16/17
ANNUAL REPORT

AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY | WWW.APRA.GOV.AU

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THE AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY (APRA) IS THE PRUDENTIAL REGULATOR OF THE AUSTRALIAN FINANCIAL SERVICES INDUSTRY.

It oversees Australia's banks, credit unions, building societies, general insurers and reinsurance companies, life insurers, private health insurers, friendly societies and most members of the superannuation industry.

APRA currently supervises institutions holding $6.1 trillion in assets for Australian depositors, policyholders and superannuation fund members.

AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY
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WAYNE BYRES
Chairman

6 October 2017

The Hon Scott Morrison, MP
Treasurer
Parliament House
CANBERRA ACT 2600

Dear Treasurer,

In accordance with sections 43 and 46 of the *Public Governance, Performance and Accountability Act 2013*, I am pleased to submit the Australian Prudential Regulation Authority Annual Report and Financial Statements for the year ended 30 June 2017.

Yours sincerely,

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APRA VISION, MISSION AND VALUES

Our Vision

is to be a world-class prudential regulator, with excellence of supervision as our foundation.

Our Mission

is to establish and enforce prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by institutions we supervise are met within a stable, efficient and competitive financial system.

We also act as a national statistical agency for the Australian financial sector.

Our Values

underpin the critical role we play in protecting the financial well-being of the Australian community. High standards are required in everything we do. In our work and in our interactions with others, we value and seek to demonstrate:

Our supervisory approach

is forward-looking, primarily risk-based, consultative, consistent and in line with international best practice. The approach also recognises that management and boards of supervised institutions are primarily responsible for financial soundness.

Integrity — **Collaboration** — **Accountability** — **Respect** — **Excellence**

GLOSSARY

ADI	Authorised deposit-taking institution
ANAO	Australian National Audit Office
APRA	Australian Prudential Regulation Authority
APRA Act	*Australian Prudential Regulation Authority Act 1998*
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
CET1	Common Equity Tier 1
CFR	Council of Financial Regulators
CLF	Committed Liquidity Facility
D2A	Direct to APRA
FCS	Financial Claims Scheme
FSI	Financial System Inquiry
ICAAP	Internal Capital Adequacy Assessment Process
LCR	Liquidity Coverage Ratio
MoU	Memorandum of Understanding
NSFR	Net Stable Funding Ratio
PHI	Private health insurers
RBA	Reserve Bank of Australia
RSE	Registrable Superannuation Entity

CH/1

FROM THE CHAIRMAN

FROM THE CHAIRMAN

Globally, economic conditions generally improved throughout 2016/17 and the outlook for the world economy remains broadly positive. At home, Australians continued to benefit from an economy that has gone more than a quarter of a century without a major downturn. These positive economic conditions continued to underpin the overall health and stability of the Australian financial system.

Building resilience when times are relatively prosperous is far easier than trying to restore it after a period of adversity. That premise has underpinned much of APRA's policy and supervisory activity in 2016/17, as well as driving changes to the way APRA itself operates.

Building resilience in the financial system

Capital provides the core source of resilience for many financial institutions. On that score, the financial position of all APRA-regulated sectors remains sound, and significantly exceeds minimum requirements. But capital, by itself, is not enough. Genuine resilience requires that institutions are not only financially sound but also well-governed and prudently managed, and that this occurs with the long-term interests of their stakeholders in mind. Issues associated with governance, risk management and culture were therefore increasingly prominent in APRA's work in 2016/17.

APRA uses a risk-based approach to assess and determine its supervisory and regulatory priorities, directing resources towards the entities and issues it deems of most significant risk. Major areas of supervisory and policy activity in 2016/17 included the following:

- For authorised deposit-taking institutions (ADIs), residential mortgage lending practices remained a major area of supervisory focus, complemented by a thematic review into commercial property lending. APRA's stress-testing program continued through the year and, in July 2017, APRA announced the quantum and timing of capital increases to achieve 'unquestionably strong' capital ratios.
- APRA conducted its first industry stress test of general insurers. As well as assessing the impact of Cyclone Debbie (which was primarily felt by reinsurers), APRA maintained its focus on the impact of strong competition in the commercial lines classes of business, and on claims increases evident in the NSW compulsory third party (CTP) motor scheme.
- For life insurers, APRA concluded its thematic review of group insurance arrangements, and identified key areas for improvements in relation to claims oversight and governance. APRA also worked with ASIC to develop improved public reporting of life insurance claims performance.
- APRA completed the integration of private health insurers (PHIs) into its supervisory framework, and finalised a thematic review of their risk management arrangements.

APRA's core functions and core capabilities

OUR CORE FUNCTIONS

APRA meets its purpose through its core functions, which reflect its role as a prudential supervisor and resolution authority. These are stable over time.

Supervision

Protect beneficiary interests and promote financial stability by identifying and responding to significant risks in a timely and effective manner.

Policy

Protect beneficiary interests by setting minimum standards for institutions and empowering supervisors to achieve supervisory outcomes.

Resolution

Protect beneficiary interests by planning for and implementing prompt and effective responses to a failure or crisis in the financial system.

OUR CORE CAPABILITIES

APRA's core capabilities are its people, its specialist skills and frameworks, and the way it manages the organisation and supporting infrastructure. These capabilities support: achievement of APRA's purpose; sound decision making that complies with policies and legislation; maintaining high standards; and making cost-effective use of the resources available to it.

People and Culture

Have highly skilled and engaged people supported by strong leaders within a values-aligned culture.

Risk intelligence and frameworks

Have strong analytical capabilities, using available data and specialist expertise within structured frameworks, which support well-founded, risk based decisions.

Organisational effectiveness and infrastructure

Have robust and efficient business support, transparent and accountable practices, and secure and reliable premises and systems.

Following on from this, APRA began consulting on the application of its cross-industry risk management prudential standard. This was the first step in a multi-year program of work to review and, where appropriate, align the PHI prudential framework with other prudentially regulated industries.

- In the superannuation industry, APRA maintained a strong emphasis on enhancing board governance and risk management practices. It also stressed the importance to industry of robust strategic and business planning processes to ensure funds deliver high quality, value-for-money outcomes for members; this will also be a key area of activity in the year ahead.

Throughout the year, APRA also devoted attention to a number of issues that are applicable across industries:

- in late 2016, APRA published an information paper on the topic of risk culture, providing a snapshot of current industry practices and highlighting APRA's expectations in relation to better practice;
- building on its stress-testing work, APRA promoted greater awareness within regulated institutions of the need for credible recovery plans in the event of a period of severe adversity; and
- APRA highlighted that risks associated with climate change can become financial in nature, and regulated institutions must consider how these risks may impact them.

Building resilience in APRA

APRA undertook a program of significant operational and organisational change in 2016/17, designed to ensure it stays 'fit for purpose' and able to respond to current and future developments.

New premises were established and/or new technology was rolled out across all APRA offices. These changes not only improved staff productivity and engagement by creating a more modern and functional working environment, but also upgraded the strength and resilience of APRA's core infrastructure.

APRA implemented a major overhaul of its organisational structure, including the creation of a new division tasked with substantially upgrading APRA's risk and data analytics capabilities. Finding ways to better combine expertise, technology and data to inform judgements is a critical issue for every organisation. APRA is no different. At its core, APRA's supervision involves having experienced people make risk-based judgements that make best use of a range of available information. APRA's policy-making is most effective when it has clearly identified, measured and analysed the risks that are being addressed. Given the substantial investment that is being made in APRA's data collection and dissemination infrastructure, the new division will maximise the value APRA extracts from its analytical capabilities, and thereby improve the risk-based judgements essential to fulfilling APRA's mandate.

In addition, APRA established a new centralised licensing unit to better position APRA to engage with applicants with innovative or non-traditional business models wishing to enter the financial system. Significant changes were also made to the allocation of supervisory portfolios, placing greater emphasis on industry-specific expertise and facilitating greater collaboration among supervisors.

Finally, a number of APRA's long-standing leaders left the organisation during 2016/17 after lengthy careers with APRA and, in some cases, its predecessor agencies. Although this represented a loss of extensive supervisory experience, it presented an opportunity to reenergise and bring through the next generation of APRA's leaders through the appointment of new executives to its leadership team.

