



## TREASURER

PARLIAMENT HOUSE  
CANBERRA ACT 2600

Telephone: (02) 6277 7340  
Facsimile: (02) 6273 3420  
[www.treasurer.gov.au](http://www.treasurer.gov.au)

20 FEB 2007

Dr John Laker  
Chairman  
Australian Prudential Regulation Authority  
GPO Box 9836  
SYDNEY NSW 2001

Dear Dr Laker

I am pleased to provide you with my Statement of Expectations for the Australian Prudential Regulation Authority (APRA). This Statement forms part of the implementation of the Government's response to the *Review of Corporate Governance of Statutory Authorities and Office Holders*, which was conducted by Mr John Uhrig (the Uhrig Report). The Uhrig Report identified ways in which the governance of Commonwealth portfolio bodies may be improved and recommended options for increasing transparency and accountability and ensuring well-defined responsibilities and clear relationships between portfolio bodies and other arms of Government.

This Statement also forms part of the implementation of the Government's response to the Report of the *Taskforce on Reducing Regulatory Burden on Business* (the Banks Report). In particular, Recommendation 5.1 of the Banks Report proposed that the Government provide specific guidance to APRA and ASIC about the appropriate balance between pursuing safety and investor protection, and market efficiency. This Statement of Expectations provides guidance to APRA on this issue, consistent with the legislative framework of APRA. This Statement also encourages APRA to implement some of the more specific recommendations of the Banks Report.

The Government is issuing a Statement of Expectations to portfolio bodies and requesting that portfolio bodies reply with a Statement of Intent. I look forward to receiving APRA's Statement of Intent within three months from the date of this letter. In the interest of public accountability both of these documents will be made public simultaneously. It is my intention that this Statement will be reviewed as circumstances require.

This Statement of Expectations outlines the Government's current objectives in the area of prudential regulation and the Government's expectations for APRA with regards to its conduct, role and responsibilities, relationships with the Government

and issues of transparency, accountability and operation. As recognised by the Uhrig Report, I have taken into account the nature of APRA's independence in making this Statement. It is imperative that APRA continues to act independently and objectively in the exercise of its powers.

At the outset, I would like to make it clear that the Government is very pleased with the overall performance of APRA as a key economic regulator. The Government has provided APRA with significant funding increases in recent years, confirming its capability and capacity to carry out its statutory mandate. However, there is a need to continually reassess performance of regulatory institutions to ensure that they are continuing to meet community expectations and market developments.

## **The Role and Responsibilities of APRA**

The effectiveness of economic regulation is a key contributor to strong economic growth and the wellbeing of the Australian people. The efficient operation of Australia's financial system is supported by a combination of laws, institutions, regulatory policies and administrative practices. The Government is committed to ensuring a regulatory environment that maintains financial stability, fosters competition, promotes innovation and enterprise and provides appropriate safeguards for consumers. The Government's focus has been on reducing unnecessary complexity, minimising compliance costs, enhancing competition and better equipping consumers to benefit from competitive markets.

### **APRA's Role, Objectives and Priorities**

The prime responsibility for ensuring that financial institutions keep the financial promises they make to consumers rests with the board and management of these institutions. Prudential regulation seeks to reinforce the role of the board and management in meeting financial promises by addressing two potential sources of market failure:

- by limiting the systemic risks associated with breaches of financial promises; and
- by reducing the risk of loss by consumers from breaches of financial promises where consumers may have difficulty assessing the creditworthiness of financial institutions making the promises.

It is recognised that prudential regulation cannot and should not seek to guarantee a zero failure rate of prudentially regulated institutions or provide absolute protection for market participants (including consumers). A regulatory approach of this intensity would remove the natural spectrum of risk that is fundamental to well-functioning markets, and ultimately reduce the efficiency and growth of the Australian economy. It is important that the prudential regulation regime maintains a low incidence of failure of regulated entities while not impeding continued improvements in efficiency or hindering competition.

