



AUSTRALIAN BANKERS'
ASSOCIATION INC.

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AUSTRALIAN BANKERS' ASSOCIATION INC.



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16 May 2013

Mr Neil Grummitt
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Dear Neil,

Consultation Package: Basel III disclosure requirements: composition of capital and remuneration April 2013

The Australian Bankers' Association (ABA) provides the attached submission, in response to the consultation package, *Basel III disclosure requirements: composition of capital and remuneration April 2013*.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Tony Burke'.

Tony Burke



AUSTRALIAN BANKERS'
ASSOCIATION INC.

Submission

Basel III disclosure requirements: composition of capital and remuneration April 2013

16 May 2013

Australian Bankers' Association Inc. ARBN 117 262 978
(Incorporated in New South Wales). Liability of members is limited.

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The ABA welcomes the opportunity to comment on APRA's consultation package, *Basel III disclosure requirements: composition of capital and remuneration*, released 9 April 2013. The ABA appreciates APRA's ongoing willingness to engage with industry and provides the following comments for APRA's consideration.

1. Capital

1.1. Implementation Timetable

APRA is proposing implementation of the new Basel III capital disclosures for financial years ending on or after 30 June 2013. For some time, the ABA has been concerned about the impact of enhanced Basel III capital disclosures and the significant amount of time and resources that will be required to implement them.

The ABA initiated discussions with APRA on Basel III capital disclosures and the BCBS' capital template in November 2012. The ABA had two discussions with APRA at that time, and during these discussions APRA informed the ABA that it expected to consult with the industry in January 2013 prior to the release of the discussion paper in February 2013.

APRA delayed this timetable resulting in a condensed consultation process for the implementation of these proposals including:

1. a reduced consultation period for the Discussion Paper of only five weeks (instead of the usual two months);
2. less than three months between the release of the Discussion Paper and the implementation date; and
3. the probable release of the final disclosure standard in late June 2013, potentially only days before the 30 June 2013 implementation date.

There are significant governance (including management and Board sign-off), process and disclosure changes involved in the amendments to APS 330 which will take some time to develop and finalise. The capital reconciliation is not a straight forward exercise, and changes will need to be made to the Financial Statements to incorporate the changes. Given that the discussion paper was not issued until April 2013 and the first ADIs will need to implement the final requirements for 30 June 2013, the implementation timeline is too compressed.

The ABA recommends that the implementation date be moved to the first balance sheet date on or after 31 December 2013, with earlier disclosure encouraged.

Should such a date be implemented, where possible, banks would look to make disclosures on a best endeavours basis in the interim.

1.2. Capital Template and Reconciliations

APRA is proposing to adopt the BCBS' template and reconciliation process, largely unchanged. The ABA previously provided feedback on the template and the reasons why it does not achieve the BCBS' intended purpose of improving comparability of bank capital positions¹.

While the ABA acknowledges the requirement for APRA to adopt the BCBS' template and reconciliation process, it does have a number of shortcomings, particularly if adopted unchanged in Australia. These shortcomings are namely:

¹ See [ABA submission](#) to the Basel Committee on Banking Supervision, titled "Proposed regulatory capital disclosure requirements issued by the Basel Committee", dated 14 February 2012. A copy of this submission was provided to APRA.

1. the BCBS' template includes only one set of capital ratios calculated under local (APRA) implementation of Basel III that will make comparison of Australian ADI's capital position to international peers difficult. (The ABA understands that APRA is considering an addendum with a second set of capital ratios. However, the ABA believes APRA's current addendum is misleading and will not address the comparability issue, see below);
2. the ABA does not believe the disclosure of a detailed Level 2 balance sheet is necessary. Any reconciliation between the financial statements and the capital calculations should be kept to an explanation of the adjustments required to shareholders' equity to produce Common Equity Tier 1;
3. the proposed reconciliation process assumes all components of the capital calculations can be derived directly from the balance sheet. This is not the case; for example, Expected Losses, that contribute towards the deduction relating to the shortfall provisions to expected losses, are a prudential concept only; and
4. in places, the level of detail in the proposed disclosures is excessive. Providing more detailed information does not necessarily lead to better disclosure outcomes. In the ABA's view the level of detail currently included has the potential to overwhelm users of the information and increase the likelihood of misinterpretation.