APRA's resourcing

APRA continues to focus on the efficiency of its operations. Despite an expanding range of activities and responsibilities, its expenditure and staffing levels have changed little in recent years, with total permanent staffing on a full-time equivalent (FTE) basis of 600 at end-June 2017, slightly down on the previous year. At the same time, a decline in APRA's cost base, combined with an increase in the value of assets APRA supervises, led to a fall in the cost per $1,000 of assets supervised in 2016/17 to 2.1 cents, down from approximately 3.0 cents in 2010/11.

As noted in last year's Annual Report, in 2016 APRA received an additional $11.2 million over the forward estimates to modernise its data capabilities. This work has now begun in earnest and will, when complete, transform how APRA collects, stores, accesses and delivers data to both internal and external users. In the 2017 Budget, APRA received an additional $40 million over the forward estimates – of which $7 million will be received in 2017/18 – to cover a number of new initiatives. This additional funding is being received in three tranches:

- APRA received $29 million over four years ($4.9 million in 2017/18) to improve its capacity to fund expanding areas of activity, such as stress testing, IT security, reviewing industry remuneration practices, data analytics and administering the Financial Claims Scheme;
- APRA received a further $8 million over the next four years ($1.4 million in 2017/18) to implement the Government's proposals to improve accountability in the banking sector; and
- APRA also received $3 million over four years ($0.7 million in 2017/18) to deal with proposed new powers over non-ADI lenders.

These additions to APRA's budget will help ensure the organisation can meet a range of new responsibilities without jeopardising its core supervisory activities.

Our people

Resilience is a key theme at APRA. Although typically used in reference to financial entities, resilience is an equally important characteristic for APRA and its staff.

That resilience has been tested over the past year in the face of the significant organisational and operational changes noted above. APRA's busy program of supervisory and regulatory activities has, however, continued seamlessly, which is a testament to the quality, tenacity and experience of APRA's workforce and their unwavering focus on APRA's important role serving the Australian community. It was therefore unsurprising that APRA's 2017 Stakeholder Survey gave APRA staff exemplary ratings for, amongst other things, their integrity and professionalism. The APRA Members are fortunate to oversee a strong and highly committed team of professionals, and we would like to acknowledge and thank them for their efforts during a very busy year.

Wayne Byres
APRA Chairman

The APRA Members 2016/17 – (left to right) Mrs Helen Rowell, Mr Geoff Summerhayes and Mr Wayne Byres.

2016/17 KEY HIGHLIGHTS

8 August 2016

APRA releases final standards in relation to governance and risk management in conglomerate groups

19 August 2016

APRA announces the results of its stress test of the life insurance industry

4 October 2016

APRA releases an information paper on cyber security risks

12 October 2016

APRA sets out its expectations for improved claims handling by life insurers and superannuation trustees

18 October 2016

APRA releases stocktake of industry practices in relation to risk culture

3 November 2016

APRA releases updated governance requirements for superannuation trustees

10 November 2016

APRA releases final standard establishing new requirements for securitisation

19 December 2016

APRA publishes a review of the superannuation industry's approach to liquidity stress testing

20 December 2016

APRA releases the final standard for the Net Stable Funding Ratio for ADIs

23 February 2017

APRA updates its prudential practice guide on residential mortgage lending

7 March 2017

APRA releases observations from a thematic review of commercial property lending

31 March 2017

APRA requests ADIs to keep the share of mortgage lending on an interest-only basis to below 30 per cent

8 May 2017

APRA and ASIC announce the pilot phase of a project to improve public reporting of life insurance claims data

10 May 2017

APRA announces a newly created Licensing Unit and a Data Analytics Unit as part of a new organisation structure

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GOVERNANCE

GOVERNANCE

THE APRA MEMBERS 2016/17

Under the *Australian Prudential Regulation Authority Act 1998* (APRA Act), APRA Members are collectively responsible and accountable for APRA's operation and performance. APRA Members are appointed by the Governor-General, on the advice of the Australian Government, for terms of up to five years.

MR WAYNE BYRES

BEc (Hons), MAppFin, SF Fin - Chairman and Member

Wayne Byres was appointed as a Member and Chairman of APRA from 1 July 2014 for a five-year term.

Mr Byres' early career was in the Reserve Bank of Australia (RBA), which he joined in 1984. After more than a decade with the RBA, including a secondment to the Bank of England in London, he transferred to APRA on its establishment in 1998. Mr Byres subsequently held a range of senior executive positions in APRA, covering both its policy and supervisory divisions. In late 2011, Mr Byres left APRA to take up the appointment as Secretary General of the Basel Committee on Banking Supervision, the global standard setting body for banks based at the Bank for International Settlements in Basel, Switzerland. He held this position until his return to Australia in mid-2014.

Mr Byres is APRA's representative on the Payments System Board, the Council of Financial Regulators, the Trans-Tasman Council on Banking Supervision, the Basel Committee and its oversight body, the Governors and Heads of Supervision.

MRS HELEN ROWELL

BA (Macquarie), FIAA - Deputy Chairman and Member

Helen Rowell was appointed Member of APRA from 1 July 2013 and Deputy Chairman from November 2015. Her term expires on 30 June 2018.

Prior to joining APRA in 2002, Mrs Rowell was a partner at the international consulting firm Towers Perrin. Mrs Rowell joined APRA in a senior executive capacity and since that time has held a range of senior roles across the breadth of APRA's activities. She was also the Chair of APRA's (cross-divisional) General Insurance Industry Group from 2006 to 2011. Mrs Rowell has represented APRA on various subcommittees of the International Association of Insurance Supervisors, on the FSB's Supervisory Intensity and Effectiveness Group and was previously co-chair of the Joint Forum Financial Conglomerates Committee. Mrs Rowell is also a Fellow, and in 2002 was President, of the Institute of Actuaries of Australia.