The existence of a prudential regulator and a regulatory regime may lead people to expect a higher degree of protection than is achievable or desirable. The prudential regulator has a role in explaining to the financial sector and the wider public, the

rationale for prudential regulation, the role of the prudential regulator, and the outcomes that can be realistically expected from the prudential regulatory framework.

APRA is responsible for regulating bodies in the financial sector in accordance with the laws of the Commonwealth that provide for prudential regulation. These laws are aimed at promoting financial system stability in Australia and protecting the interests of depositors, insurance policyholders and superannuation fund members, while allowing the continued development of viable, competitive and innovative industries in the financial services sector.

APRA is expected to license only those institutions which are able to meet prudential requirements, to promote sound risk management practices in regulated institutions, provide for early detection and resolution of financial difficulties and enforce prudential requirements to reinforce prudent behaviour. This contributes to the financial health of market participants, the integrity of the market, the promotion of financial stability and the protection of the interests of consumers as a whole.

While effective regulation can help support business activities and economic growth, over-regulation or inappropriate regulation can impose unnecessary complexity and compliance costs on regulated financial institutions and on the wider economy. This highlights the inherent need to balance safety and efficiency considerations in all prudential decisions. In performing and exercising its functions and powers, APRA is required by its enabling legislation, the *Australian Prudential Regulation Authority Act 1998* (the APRA Act), to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality.

The Government expects that APRA will comply with the Government's policy on best practice regulation on all regulatory proposals before they are introduced. Within the context of government policy and legislation, priority should be given to initiatives which minimise procedural requirements and business costs and improve commercial certainty about the practical operation of the regulatory framework administered by APRA.

The Government's preference is for the avoidance of unnecessarily prescriptive regulation and for APRA's prudential regulation to identify the outcomes that are desired from financial institutions rather than prescribe how those outcomes should be achieved. An outcomes-based approach is also more likely to accommodate structural change within the financial sector and not unduly constrain financial institutions from pursuing opportunities for competition and innovative development.

APRA should regularly and proactively review the effectiveness and continuing relevance of the prudential regulation regime in the context of market developments, which will also help identify possible future material risks and regulatory responses.

#### *Collection of Data*

APRA is responsible for collecting and analysing data from prudentially regulated and other financial institutions. It is important that APRA maintain its high standard of data collection and analysis, including where APRA shares data with the Reserve Bank of Australia and the Australian Bureau of Statistics, by continuing to:

- collect relevant and necessary data;
- provide electronic means for entities to submit data securely and efficiently;
- ensure entities provide timely and accurate data; and
- publish useful data and statistical analysis of a high standard.

#### *Review of APRA guidance*

Recommendation 5.5 of the Banks Report recommended that APRA review its guidance material to ensure it provides effective guidance on good practice in meeting regulatory requirements and does not impose additional or inflexible regulatory requirements. The Government acknowledges that APRA is undertaking work in this area and encourages APRA to implement this recommendation.

#### *Key performance indicators*

Recommendation 5.2 of the Banks Report recommended that APRA develop a broader suite of performance indicators, in addition to existing safety measures, consistent with its statutory responsibilities. The Report recommended that any indicators should be reported in APRA's annual report and should be accompanied by guidance in their interpretation, particularly where outcomes may be influenced by factors outside APRA's control. The Report also recommended that the performance indicators and accompanying guidance should be developed in consultation with the Government.

The Government encourages APRA to implement this recommendation, thus ensuring that APRA continues to take a balanced approach to regulation. I have asked Treasury to work with APRA during the implementation stage. As an initial priority, APRA could develop reporting against indicators of timeliness, stakeholder satisfaction and business compliance costs.

Indicators of the broader economic impact of APRA's supervisory conduct may be developed over the longer term.

### **Relationships between APRA and the Government**

The Government recognises and will continue to respect the operational independence of APRA and its responsibility for prudential regulation as provided by statute. It is important for confidence in the regulatory framework that APRA is, and is seen to be, exercising independent judgment about the application of the framework to individual circumstances.