The ABA believes these shortcomings will lead to users of the disclosures being misinformed.

The difficulty of using the capital template to compare Australian ADI's capital position to international peers was recognised by the Senate Economics Committee in its report into the Post-GFC Banking Sector:

*"The committee does consider that APRA could be more proactive in some areas. A particular issue is that Australian banks may appear less capitalised than their peers as a result of the different regulatory capital calculations that APRA requires."*²

*"APRA should facilitate the publication of headline capital ratios that are calculated according to the Basel Committee's standard requirements. The committee also encourages APRA to look at other ways that it could improve the understanding of the Australian banking sector's underlying strength internationally, to ensure that Australians receive the full benefits of this."*³

This led to the Senate Economics Committee making the following recommendation:

"Recommendation 3.1

3.72 In light of the evidence that international observers are misinterpreting the level of capital held by Australian banks due to the Australian Prudential Regulation Authority's (APRA) requirements, the committee recommends that APRA:

- *ensures it initiates consultation on the common disclosure template developed by the Basel Committee in early 2013;*
- *in the interim before the common disclosure template is adopted, facilitates the publication of headline capital ratios for Australian ADIs that are calculated according to the Basel Committee's standard methodology and are therefore easier to compare internationally; and*
- *be more active in promoting internationally that Australian banks are well-capitalised."*⁴

It was for this reason the ABA published its Fact Sheet titled "Comparison of APRA and the Basel Committee on Banking Supervision Basel III capital ratios"⁵ in December 2012 (provided to APRA in

² [The post-GFC banking sector, Senate Economics Committee, November 2012](#), page 53.

³ [ibid.](#), page 54.

⁴ [ibid.](#), page 54.

⁵ ABA Fact Sheet, [Comparison of APRA and the Basel Committee on Banking Supervision Basel III capital ratios](#), December 2012.

November 2012) and produced a proposed addendum to the BCBS' capital template (provided to APRA in December 2012).

While APRA has included an addendum in its proposed Basel III capital disclosures, APRA's addendum is misleading as it does not facilitate the comparison of Australian ADI's capital ratios with international peers. In fact the "Basel III (not applying national discretions)" ratios contained within APRA's proposed addendum involve internal inconsistencies in their calculation methodology and will exacerbate the issues with comparing Australian ADI headline capital ratios with international peers, as users will incorrectly assume these ratios are comparable to international peer capital ratios when they are not.

The ABA recommends that APRA either:

- replace the proposed "Basel III (not applying national discretions)" ratios in the addendum with internationally harmonised capital ratios that allow for both numerator (definition of capital) and denominator (risk-weighted assets) differences; or
- remove the addendum (until internationally harmonised capital ratios can be developed) and allow flexibility for Australian ADIs to disclose their own internationally harmonised capital ratios.

Additionally, it is the ABA's view that where capital calculations cannot be derived directly from the balance sheet, APRA and the BCBS should provide guidance on how these items, such as Regulatory Expected Loss, are to be reported.

The ABA will continue to engage with APRA in regards to the development of a suitable addendum that provides for the needs of investors, regulators and ADIs.

1.3. Balance sheet reconciliation

Clarification is sought on whether only material entities/company groups need to be disclosed. For example, the draft APS 330 at paragraphs 11 and 12 requires disclosure of the list of legal entities that are included or excluded when comparing accounting and regulatory consolidation levels, together with their total balance sheet assets, liabilities and principal activities. For large banking groups, this list is potentially extensive as it would primarily include all of the legal entities in the Wealth Management group and SPVs. Furthermore, consideration needs to be made of the relevance of disclosing details by entity where information provided at company group level would be more meaningful and succinct. The requirement to list every entity within a grouping will be onerous and result in the required balance sheet information being inflated by inter group transactions and potentially result in information of limited use being reported.

Further paragraph 38 states that "an ADI is not required to make a prudential disclosure if it considers the matter to be disclosed to be immaterial". On that basis, it would be appropriate to only disclose the information in relation material entities that are included/excluded. However, the wording of paragraph 12 is that the information is to be disclosed "For each entity" and in paragraph 11 "any entities" which implies that the requirement is for every entity to be listed.

The ABA seeks clarification as to whether details for only material entities/company groups need to be disclosed.