MR GEOFF SUMMERHAYES

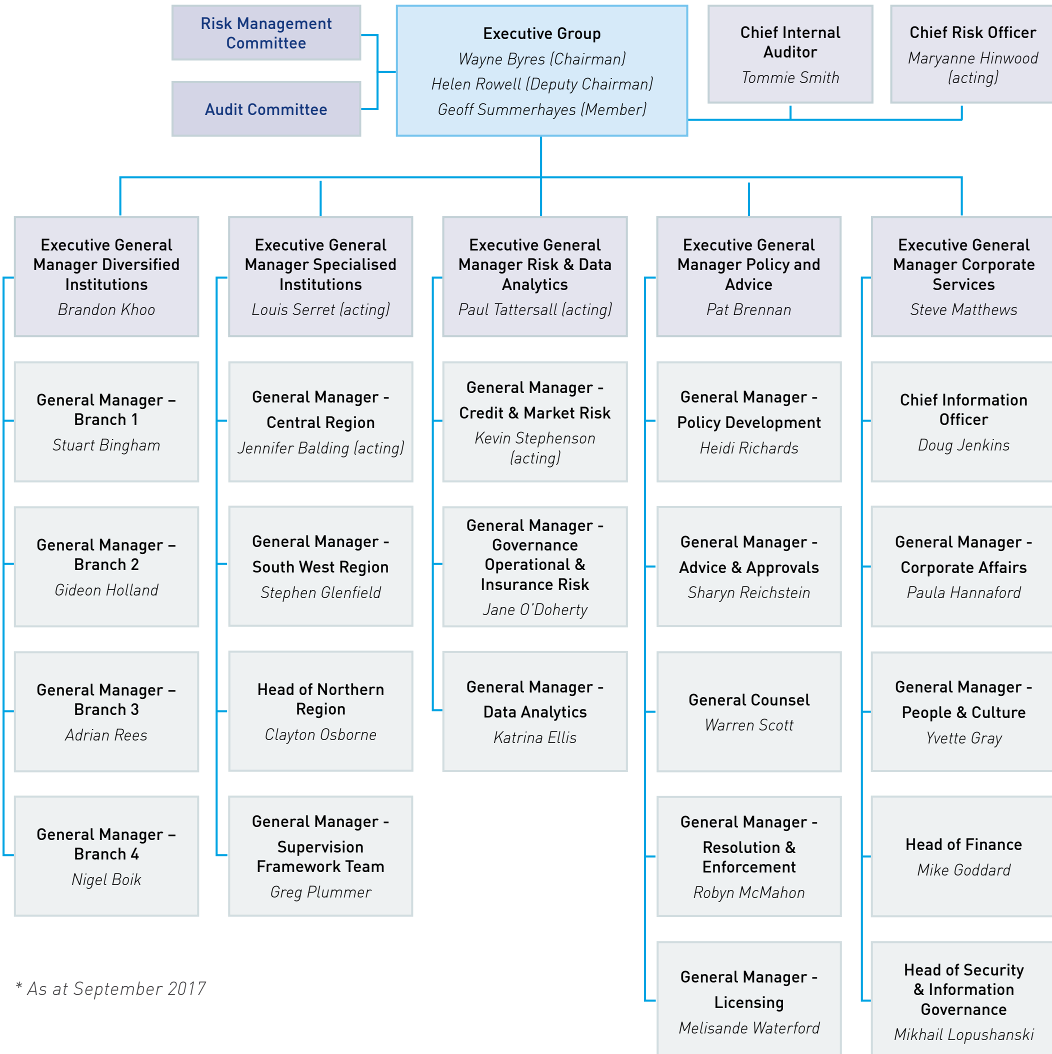
B. Bus, GMQ (AGSM) - Member

Geoff Summerhayes was appointed a Member of APRA from 1 January 2016 for a five-year term.

As an Executive Board Member of APRA, Mr Summerhayes' responsibilities include oversight of the general, life and private health insurance sectors. Prior to his APRA appointment, Mr Summerhayes was Chief Executive Officer of Suncorp Life from 2008 to 2015, as well as being a director of Suncorp Portfolio Services Ltd and of Asteron Life NZ. Before joining Suncorp, he held a number of senior roles at the National Australia Bank (NAB) in strategy, product and distribution. Prior to that, he was CEO of Retail Investment at MLC and also held senior roles at Lendlease. Mr Summerhayes was previously a director of the Financial Services Council and was co-chair of their Life Board Committee.

Mr Summerhayes is a member of the Executive Committee of the International Association of Insurance Supervisors, and a member of its Audit and Risk Committee.

ORGANISATIONAL CHART*



* As at September 2017

RISK MANAGEMENT AND AUDIT

APRA's risk management and audit matters are the subject of oversight by a Risk Management Committee and an Audit Committee that comprise an independent non-executive chair, another independent non-executive member and APRA's Deputy Chairman. The Audit Committee works closely with the Risk Management Committee to ensure APRA's risks are being identified and appropriately managed.

The Risk Management Committee provides independent assurance and advice to the

APRA Chairman on APRA's risk management. This includes assisting the APRA Chairman understand and manage risks that may impede APRA from achieving its goals and objectives, and impact on APRA's performance and reputation.

The Audit Committee provides independent assurance to the APRA Chairman on financial and performance reporting responsibilities, APRA's systems of internal control and compliance with applicable laws and regulations.

The Risk Management Committee met five times during the year. The Committee reviewed and assessed the Enterprise Risk Management Framework and its use across APRA, obtained regular briefings from APRA executives, and assessed the approach to managing APRA's key risks, including those associated with high-risk projects, programs and activities.

The Audit Committee also met five times during 2016/17. It reviewed and endorsed APRA's internal and external audit plans and monitored progress against those plans. The committee provided attestations to the APRA Chairman in relation to its activities and whether it was aware of any impediments to signing APRA's annual financial statements.

In addition to its members, the Australian National Audit Office (ANAO), Chief Internal Auditor, Chief Risk Officer and APRA management representatives are regular attendees at both committee meetings.

The members of the Risk Management Committee and the Audit Committee in 2016/17 were:

Ms Fiona Bennett

BA (Hons), FCA, FAICD, FAIM
Risk Management Committee - Chair
Audit Committee - Independent member

Fiona Bennett originally joined APRA's previous Risk Management and Audit Committee (RMAC) as an independent member on 1 January 2011. With the restructure of the RMAC into separate risk and audit committees, Ms Bennett was appointed as independent Chair of APRA's Risk Management Committee on 1 January 2015 for a three-year term. She also remains an independent member of the Audit Committee for the same period.

Ms Bennett is Chair of the Victorian Legal Services Board and a non-executive director of Hills Limited, Beach Energy Limited and Select Harvests Limited. During her executive career, Fiona held senior executive positions at BHP Billiton Limited and Coles Group Limited, and has been Chief Financial Officer in several organisations in the health sector.

Ms Sam Lewis

BA (Hons), CA, ACA, GAICD
Audit Committee – Chair
Risk Management Committee - Independent member

Sam Lewis was appointed independent Chair of APRA's Audit Committee and an independent member of APRA's Risk Management Committee for a three-year term from 31 May 2016.

Ms Lewis is a chartered accountant, and has been lead auditor to a number of major Australian listed entities. She has extensive expertise in accounting, finance, auditing, risk management and corporate governance. After 24 years with Deloitte, where Ms Lewis was an Assurance and Advisory partner for 14 years, she has more recently taken on roles as a non-executive director of Aurizon Ltd (since February 2015), acting as Chair of the Audit, Governance and Risk Management Committee and as non-executive director of Orora Ltd (since March 2014), where she is Chair of the Audit and Compliance Committee and non-executive director of Nine Entertainment Co. Holding Ltd, where she is Chair of the Audit and Risk Committee.

Mrs Helen Rowell

APRA Deputy Chairman and Member

Further information on attendance at Risk Management Committee and Audit Committee meetings is provided in Chapter 8 – Statutory report.

CH/3

FINANCIAL SECTOR DEVELOPMENTS

FINANCIAL SECTOR DEVELOPMENTS

THE FINANCIAL ENVIRONMENT

Global economic conditions have generally improved over the past year, and the outlook remains positive. Following several years of expansionary monetary policy, central banks did not deliver additional monetary stimulus, and in some cases increased policy interest rates. Policy uncertainty and political risks in the international environment increased, however.

Despite this, global equity markets performed positively, and market volatility has generally remained low and recovered quickly from occasional spikes in response to various geopolitical issues. In China, economic growth throughout 2016, at 6.7 per cent, was the slowest for 26 years. However, thus far in 2017, growth figures for the Chinese economy have marginally beaten expectations. An important concern is the growth in debt levels which continues to rise. The large stock of debt and China's rapid credit growth continue to create vulnerabilities related to high levels of leverage.

International standard-setters maintained their active agendas in 2016/17. The Basel Committee on Banking Supervision (Basel Committee) has made further progress towards the finalisation of the Basel III reforms, although agreement on a final package remains elusive. These reforms will, when complete, include revisions to the risk-weighted asset framework, the leverage ratio framework and the output floor. The International Association of Insurance Supervisors (IAIS) continues to pursue an international capital standard (ICS) for insurers, and is in the process of extended field testing. The IAIS also consulted on revisions to the qualitative components of its common framework for the supervision of internationally active insurance groups (ComFrame) and a number of IAIS insurance core principles.

Australia continues to benefit from a fundamentally sound financial system, reflecting a long period of economic growth. The domestic economic environment of low interest rates, subdued wage growth and high household debt has continued in 2016/17. In this environment, the risks associated with residential mortgage lending have remained an area of focus. The low interest rate environment has also impacted commercial property markets, where valuations have continued to increase at faster rates than underlying rents.

Australian bank credit ratings remain among the strongest in the world. However, at the start of 2016/17, ratings agencies assigned Australia's rating a negative outlook, citing concerns about the build-up of household debt and a higher risk of a sharp property price correction. As property prices kept climbing, both Standard & Poor's and Moody's downgraded the ratings for several Australian financial institutions on these concerns towards the end of the financial year.

Ongoing subdued wage growth has contributed to general insurers making large releases of prior-year claims reserves in the liability classes of business, which have aided their underwriting profitability. However, the persistent low interest rate environment has put pressure on investment earnings for insurers, although there is no evidence they are substantially changing their investment mix towards higher risk assets to compensate. Despite the low interest rates, the investment returns of superannuation funds have generally performed well due to diversified portfolios benefiting from Australian and global equity market gains.