Nevertheless, APRA was established to administer regulatory frameworks which have been designed to implement government policies and priorities relating to business regulation generally and prudential regulation in particular. The Government has a legitimate interest in APRA's operations, its policies and the way they are applied given their potential impact on the economy and individuals' well-being.

### *Relationship with the Minister*

It is important that, in performing its statutory functions and powers, APRA has regard to the Government's broader microeconomic reform objectives. Maintaining a high level of awareness of the Government's policy agenda will place APRA in a position to fully respond to Government policy directions and objectives.

The Government has primary responsibility for setting prudential policy. APRA plays an essential role in ensuring that the Government is well placed to respond promptly to issues that may arise in this area. Under the APRA Act, APRA may provide the Minister with advice on matters concerning improvements to financial safety and efficiency, competition, contestability or competitive neutrality of the financial sector, or changes to prudential framework laws that would overcome or assist in overcoming problems APRA has identified in the course of performing any of its functions. APRA must also provide the Minister with advice if it considers an APRA-regulated body is in financial difficulty.

Another key role of APRA is to provide me, and other Treasury portfolio Ministers as appropriate, with accurate and timely advice on significant issues in its core area of business. Significant issues might include: issues for which the Government is likely to be accountable in Parliament; important APRA operational and budgetary issues; and APRA's decisions regarding the appropriate action for it to take following substantial problems or disruptions in the market, including a substantial breach of the prudential framework.

Under section 12 of the APRA Act, the Minister is able to give APRA a written direction about policies it should pursue or priorities it should follow, but must not give a direction about a particular case. This means that APRA has complete independence in relation to the performance of its functions and exercise of its powers in relation to a specific matter. Given the importance the Government attaches to protecting APRA's independence, both real and perceived, the use of the directions power would only be considered in rare and exceptional circumstances. I note that this power has not been used to date.

### *Relationship with Treasury*

The Government, with advice from Treasury, is responsible for developing legislation to give effect to its policy objectives relating to APRA and prudential regulation. APRA is primarily responsible for the administration of those laws and the conduct of prudential regulation, including developing prudential standards and guidance.

To fulfil these respective roles, Treasury and APRA need to maintain a close working relationship. Treasury takes into account the views and experience of APRA when considering and advising on changes to prudential regulation policy and legislation. By advising Treasury on the operational implications of Government policy initiatives, APRA contributes to policy development. It is also imperative that APRA continues to consult with Treasury, in the development of substantive operational policies, to facilitate consistency between the objectives of legislation and its practical implementation through prudential standards and guidance.

The Memorandum of Understanding between Treasury and APRA clarifies the priorities of each organisation and assists both in carrying out their respective roles effectively.

The Government accepted the Uhrig Report recommendation that portfolio bodies should provide information to portfolio secretaries in parallel to that information being provided to Ministers. This should ensure that Treasury continues to be placed in a good position to fulfil its role as the principal source of advice on prudential policy matters. The Chair of APRA remains responsible for the direct oversight of APRA.

### *Regulatory Cooperation*

Given the growing interdependence of markets, APRA does not operate in isolation. It forms one part of Australia's system of economic regulation. It is important that robust, effective and collaborative working partnerships be maintained between APRA and other Commonwealth and State and Territory agencies, particularly the Australian Securities and Investments Commission (ASIC), the Australian Taxation Office, the Reserve Bank of Australia, AUSTRAC and the Australian Competition and Consumer Commission (ACCC). The structure of Australia's regulatory framework is such that it depends on close cooperation and liaison between the regulators to manage areas where their responsibilities intersect.

By taking a holistic approach to formulating and reviewing its standards and guidance and undertaking its supervision and enforcement activities, APRA should ensure that its prudential requirements and activities intergrade as comfortably as possible with those of the other economic regulators.