Please see Attachment A for technical questions in relation to capital disclosures.

1.4. Audit Requirements

1.4.1 Inclusion of capital disclosure in financial statements

APS 330 paragraph 24 requires that prudential disclosures are "consistent with information that has been subject to review by an external auditor". Paragraph 27 of APS 330 requires that the Capital

Disclosures to be included in full in the Financial Statements or provide a direct link in them to/from the Financial Statements.

Financial statements as defined by accounting standards (AASB 101:10) do not include the proposed APS 330 disclosures. Introducing new requirements will make the financial statements inconsistent with Australian and international accounting standards.

Preliminary feedback from auditors indicates that the inclusion of a direct link in a Financial Statement changes (increases) the audit requirements; if there is a link in the financial statements to another document, or if those disclosures were to be included in the half year/annual financial statements, auditors would want to review the additional/linked disclosures irrespective of guidance provided in APS 330. Inclusion of the information into the scope of the annual statutory audit potentially has significant process and cost implications.

The ABA recommends that the capital disclosure be a Pillar 3 reporting obligation.

1.4.2 Timing of disclosure

It is unclear if the 'direct link' option means that where an ADI chooses to disclose the Capital Disclosures in a separate APS 330 document (as is the current common practice in Australia) that the APS 330 document will need to be published on the same day as the Financial Statements. The current practice of releasing APS 330 document within two weeks after the Financial Statements has allowed a staging of governance and assurance processes during a very busy period for all ADIs, which, in the ABA's view, results in a higher quality document.

Clarification of APRA's expectations as to the timing of the release of a separate APS 330 document would be appreciated.

1.5. Capital instruments disclosure

Currently APRA is seeking to adopt the BCBS version of the capital instruments disclosure (main features template) in full rather than use an adapted version. To make the disclosure applicable and relevant to the Australian regime, it seems more appropriate to align the disclosure with APS 111.

The ABA also questions whether the capital instruments disclosure (main features template) will replace the requirements under APS 111 (Attachment E, paragraph 1.(s) and Attachment H, paragraph 1.(t)) to separately disclose all Additional Tier 1 and Tier 2 securities in the financial statements. Retaining the existing APS 111 disclosure requirements would seem an unnecessary duplication of disclosures.

The ABA recommends that the template be aligned with APS 111 (both in relation to adequacy and instruments).

Please see Attachment B for questions on the main features of capital instruments.

2. Remuneration

2.1. Timing and transition

Companies such as ADIs are already subject to existing remuneration disclosures under the Corporations Act and Accounting Standards.

The new quantitative disclosures are additional to these requirements. They must be fully aligned with existing remuneration disclosure requirements and the new proposed "past, present and future" disclosure requirements under the Corporations Act. In this regard, it is noted that the "past, present and future" requirements have not yet been defined in detail and will impact reporting for the 2014 financial year.

It is proposed that the first reporting period for the new prudential disclosures be the financial year ending in 2014:

- This will provide an opportunity for authorities to ensure appropriate alignment and complementarity between all the existing and newly proposed Corporations Act requirements with those of the prudential disclosures; and
- It will also provide sufficient time for companies to conduct the necessary work to ensure the disclosures are presented in the most meaningful way. Otherwise, companies with 30 June balance dates could have only a matter of weeks after the prudential standard is finalised to very quickly produce their first set of disclosures under this standard for the 2013 financial year.

For unlisted entities it is requested that APRA confirms that the Attachment E requirements need only be disclosed on the entities' websites.

2.2. Definition of Risk Taker

Industry's understands that APRA does not intend to change the current policy in regards to the definition of risk taker. Given this position, it is industry's assumption that disclosures in Attachment E apply only to senior managers as defined under paragraph 19 in CPS 520 and material risk takers, as the group of employees defined under paragraph 48 (c) in CPS 510. Any reference in Attachment E to "employees", should only apply to those defined groups of employees. APRA's feedback on industry's working assumption is requested.

2.3. Qualitative disclosures

The ABA believes qualitative disclosures should be policy or principles-based and be restricted to the same group of individuals who are subject to the quantitative disclosures (see below). Extending the disclosure to a broader group would introduce undue complexity, with limited benefit to market participants given the significant variation in remuneration structures typical across any sizeable banking group.