AUTHORISED DEPOSIT-TAKING INSTITUTIONS (ADIs)

The long-term trend of consolidation among smaller institutions in the banking sector continued in 2016/17, as the total number of ADIs operating in Australia (Figure 1a) fell from 157 to 149. Within this longer-term trend, the number of building societies and credit unions has declined considerably in recent years as many have chosen to merge or convert to mutual banks, a trend that is expected to continue. The 149 ADIs at end-June 2017 comprised 84 banks, 4 building societies, 54 credit unions, as well as 7 other ADIs.

2016/17 marked a slight reversal of the long-term trend towards increasing concentration in the banking sector. Some 78 per cent of industry assets are now held by the largest five ADIs (Figure 1b). This is marginally lower than the 79 per cent recorded a year ago. Consistent with that, there was an increase in both the absolute value of assets, and the proportion of total industry assets, held by ADIs outside of the largest 20.

Profitability within the ADI industry as a whole remained healthy. The average return-on-equity was 12.0 per cent in the year to June 2017 (Figure 1c). This is slightly higher than the previous year, which was impacted by a large one-off transaction, but still below the average return-on-equity over the last 10 years. The average net interest margin declined slightly over the year to 1.6 per cent overall, although there were signs of margins increasing slightly towards the end of the financial year. Behind these averages, both profitability and return-on-equity were unevenly distributed across the industry due, amongst other things, to the not-for-profit structure of some smaller ADIs.

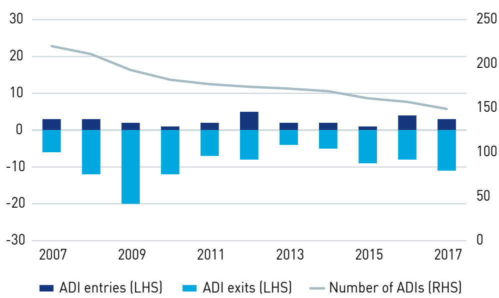
The long-term trend of an improving cost-to-income ratio continued in 2016/17, reducing to 50.5 per cent. This helped maintain strong profitability within the industry despite interest margin pressure (Figure 1d). The improvement in the cost-to-income ratio at an industry level has been achieved primarily through expense management and improved productivity at the larger ADIs. However, the cost-to-income ratio for building societies and credit unions continued to increase, rising to 73.9 and 80.1 per cent respectively, and has been one factor driving consolidation amongst existing players as they attempt to generate efficiency benefits from greater scale.

Economic conditions have remained stable and most asset prices have increased. As a result, non-performing loans have remained at quite low levels, representing less than 1 per cent of gross loans and advances at end-June 2017 (Figure 1e).

Over the past year, the industry's risk-based capital ratios rose by around 10 basis points overall, compared with June 2016 levels. At end-June 2017, the industry Common Equity Tier 1 ratio stood at 10.2 per cent, while the industry Tier 1 ratio was 12.1 per cent (Figure 1f). This relatively modest increase in capital ratios, despite solid organic capital generation, is in part attributable to revised mortgage risk weight targets applied by APRA to banks using internal models.

In July 2017, APRA announced its intention to increase capital requirements for ADIs in order to remain 'unquestionably strong' (see Chapter 4). APRA envisages that the minimum capital requirements for ADIs using an internal ratings-based approach to capital adequacy will be increased by 150 basis points. ADIs using the standardised approach to capital adequacy will have minimum capital requirements that are, on average, higher by 50 basis points. For those ADIs that currently do not meet these higher requirements, APRA expects that they will do so by the beginning of 2020, if not before. The gradual upward trajectory in capital ratios that has been evident across the industry in recent years is therefore expected to continue for some time yet.

Figure 1a - Number of ADI entries and exits



Representative offices of foreign banks excluded

Figure 1b - Assets of largest ADIs

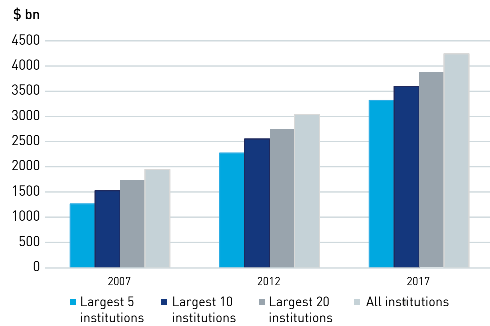


Figure 1c - ADI return on equity

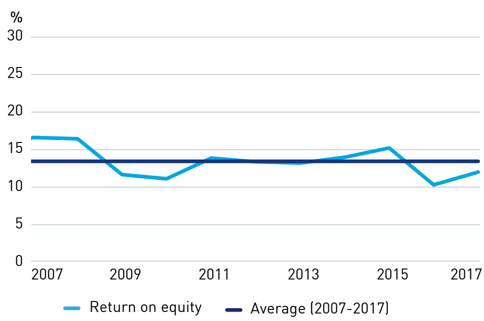


Figure 1d - ADI cost-to-income ratio

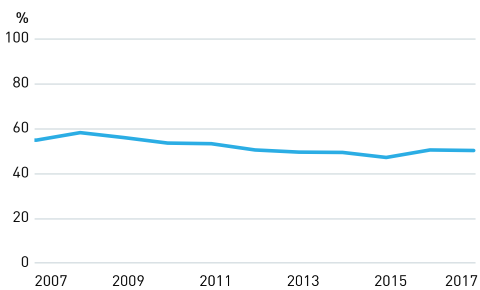


Figure 1e - Ratio of ADI non-performing loans to gross loans and advances

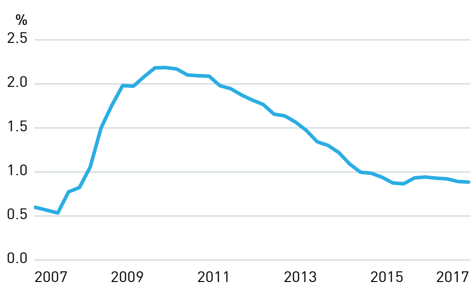
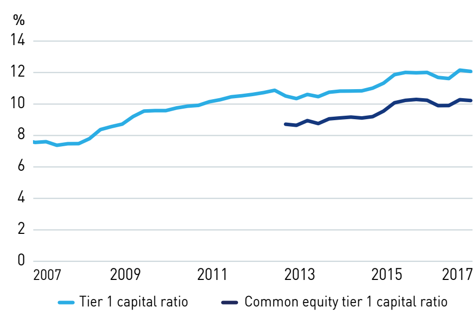


Figure 1f - ADI capital ratios



Capital data presented is collected under three different APRA reporting frameworks: the Basel I capital framework prior to 1 January 2008, the Basel II capital framework from 1 January 2008, and the Basel III capital framework from 1 January 2013.

GENERAL INSURANCE

Five APRA-authorised general insurers left the market in 2016/17, continuing a steady fall in the number of insurers over recent years (Figure 2a). At end-June 2017, there were 104 APRA-authorised insurers: 81 direct insurers, 9 reinsurers and 14 insurers only authorised to conduct run-off business. The decline in the number of authorised insurers over recent years has been largely driven by insurance groups rationalising their insurance licences from past acquisitions, rather than any significant reduction in market capacity or withdrawal of underwriters.

As a result of the licence consolidation, industry concentration has steadily increased, reflected in the balance sheets of the largest five insurers now accounting for 55 per cent of gross written premium, compared to 42 per cent a decade earlier (Figure 2b). Concentration is higher in the personal lines market, while the market shares of insurers in the commercial market are generally lower due to the large presence of foreign insurers. The reinsurance market is, on the other hand, highly concentrated; the two largest reinsurers account for 76 per cent of the market between them.

The industry's return on net assets in 2016/17 remained below its 10-year average for the third consecutive year (Figure 2c), albeit slightly up on the previous year. This lower-than-average result has been partly attributable to a deterioration in the underwriting results in the short-tail property classes of business, with recent higher net loss ratios stemming from subdued premium growth and increased claims costs from severe weather events, particularly Cyclone Debbie in March 2017 (Figure 2d). In recent years, underwriting results have also deteriorated in the domestic motor class of business, which had been a mainstay of personal lines profitability in the past. In contrast, the long-tail classes of business continue to report generally positive underwriting results due to releases of claims reserves from prior accident years.

