 3(a). APRA should clarify in CPS 220 that the requirement for

regulated institutions to include an ICAAP in their risk management framework does not apply to foreign ADIs. Such a requirement would be particularly onerous and impractical for foreign bank branches. In particular, some elements of an ICAAP process, including stress testing and concentration risks, can only be considered and analysed at the group level in order to enable a comprehensive representation of risks effectively born by the group and to take into account diversification effect. The need for an ICAAP to be applied at the group level for foreign bank branches is recognised in APS 110, and this treatment should also be reflected in CPS 220 to avoid inconsistency.

In relation to the minimum material risks that the risk management framework must address, “other risks” (at paragraph 27 (g)) are defined very widely and would appear to include legal risk, compliance risk, technology risk, accounting risk, etc. A risk management framework drafted to include all of these areas would be vast and unwieldy.

Chief Risk Officer

Draft CPS 220 refers to the role of the Chief Risk Officer (CRO) in heading the risk management function. For global banks, the CRO and risk framework will operate in accordance with the requirements of the home regulator (which may be similar to what APRA requires). Clarification around the application of the standard to foreign ADIs for all clauses that refer to the CRO is required.

In particular, clarity is sought in respect of whether the CRO can be based offshore (for example, in a dedicated CRO regional role). We note that the double hatting limitations in paragraph 39 may be unrealistic for small foreign ADIs, which may not have the resources to assign dedicated personnel to these roles.

Further, some members may consider a matrix-style risk management structure to be more effective than a generic risk management function given their specific organisational structure. The skills and experience needed to effectively supervise different areas of risk management are not the same. For instance, operational risk is closely connected with control and operational systems whereas market risk requires knowledge of trading and market dynamics.

While the spirit of the proposed changes is well understood, the practicality of the requirements may present a problem. We suggest that APRA consider allowing regulated institutions’ regulatory supervisor sufficient discretionary power to approve variations to the requirements in view of an ADI’s internal reporting and processes, and organisational structure. This is consistent with APRA’s statement that it will “...maintain its principles based approach to the application of its risk management requirements and will, where appropriate, consider exceptions for smaller institutions that can demonstrate they meet, in substance, the principles underlying the requirements” (p.6, Discussion Paper).

Review of the Risk Management Framework

Draft CPS 220 refers to the requirement for the risk management framework to be reviewed at least annually. For global banks, the corporate audit function designs the internal review program. There may be times where not all business in a branch would be assessed in a given year due to the size of the organisation or lower priority status. Clarification is sought on APRA's expectations in relation to foreign ADIs, and in particular, whether the global framework is sufficient for the purposes of complying with CPS 220.

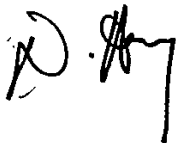
Internal audit functions generally operate a risk based audit process and so may only conduct a detailed review every 3 or 4 years, as part of a global or regional review. Would an annual risk assessment (without detailed audit) meet APRA's annual review requirement?

Definitions

There are several terms in draft CPS 220 which are not defined. Of note are: "significant breach" and "material deviation" (p.1); "reasonable assurance" (paragraph 23); "regular, accurate, and timely" (paragraph 26). Definition of these terms would provide greater clarity to regulated institutions.

Thank you for the opportunity to comment on the proposed harmonisation and enhancement of risk management requirements applicable to regulated institutions. We also appreciate your time and commitment to consult with our members in attending the forum we facilitated in May. Should you have any queries about the issues raised in this submission, please do not hesitate to contact me at dhang@afma.com.au or (02) 9776 7994.

Yours sincerely

A handwritten signature in black ink, appearing to read 'D. Hang', with a stylized flourish at the end.

Denise Hang
Director, Policy