The ABA believes the use of the word "criteria" in section (e) of the qualitative disclosure requirements, relating to remuneration adjustments, is too restrictive, and that APRA should consider adopting the word "approach" in this section instead, which would deliver more meaningful disclosures. The term "criteria" implies there is a strict formulaic approach to adjustments, whereas in practice such adjustments may result from a wide range of causes too broad to be broken down into a checklist of criteria.

2.4. Audit requirements

The requirement for additional remuneration disclosures, either in the annual financial statements or accessed via a link included in the financial statements, will require additional audit review and cost, as detailed in section 1.4.1. These disclosures should also form part of the Pillar 3 document.

It is requested that APRA clarify that disclosures be limited to information that has been subject to review by an auditor or that the information being disclosed be reconciled to audited information.

2.5. Flexibility

APS 330-35 states that Attachment E disclosures must be published concurrent with the publication of audited financial statements.

While noting the comments on timing in Section 2.1, the ABA requests clarification of "concurrent". Does it mean that the Level 2 remuneration disclosures are to be published concurrently with the Annual Report, which contains the remuneration report required under the Corporations Act? Or, that the

reporting periods have to be concurrent, and that companies have the flexibility to post the prudential disclosures at a later time in the year under the Regulatory Disclosures section of the website?

The latter approach would be preferable, allowing greater flexibility, as non-KMP remuneration outcomes will not be available at the same timing as the audit statements/ Remuneration Report (assuming that the requirements potentially extend beyond the KMP group).

2.6. Variable remuneration

In relation to reporting on bank employees receiving a variable remuneration award during the financial year:

Clarification is requested of the meaning of “during the financial year”. For example, for a financial year ending on 31 March 2014, would the report include:

- the number of staff receiving variable remuneration during the 12 months to 31 March 2014, which would comprise the available portion of variable remuneration related to performance in respect of the 12 months to 31 March 2013 and vesting of prior year variable remuneration which relates to performance in prior years; or
- the number staff awarded variable remuneration related to performance for the 12 months to 31 March 2014, e.g. profit share allocations physically awarded in May 2014 in respect of the period 1 April 2013 to 31 March 2014, including deferred amounts; or
- the number staff awarded variable remuneration during the 12 months to 31 March 2014 relating performance from the prior year, e.g. profit share allocations awarded in April 2013 in respect of the period 1 April 2012 to 31 March 2013, including deferred amounts.

In relation to the breakdown of amount of remuneration awards for the financial year to show:

- Fixed and variable
- Deferred and non-deferred
- Different forms used (cash, shares and share-linked instruments, other forms).

Clarification is requested on whether this should be for remuneration awarded in respect of performance for the respective financial year, or remuneration awarded during the respective financial year?

It is also requested that there be some flexibility in application of the quantitative disclosures, as the disclosure terminology under APS 330 and 300A of the Corporations Act are not fully aligned. Consideration will also need to be given to the impact of the proposed past, present and future pay categorisations under the Corporations Act.

2.7. Bonus payments

Can APRA clarify how the remuneration disclosures align with the ‘bonus payments’ restrictions in APS 110 Paragraph 27(c) as to population of officers covered?

Attachment A: Technical questions in relation to capital disclosures

(APS 330 Attachment A Table 1) – Can APRA clarify the treatment of the blank lines (for example, should a 'n/a' value or 'zero' be included)?

(APS 330 Attachment A Table 1) – How are Minority Interest components and associated hair-cuts dealt with in a line by line basis?

(APS 330 Attachment A Table 1, item 1 and 3) – It is industry's assumption that the Retained Earnings figure is adjusted for the retained earnings and other reserves of deconsolidated entities such as insurance and funds management entities. Is this APRA's expectation?

(APS 330 Attachment A Table 1, item 2) – Is APRA able to clarify why insurance subsidiary earnings (removed from line 2) are treated differently from cash flow reserve?

(APS 330 Attachment A Table 1, item 23) – Can APRA provide guidance on how:

- the items that are not listed or are immaterial should be treated, i.e. should an "other" line be included (and given immaterial in nature will not be required to be reconciled to balance sheet); and
- how ADI's should split the >15% threshold across the 23 lines required by line 23 thru 25?