The low interest rate environment has also contributed to an overall decline in industry profits, with the interest income generated on insurers' substantial interest rate investment portfolios steadily falling in recent years (Figure 2e). Despite this, most insurers continue to invest predominantly in interest rate investments with little appetite to shift into higher risk investment classes such as equities and property. Conservative investment allocations are most evident in the investments insurers hold to meet their insurance liabilities.

The capital coverage ratio for the industry improved through the year to reach 1.84 times the minimum requirement at end-June 2017 (Figure 2f). This healthy capital position reflects the surplus eligible capital that most insurers are choosing to hold above their prudential capital requirements. The quality of capital held by insurers also remains strong, with Common Equity Tier 1 capital being the dominant form of eligible capital.

Figure 2a - Number of general insurance entries and exits

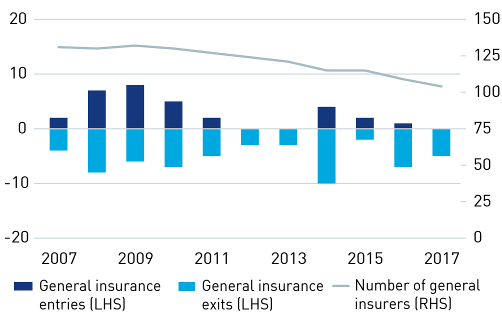


Figure 2b - Largest institutions' share of general insurance industry gross written premium

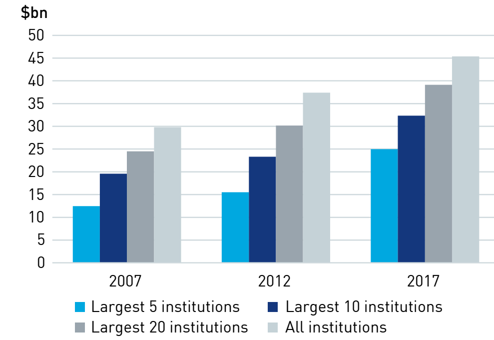
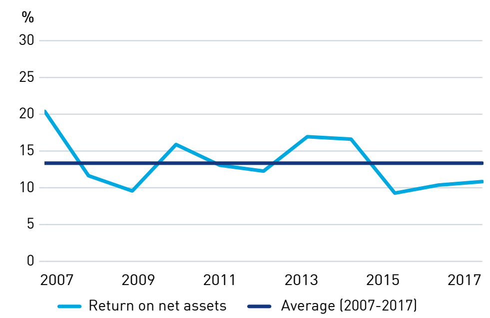


Figure 2c - General insurers' return on net assets



Return on equity is net profit (loss) for the year divided by average net assets over the year.

Figure 2d - General insurers' net loss ratios

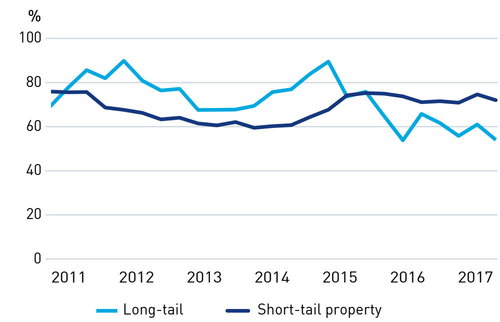


Figure 2e - Investment performance

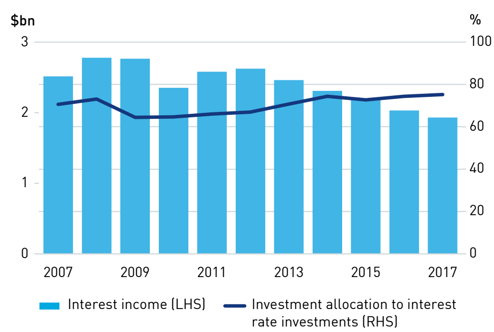
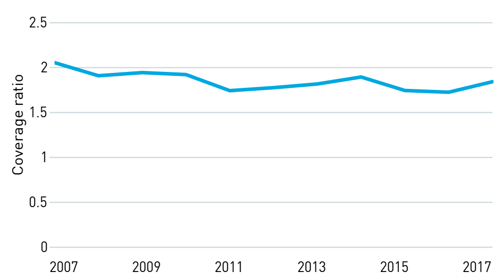


Figure 2f - General insurers' capital



From 1 January 2013, data are based on APRA's new capital standards

LIFE INSURANCE

At end-June 2017, 29 APRA-authorised life insurers and 12 friendly societies operated in the Australian financial sector. These numbers have stayed relatively stable in recent years, with one new life insurance licence granted in 2016/17 and no revocation of licences (Figure 3a). The industry now consists of 7 large diversified insurers, 4 insurance risk specialists, 11 small or niche market players and 7 reinsurers that support the local risk market.

The life insurance industry remains highly concentrated, with the top 5 life insurers accounting for 81 per cent of gross industry assets (Figure 3b), fractionally up over the year. However, ownership of the industry has become more diverse; recent years have seen an increase in foreign ownership in the life insurance industry, particularly by Japanese insurers, which have acquired substantial stakes in a number of local life insurers.

The industry's return on net assets in 2016/17 (10 per cent) declined notably in the most recent year, and is now well below the 10-year average of 13 per cent (Figure 3c). Returns for 2016/17 declined markedly from the preceding year, driven largely by a significant deterioration in insurance risk profitability. This was driven by poor results across several product categories, but was most significant for individual disability income insurance where the industry experienced a substantial loss. Although premium rates have increased since the heavy losses reported during 2014/15, the effect has been outweighed by continuing poor experience and the need for further reserve strengthening as insurers adopted revised morbidity assumptions.

In addition, the profitability of individual lump sum business has maintained the downward trend evident since 2014/15. Group lump sum profitability also declined significantly in the past year, albeit it is still well ahead of the poor results experienced in 2014/15. The overall net profit margin for 2016/17 was 5 per cent, well below the longer-term average of around 8.5 per cent.

Following the global financial crisis, most insurers reduced their exposure to higher risk asset classes, such as equities and property, in their investment portfolios (Figure 3e), and fixed-interest securities now make up a significant part of these portfolios. In a low interest rate environment, yields on fixed-interest investments have reduced, but for existing portfolio holdings there have been compensating capital gains, meaning aggregate returns have been impacted to a lesser extent. As a result, most insurers have not sought to increase their exposure to higher yielding fixed-interest securities to offset the low yield environment to date.

The industry has maintained sound capital ratios over recent years, reflected in an aggregate capital coverage ratio at end-June 2017 of 1.81 times the minimum requirement (Figure 3f). However, the level of surplus capital held above regulatory requirements differs from insurer to insurer, with each facing different risks depending on its business model. The quality of capital held by insurers remains strong, with Common Equity Tier One capital continuing to be the predominant form of eligible capital.