This may be achieved by considering whether proposed new standards or practices have consequential changes for existing APRA regulation. In addition, avoiding the duplication of the supervisory activities of other regulators, and considering whether outcomes could be achieved by utilising existing regulation administered by another regulator, would ensure an integrated regulatory framework. APRA should also consider the outcomes or recommendations of relevant Government-established panels, reviews or inquiries.

The Government also considers it important that APRA's standards and practices support Australia's financial sector in globally integrated markets through the consideration of regulatory frameworks in other jurisdictions.

In addition, by engaging actively with international regulatory counterparts, APRA should assist in monitoring the integrity and management practices of multinational financial institutions and in minimising regulatory barriers to trade in financial services.

APRA's role in providing technical and other assistance to its regulatory counterparts is also important in enhancing standards and practices in the Asian and Pacific regions.

## **Transparency and Accountability**

APRA was established as an independent body to administer the prudential regulatory framework. However, APRA performs its statutory functions as part of the Australian Government and remains accountable to the Parliament, and ultimately to the public, through the Treasury Ministers, the Parliamentary Committee process and the tabling of its annual report. Open consultation and a sound working relationship with the entities that it supervises should help to ensure that APRA interacts with market participants and the community more generally in a transparent and accountable manner.

It is important that industry participants are encouraged to communicate considered and candid views to APRA. Engaging effectively with industry early in the development of prudential standards and guidelines can enhance the regulatory framework and outcomes. The overall objectives of stakeholder consultations are to ascertain the impact of regulation, enhance the efficiency and effectiveness with which regulation objectives are achieved, increase understanding of the context of regulatory changes within the overall legislative and regulatory framework, as well as increase understanding of the regulatory implications of structural changes and developments in the financial sector.

The Government has accepted a number of the recommendations of the Banks Report, the speedy implementation of which will improve the transparency and accountability of APRA's operations.

### *Joint industry consultative body*

Recommendation 5.12 of the Banks Report recommended that APRA and ASIC convene a joint industry consultative body, with membership drawn from the key sectors regulated by APRA or ASIC and the regulators themselves.

The Government encourages APRA and ASIC to cooperate and liaise with each other, and industry representatives, to identify and explore possible mechanisms to provide industry with the opportunity to raise issues about how regulatory coordination operates in practice. I note that APRA's working group with ASIC is continuing to review areas of regulatory overlap and duplication, including financial reports, licensing requirements and breach notifications, and look forward to the issuing of a joint progress report in the near future.

### *Service charter*

Recommendation 5.13 of the Banks Report recommended that APRA, in consultation with Government and industry, develop an industry charter, setting out the key rights and responsibilities of APRA and its regulated entities. The principal objective of the charter should be to clarify key expectations of both the regulated entity and the regulator, to enhance transparency and accountability.

The Government encourages APRA to implement this recommendation. I have asked Treasury to work with APRA in developing a charter.

## **Operational Issues**

The requirements for APRA's financial management are set out in the *Commonwealth Authorities and Companies Act 1997* and the Finance Minister's Orders. In this regard, I note that it is the intention of the Government to make APRA an agency under the *Financial Management and Accountability Act 1997* as soon as practicable.

It is Government policy that all departments and portfolio bodies should continue efforts to secure improved efficiency in their operations and demonstrate value for money for the services that they deliver. I appreciate that APRA continues to seek opportunities to achieve outcomes in a more cost effective manner.

## **Conclusion**

In conclusion, the Government's vision is that APRA remain a high performing and responsive agency that administers a principles-based regulatory framework in a manner that is efficient and effective, and that balances the objectives of financial safety and efficiency, competition, contestability and competitive neutrality. The framework should continue to facilitate innovation and enterprise, contributing to economic efficiency and growth. I look forward to working with APRA under a new era of enhanced governance arrangements.

I have copied this correspondence to the Prime Minister and the Minister for Finance and Administration.

Yours sincerely



PETER COSTELLO