(APS 330 Attachment A Table 1, item 26) – Should capital as per the BCBS (before national adjustments) be sub-totalled before line 26?

(APS 330 Attachment A Table 1, item 26(d) and 26(e)) – Is it APRA's intention that (secondary) impacts on the 10% and 15% threshold, by higher national deductions reducing the 10% threshold and hence a higher deduction, are to be included in line 26(d) and 26(e)?

(APS 330 Attachment A Table 1, Item 64 and Item 65) – It is industry's understanding that capital conservation buffers may vary between institutions. Is it APRA's intention that institution specific capital conservation buffers be disclosed (as opposed to being confidential similar to the PCR)?

(APS 330 Attachment A Table 3) – It is unclear to industry why it is not possible to adjust for the differential in RWA treatment – not only the RWA impact of items such as equity exposures under Basel but also the impact of IRRBB, Mortgages LGD. Can APRA provide its thinking on this issue?

(APS 330 Attachment A Table 1A paragraph 30) – Can APRA confirm that there is no expectation for provision of comparatives in the capital disclosures (comparatives are specified for Attachment C, D and remuneration disclosures)?

(APS 330 Attachment A Table 1) – It is industry's interpretation that the starting point for the compilation of regulatory capital, in the common disclosure template for regulatory capital, is the Consolidated Level 2 position, rather than the Consolidated Group. Can APRA confirm that this is the correct interpretation? This would change the way the following items are dealt with:

- a) Deconsolidation of Wealth business profits and reserves would no longer be relevant as they are not included in the Level 2 financial statements to begin with.
- b) Treasury shares owned by Wealth businesses on behalf of policy holders would not be eliminated from financial statement of the Level 2 Group as these shares are not owned by entities of the Level 2 Group.
- c) Investment in Wealth businesses would be reported as a single figure in the Level 2 financial statement, with the goodwill and intangible embedded in the single figure. Further, the ABA notes that the BCBS Basel III standards appear to suggest the Goodwill and Other Intangibles reported in the common template should include Wealth Goodwill and Other Intangibles.

This would not be visible in the Level 2 financial statement although this would be visible in the Consolidated Wealth Management financial statement. Can APRA provide clarification on whether it intends that Wealth Goodwill and Other Intangibles should be captured?

(APS 330 Attachment A Table 1) – The regulatory capital details are currently reported in the APRA forms as per the APRA Prudential Standards and instructions, with the Banking Group as the starting point. Subject to clarification of the above question regarding starting point for compilation of regulatory capital, is there any requirement to amend the regulatory reporting details reported in the APRA forms to be in line with the Common Disclosure Template regarding the items mentioned in the query above?

(APS 330 Attachment A Table 1) – Certain regulatory capital adjustments are compiled based on items reported in the financial statements as well as credit risk related information, such as shortfall of provisions to expected losses, provisions included in Tier 2 Capital, estimated DRP etc. Industry has assumed there are no reconciliation requirements for this type of reporting item. APRA's feedback on this interpretation would be appreciated.

Attachment B: Main features of capital instruments

(APS 330 Attachment B) – The ABA notes that the template does not allow for unique features of 'bespoke' instruments i.e. stapled securities, de-stapling events, various triggers etc. It is the ABA's view that this provides an unnecessary restriction on the template and reduces its usefulness to investors. The ABA recommends that the APRA incorporate flexibility for reporting to take these features into consideration.

(APS 330 Attachment B paragraph 1) – Can APRA clarify if it is possible to aggregate some of the disclosures for instruments that will have the same terms and conditions i.e. Tier 2 subordinated debt?

(APS 330 Attachment B Table 2, item 7) – It is unclear to industry why ordinary shares would be included in the instruments table. Industry's assumption is that this disclosure only applies to Additional Tier 1 and Tier 2 instruments. Can APRA provide its thinking on these points?

(APS 330 Attachment B Table 2, item 8) – Can APRA provide its thinking in regards to the application of the cap at the individual security level?

(APS 330 Attachment B Table 2, item 35) – Industry notes that there is no discussion on subordination at the Point of Non Viability. Was this APRA's intention?

(APS 330 Attachment B Table 2, item 15) – Industry has assumed this item includes takeover events. Is this APRA intention?