Figure 3a - Number of life insurance entries and exits

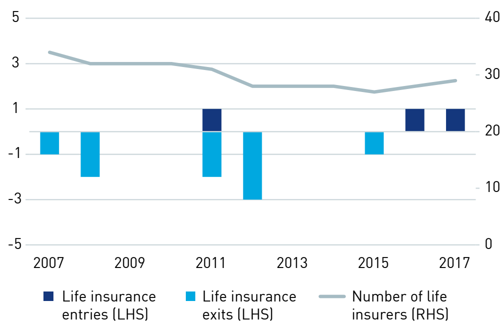


Figure 3b - Largest institutions' share of life insurance industry assets

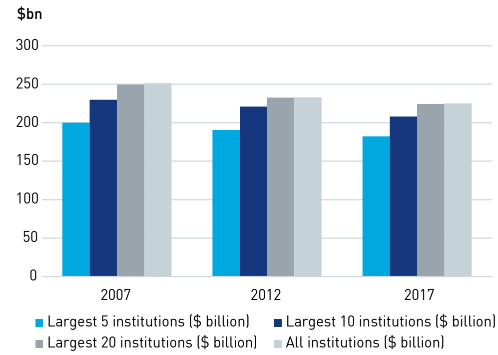


Figure 3c - Life insurers' return on net assets

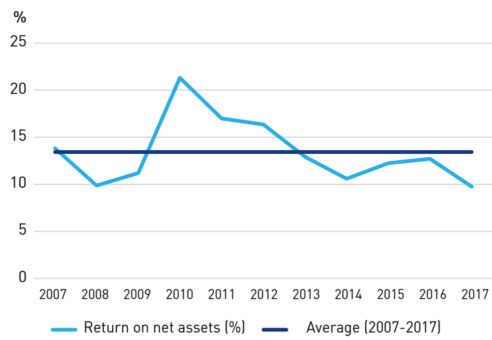


Figure 3d - Net profit after tax (risk products)

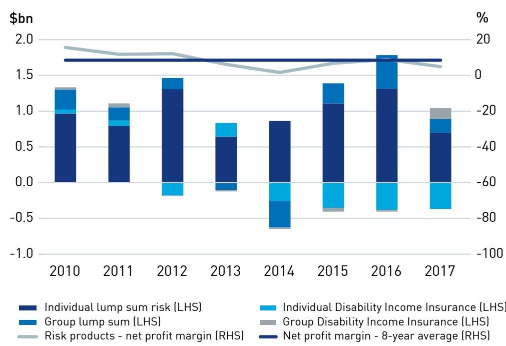


Figure 3e - Non-investment-linked assets

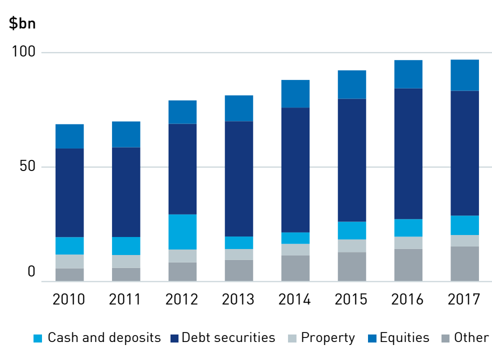
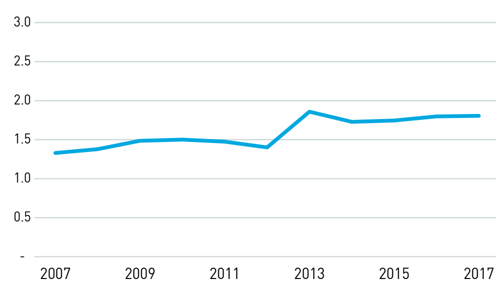


Figure 3f - Life insurers' capital coverage ratio



PRIVATE HEALTH INSURANCE

APRA authorised three new private health insurers during 2016/17. With no departures or amalgamations during the year, the industry comprised 37 insurers at end-June 2017 (Figure 4a). This increase in the number of participants reversed a long-term decline in the number of insurers offering private health insurance, and represented the first annual increase in the number of insurers for more than a decade. Market shares within the industry remain both relatively stable and relatively concentrated, with the largest five insurers accounting for 81 per cent of the market (Figure 4b).

Overall industry profitability increased during 2016/17, up 14.3 per cent year-on-year (Figure 4c). However, this was largely driven by other health-related businesses and investment profits; after three years of increases, profits from health insurance business (HIB) were down in 2016/17, declining by 1.5 per cent overall.

HIB revenue increased by 4.6 per cent over the year, primarily reflecting the average increase in premiums from the previous year rather than any expansion in policy coverage, which increased only marginally. Total benefit payments increased by 4.3 per cent, reflecting growing service costs and rising utilisation rates. Overall, the industry strengthened its gross margins[1] to 14 per cent in 2016/17 due to slower growth in benefit expenditure (Figure 4d). Net margins,[2] on the other hand, fell slightly from the previous year to 5.1 per cent (Figure 4d), reflecting a small increase in the rate of HIB management expenses (to 8.9 per cent) compared with the previous year. Looked at over the longer term, the industry has achieved generally stable margins, reflecting in part relatively few changing or adverse government policy impacts.

Health insurers face multiple challenges in increasing participation rates within the industry, in particular due to product affordability. Hospital treatment policyholders increased slightly during the year, with the number of policies growing by 0.1 per cent. Despite this, insured persons covered over the period fell slightly to 11.3 million and the proportion of the population with hospital coverage continued to decline, falling to 46.1 per cent of the population (Figure 4e). The average age of policyholders continues to increase, with a rising proportion of the 65 and older age cohort maintaining insurance coverage occurring at the same time as declines in the proportion of younger age cohorts.

Current policy coverage levels and solid profitability place the industry in a strong position to continue to meet its prudential obligations to policyholders. The industry held assets well above the minimum capital adequacy requirements, with the coverage multiple at 1.8 times in 2016/17. Industry assets grew by almost $1 billion over 2016/17 to $13.8 billion (Figure 4f).

1. Gross margin is the difference between total premium revenue and total cost of benefits expressed as a percentage of total premium revenue.
2. Net margin is the gross margin less management expenses expressed as a percentage of total premium revenue.

Figure 4a - Number of PHI entries and exits

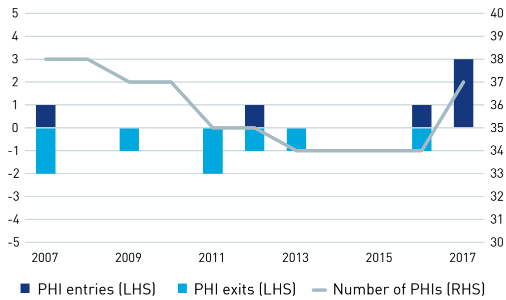


Figure 4b - Largest institutions' share of total health insurance policies

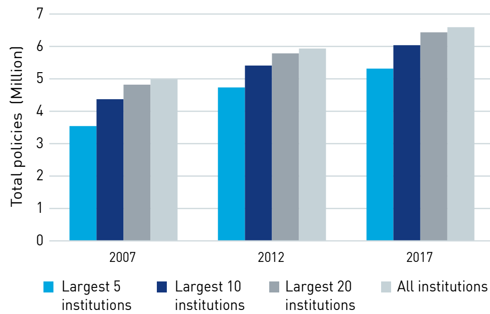


Figure 4c - Sources of industry profit

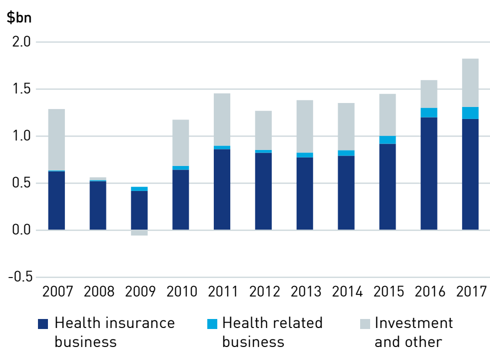


Figure 4d - Health insurers' gross and net margin

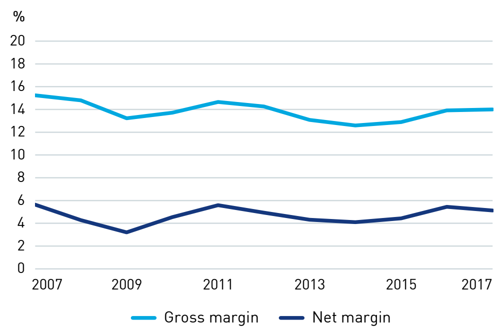


Figure 4e - Hospital treatment persons and population coverage

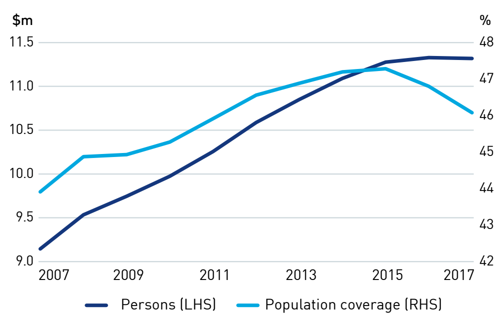
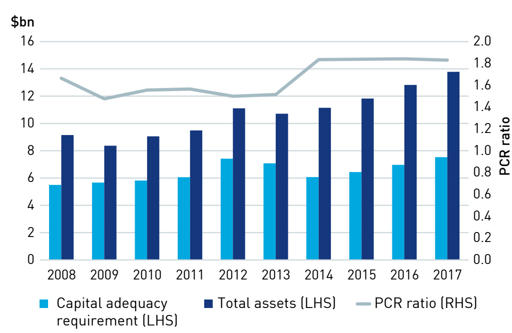


Figure 4f - PHI capital adequacy requirement and total assets



SUPERANNUATION

At end-June 2017, there were 139 licensed superannuation trustees who were responsible for 214 APRA-regulated superannuation funds with more than four members, along with another 2,071 small APRA funds (with four or less members). There were also 12 single-member approved deposit funds and 41 pooled superannuation trusts subject to APRA's supervision.

