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Proposed revisions to Prudential Standard APS 221 Large Exposures

The Australian Financial Markets Association (AFMA) welcomes the opportunity to make this submission commenting on the proposed revisions to *Prudential Standard APS 221 Large Exposures.* AFMA's comments express the views and concerns of our foreign ADI membership, and are specific to reporting obligations as proposed under form ARF 221.1. AFMA notes that APRA intends to introduce the revised reporting standard on 1 January 2019 in line with Basel Committee timeframes.

Key Issues

1. Reporting of large exposures of the Australian operations of the foreign ADI

As described in paragraph 3(b) of the April 2017 draft revised standard, APS 221 does not apply to foreign ADIs that are subject to consolidated supervision by their home country supervisors in respect of credit concentrations and large exposure limits. This indicates that APRA is comfortable with the oversight of a home country supervisor, and that it does not consider that the domestic book exposures of foreign ADIs pose any material threat or introduce system-wide contagion risk to the Australian banking system.

The activities of a foreign ADI are part of its head office operation and as such, operate within the parameters of the respective head office risk appetite framework with regard to credit risk, market risk and large exposure risk amongst others. These frameworks are generally aligned with the Basel III risk and capital framework, as are the home office reporting protocols.

APRA's prudential oversight of Australian operations and its assessment of the control mechanisms takes into account that foreign ADIs are subject to consolidated supervision by their home country supervisors in respect of credit concentrations and large exposure limits. As part of its prudential oversight, APRA may choose to discuss with the foreign ADI's parent and home supervisor any undue credit risk concentrations associated with the foreign ADI's Australian operations.

AFMA agrees that a form of reporting of large exposures by foreign ADIs is prudent. However, as APS 221 does not apply to foreign ADIs that are subject to consolidated supervision by their home country supervisors in respect of credit concentrations and large exposure limits, there is no need for material or onerous reporting of large exposures to be imposed on foreign ADIs. Rather than introducing a reporting standard generally aligned to that applicable to other ADIs, there is merit in being directly aligned to a foreign ADI's home office reporting protocol, which is or will be calibrated to Basel standards, and to which it is anticipated that APRA reporting standards will also be further calibrated. This being the case, there will be a natural convergence of reporting to both APRA and the home office over time.

APRA's reliance on current home office large exposures reporting protocols will provide efficiencies in the resolution of any matter or query directed by APRA to the home office or its regulator. All parties will be interrogating and referring to the same information.

It is recommended that, rather than introducing a new and onerous reporting protocol, APRA should rely on a foreign ADI's existing home office large exposures reporting, which is largely calibrated to, or will be calibrated to, Basel standards. It is anticipated that APRA reporting standards will also be further calibrated to Basel standards, resulting in a natural convergence of reporting to both APRA and home office over time.

If APRA is not minded to accept this recommendation, then AFMA recommends the adoption of a threshold for reporting of material large exposures by foreign ADIs.

There are reporting obligations under ARF 221.1 for foreign ADIs which are in many ways comparable to that of ADIs to whom the prudential standard applies - that is, a foreign ADI is required to report its twenty largest exposures but without the application of any reporting threshold. Our members are concerned that this level of reporting is onerous relative to the size of the foreign ADI's activities.

It is recommended that a reporting threshold be introduced such that only material large exposures are reported by foreign ADIs, given that foreign ADIs are otherwise exempt from APS 221.

2. Groups of connected counterparties

Risk concentrations arise where clients are engaged in similar activities, are located in the same geographical region or have comparable economic characteristics. Many foreign ADIs have established limits or operational controls that monitor those risk concentrations at portfolio and sub-portfolio levels in relation to sector exposure, country risk, and product exposure or any other exposures. The identification and disclosure of economic interdependence of connected counterparties as defined in APS 221 doesn't necessarily reflect the way concentration risk is managed.

It is recommended that, as relevant to reporting under ARF 221.1, the definition of a 'connected counterparty' be in accordance with that accepted in the home jurisdiction, thereby allowing the foreign ADI to rely firstly on the reference data groupings and logic implemented at the home office, and secondly on the exposure levels calculated in accordance with home jurisdiction rules.