A slowdown in the consolidation of the superannuation industry continued during 2016/17. The number of APRA-regulated superannuation funds with more than four members fell by 0.9 per cent, in contrast with the higher rate of decline over the previous 13 years (Figure 5a). Regulatory reform — including superannuation trustee licensing throughout 2004-2006, and the introduction of prudential standards in 2013 — partly drove the faster pace of industry consolidation in the earlier period. Also, the introduction of the MySuper regime in 2013 led to a spike in consolidation as a number of funds exited the industry due to a lack of scale.

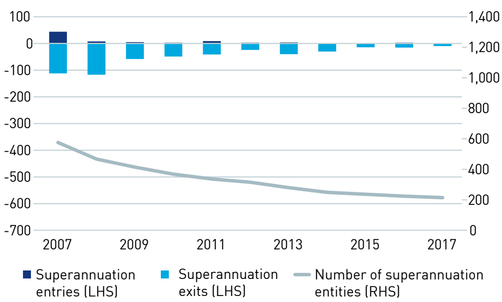
While still low relative to other APRA-regulated industries, industry concentration continues to increase. The top five funds accounted for 28 per cent of total industry assets at end-June 2017. This compared to just under 21 per cent a decade earlier (Figure 5b).

In the 10 years to June 2017, total net assets in superannuation funds with more than four members grew by 93 per cent, while the number of such funds fell by 24 per cent. This has resulted in a 153 per cent rise in average net assets per fund, rising from $2.6 billion to $6.6 billion over the decade. However, the expected scale-related cost benefits from the increased size of these superannuation funds have been not evident. Total administration and operating expenses as a percentage of net assets have declined only marginally to 0.43 per cent during the financial year, compared with 0.46 per cent a decade ago (Figure 5c).

Net contribution flows into the superannuation industry have gradually declined as a percentage of average net assets. This reflects Australia's ageing population and the maturing of the superannuation system, as a growing number of members reach retirement age and begin to draw down their superannuation assets (Figure 5d). This is slowly removing one of the superannuation industry's two primary sources of growth (positive net contributions), and poses a structural challenge to funds' ability to maintain and gain scale.

Long-term investment returns, being the industry's other primary source of growth, were 4.1 per cent per annum over the past decade, and 9.2 per cent over the past five years (Figure 5e). A return of 9.1 per cent was achieved in 2016/17. The industry's traditionally high allocation to growth assets, such as equity and property, has helped drive the longer-term performance, albeit with some volatility over shorter time periods (Figure 5f).

Figure 5a - Number of superannuation entries and exits



Only includes APRA regulated entities with more than four members

Figure 5b - Largest institutions' share of APRA-regulated superannuation industry assets

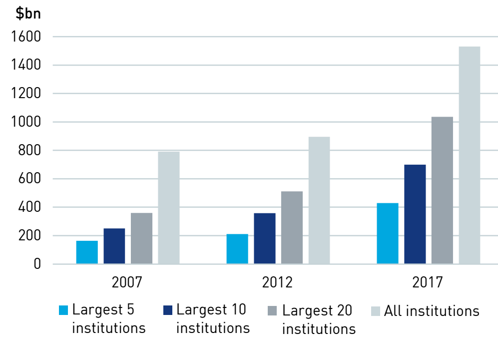


Figure 5c - Administration and operating cost ratio vs. average net assets per entity

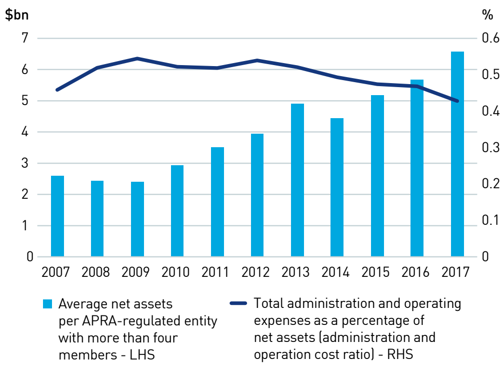


Figure 5d - Net contribution flows as a percentage of average net assets (net cash flow ratio)

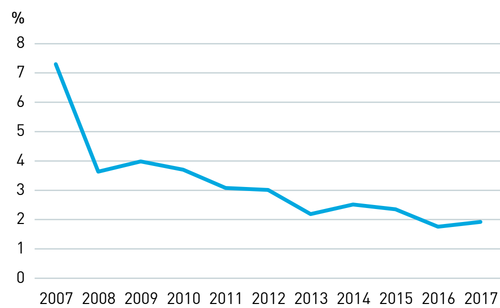


Figure 5e - Five-and 10-year average annualised rate of return

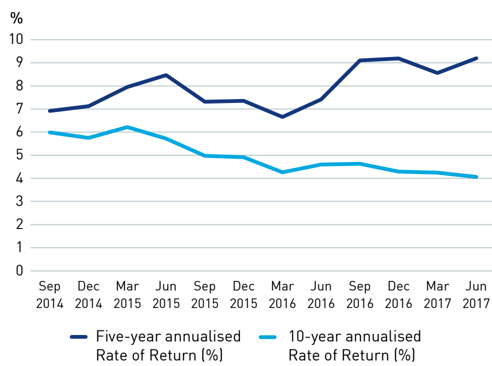


Figure 5f - Asset allocation

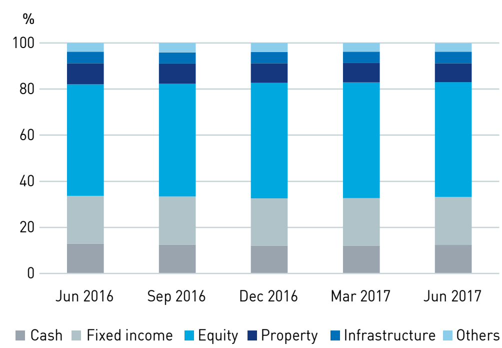


Table: APRA-regulated institutions

	Number of entities[1]			Assets ($ billion)[2]		
	30 Jun 16	30 Jun 17	% change	30 Jun 16	30 Jun 17	% change
ADIs[3]	157	149	-5.1%	4,171.6	4,242.0	1.7%
Banks	80	84	5.0%	4,116.3	4,187.3	1.7%
Building societies	4	4	0.0%	11.9	13.0	9.2%
Credit unions	66	54	-18.2%	39.8	37.6	-5.5%
Other ADIs	7	7	0.0%	3.6	4.0	11.1%
Representative offices of foreign banks	16	14	-12.5%			
General insurers	108	104	-3.7%	122.8	124.9	1.7%
Life insurers[4]	28	29	3.6%	293.0	229.5	-21.7%
Friendly societies	12	12	0.0%	6.8	7.2	5.9%
Private health insurers	34[7]	37	8.8%	12.8	13.8	7.8%
Licensed trustees	144	139	N/A			N/A
Superannuation entities[5]	2321	2,338	0.7%	1292.3	1,444.1	11.7%
Public offer funds	140	136	-2.9%	1,050.5	1,192.0	13.5%
Non-public offer funds	73	67	-8.2%	235.1	245.8	4.6%
Small APRA funds	2,022	2,071	2.4%	2.0	1.9	-5.0%
Approved deposit funds	34	15	-55.9%	0.1	0.1	0.0%
Eligible rollover funds	8	8	0.0%	4.7	4.4	-6.4%
Pooled superannuation trusts[6]	44	41	-6.8%	123.2	137.7	11.8%
Non-operating holding companies	24	25	4.2%			
TOTAL	**2,844**	**2,847**	**0.1%**	**5,899.3**	**6,061.5**	**2.7%**