We also note the prudential limits and other requirements for an ADI's exposures to other related entities are contained in *Prudential Standard APS 222 Associations with Related Entities* (APS 222), and that the current ARF 221.0 instruction guidance draws attention to this by way of the notation *'Do not include an ADI's exposures to related entities* *(defined in accordance with Prudential Standard APS 222 Associations with Related Entities (APS 222)) in this form. Such exposures are to be reported in ARF 222.0 Exposures to Related Entities.'*

It is recommended that this or a similar notation as used in the current ARF 221.0 instruction guidance on APS 222 is included in the proposed ARF 221.1.

3. Definition of total exposure

Total liabilities are measured under APS 210 Liquidity. In the context of ARF 221.1 foreign ADIs are presuming that total exposure applies only to assets, after allowance for any netting under legally binding agreements. However, guidance on the definition of total exposures will assist in the consistent application of the measure.

APRA guidance is sought on the definition of *total exposure* (Column 7, ARF 221.1).

4. Implementation timeline

The 2014 Basel proposals mandated 1 January 2019 as the implementation date for large exposures reporting. However, as revised APS 221 and its reporting protocols have not been finalised, the proposed implementation date of 1 January 2019 for foreign ADI reporting under ARF 221.1 is unlikely to be achieved other than by way of onerous manual compilation.

As outlined above, foreign ADIs contend that APRA should rely on existing home office reporting by the foreign ADI, given the exemption from the remainder of the prudential standard. Adoption of this approach will mean there is no undue delay in introducing a reporting standard. AFMA believes that there are other more pressing regulatory and statistical reporting proposals by regulators, which should be the short-term priority of the foreign ADIs. Otherwise, there is a risk that data quality issues may be encountered due to the competing imperatives of rolling out new reporting standards.

It is recommended that, absent the adoption of the home office reporting protocol in lieu of the current form of ARF 221.1, APRA establishes an implementation date that is at least two years later than the date of finalisation of APS 221.

5. Cost benefit analysis

Reliance on the home office reporting protocol in lieu of introducing ARF 221.1 in its current form is considered by foreign ADIs as appropriate in light of the inapplicability of the rest of the prudential standard. Otherwise, foreign ADIs will need to invest in technology to construct the reporting protocol and incur material costs associated with implementation of the reporting solution, including its validation, audit and ongoing maintenance.

Separately, the Basel Committee's standardised approach for measuring counterparty credit risk exposures (SA-CCR[1]) and which is relevant under Prudential Standards APS 112 and 180 will further change foreign ADIs' reporting processes, particularly in relation to home office reporting. Bearing this in mind, there is further merit in APRA aligning large exposure reporting with the home office reporting protocol. Over time, Basel standards for global regulatory reporting will converge into a relatively standard format, and it is

[1] Basel Committee's new non-internal model approach for measuring counterparty credit risk associated with OTC derivatives, exchange-traded derivatives, and long settlement transactions.

predicted that the foreign ADI home office report and APRA's reporting standards will largely converge into a common format.

6. Other matters

6.1. Treatment of uncommitted and unadvised limits

Clarification is sought as to whether any exposure to the client is to be reported other than in circumstances where the uncommitted or unadvised limit is utilised.

6.2. Treatment of failed settlements

Operational problems can result in a failed settlement process with the client. While not directly a credit failure, clarification is sought as to whether such operational failure exposure to the client is to be reported.

7. Conclusion

Given the above considerations, AFMA's foreign ADI members recommend that APRA adopts the existing home office reporting protocol for large exposures and applies this to all foreign ADIs, in lieu of introducing ARF 221.1 in its current form. Alternatively, members recommend that the reporting implementation date for ARF 221.1 be at least two years later than the date of finalisation of APS 221 in order that an automated and fully tested reporting methodology can be developed. It is further recommended that if ARF221.1 as drafted is implemented, then:

- a reporting threshold also be introduced such that only material large exposures are reported by foreign ADIs in consideration of the exemption from Prudential Standard APS 221;
- the definition of a 'connected counterparty' be in accordance with that accepted in the home jurisdiction;
- APRA is requested to provide guidance on:
  - the definition of total exposure;
  - the treatment of uncommitted and unadvised limits; and
  - the treatment of failed settlements.

AFMA foreign ADI members welcome the opportunity to provide further feedback on any of the above issues.

Yours sincerely

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