1. Number of entities for end-June 2016 has been revised where better source data has become available.
2. Asset figures for end-June 2017 are based on the most recently submitted returns. Asset figures for end-June 2016 have been revised slightly from APRA's 2016 Annual Report in line with the audited returns received during the year.
3. The ADI classification does not include representative offices of foreign banks. Other ADIs includes Specialist Credit Card Institutions (SCCIs) until 31 December 2014.
4. The decline of assets in the year ended June 2017 was largely due to MLC Limited. On 1 July 2016, MLC insurance policies in super (including MLC Insurance Super, Life Cover Super and Protectionfirst Super) were transferred from The Universal Super Scheme to a new super fund called the MLC Super Fund on a successor fund transfer basis. The MLC Super Fund is operated under the governance of another trustee in the NAB Group, NULIS Nominees (Australia) Limited.
5. This data excludes superannuation entities that APRA does not regulate, that is, exempt public sector superannuation schemes and Australian Taxation Office regulated self-managed superannuation funds.
6. Pooled superannuation trust assets are not included in totals as these assets are already recorded in other superannuation categories.
7. The number of entries for end-June 2016 has been revised to include all private health insurers authorised by APRA.

CH/4

APRA’S ACTIVITIES

APRA'S ACTIVITIES

During 2016/17, APRA's activities encompassed the full gamut of its primary supervisory, policy and resolution functions, its role as a national statistical agency for the financial sector, and domestic and international liaison. The key activities in these areas are set out below.

SUPERVISORY AND REGULATORY ACTIVITIES

Authorised deposit-taking institutions (ADIs)

Residential mortgage lending

Residential mortgage lending has been a key area of supervisory focus for APRA in recent years, in an environment of high house prices, high household indebtedness, low interest rates, subdued income growth and strong competitive pressures. Sound lending standards are vital for the stability and safety of the Australian banking system, and given the high proportion of property lending (particularly residential mortgages) in the aggregate loan portfolio of the banking system, there is not expected to be any let up in the intensity of APRA's scrutiny in the foreseeable future.

Over the past few years, APRA's activities in this area have included:

- commencing more detailed information collections on a range of housing loan risk metrics;
- stress-testing the largest lenders against scenarios involving a significant housing market downturn;
- issuing a prudential practice guide on sound risk management practices for residential mortgage lending; and
- conducting hypothetical borrower exercises to assess differences in lending standards between lenders, and changes over time.

In addition, APRA wrote to all ADIs in late 2014 identifying specific areas of prudential concern, advising of the need for stronger serviceability assessments and requesting annual investor lending growth be contained to below a benchmark of 10 per cent.

Building on the need to further safeguard against the heightened risk environment, APRA initiated additional supervisory measures in March 2017 to further moderate the risk in new lending. APRA outlined its expectations that ADIs limit interest-only loans to 30 per cent of total new residential mortgage lending, continue to limit investor lending growth below the 10 per cent benchmark, contain growth in higher-risk segments, and ensure serviceability metrics are set at appropriate levels for current conditions.

Commercial property lending

In 2016, APRA completed its thematic review of commercial real estate lending (commenced in the second half of 2015), underwriting standards and portfolio controls at the larger domestic banks, as well as foreign bank branches which have been increasing market share in this area.

In March 2017, APRA released a letter to all ADIs that set out the key observations from this review, including that:

- in current market conditions, it is important that the Boards of ADIs are conscious of the settings for underwriting standards and portfolio controls, and in a position to challenge as appropriate;
- Boards should also actively challenge whether expectations of growth in commercial property lending are achievable, given the position in the credit cycle, without compromising the quality of lending; and
- APRA's review revealed that the ability of the Board and senior management to fully understand and challenge the risk profile of lending has often been hampered by inadequate data, poor monitoring and incomplete portfolio controls.

APRA has continued to closely monitor commercial property lending and continues to follow up with ADIs to respond to issues identified through the review.

Financial System Inquiry: 'unquestionably strong' capital ratios

In early 2017, APRA indicated that it intended to push ahead with a response to the first recommendation of the Financial System Inquiry (FSI) that the capital ratios of Australian ADIs should be 'unquestionably strong'. APRA had deferred a final decision on this recommendation pending the expected completion at the end of 2016 of international reforms to the bank capital framework being proposed by the Basel Committee on Banking Supervision. However, once it became clear that the international work would be delayed, APRA elected not to wait any longer to progress this matter.

APRA subsequently released the Information Paper, *Strengthening banking system resilience – unquestionably strong capital ratios*, in July 2017. APRA's information paper established the quantum and timing of capital increases for ADIs to achieve the FSI's objective. In its assessment, APRA focused on the appropriate calibration of Common Equity Tier 1 (CET1) capital requirements. In the case of the four major Australian banks, APRA announced a benchmark CET1 capital ratio of at least 10.5 per cent under the current capital adequacy framework. This was broadly equivalent to an average 100 basis point increase in CET1 capital ratios relative to their position at end December 2016. For other ADIs that use the standardised approach to credit risk, APRA concluded it would be necessary to raise minimum capital requirements by approximately 50 basis points to achieve capital ratios consistent with the 'unquestionably strong' goal. APRA announced it expected ADIs to meet the 'unquestionably strong' capital benchmarks by 2020.

In addition, APRA announced it would release a discussion paper in late 2017 on proposed revisions to the capital framework, designed to establish the detailed capital requirements that would underpin these new benchmarks. In doing so, the discussion paper will also outline measures to address Australian ADIs' structural concentration of exposures to residential mortgages, as well as provide guidance as to APRA's implementation of the Basel Committee reforms (known as Basel III), assuming they are finalised by that time. It will also outline a range of options APRA is considering to improve the transparency and international comparability of ADI capital ratios.

Stress testing

APRA's ongoing stress-testing program for ADIs contained a number of different work streams through 2016/17 aimed at assessing the banking sector's resilience and encouraging ADIs to think more broadly about their risks.

In 2016, APRA ran – for the first time – a reverse stress test for the largest ADIs in which they were required to identify the most plausible causes of two stressed outcomes: (i) a breach of their prudential capital requirements for any tier of capital, and (ii) a financial year loss. Following the test, ADIs indicated there were a number of insights for their risk identification processes, recovery plan actions, and capital and liquidity management strategies.

APRA also undertook a stress test of eight smaller ADIs that had not previously participated in APRA stress-testing exercises. The scenario utilised for these tests was the same as the 2015 stress test conducted with the larger banks – a weakening in China's economy leading to an economic downturn in Australia. The results largely mirrored those of 2015, with the participating entities proving to be relatively resilient. Importantly, those ADIs that forecast capital breaches under the stress scenario were able to recover their capital positions through a range of mitigating actions such that no entity reported they would breach their prudential capital requirement either at the CET1 or the total capital level.

In 2017, APRA also launched a more extensive ADI industry stress test. This was similar in scope and design to the 2014 exercise with 13 participating ADIs, including the major banks, and two lenders mortgage insurers. Participants were asked to model two scenarios: one constituting an economic downturn and the second incorporating a major operational risk event. The results of this stress test will be finalised later this year.

Recovery planning

During 2016/17, an important area of activity for APRA continued to be the development of robust and credible recovery plans by ADIs. Recovery plans help ensure that ADIs are well positioned to respond to, and recover from, a period of severe adversity. A robust and credible recovery plan will include a realistic and up-to-date menu of practical actions that can be implemented in stressed operating conditions to improve the financial strength of the ADI, acknowledging that at least some other ADIs may well be seeking to undertake similar (or related) actions at the same time.

Over the past year, APRA concluded a thematic review and benchmarking exercise of recovery plans submitted by the larger ADIs. APRA provided entity-specific feedback on the plans, which outlined the key areas assessed as requiring improvement. APRA's recovery planning guidance was also updated to reflect better practice examples identified during the benchmarking process so that relevant ADIs can reflect these in the next iterations of the plans due in late 2017. Although primarily directed at the largest institutions, the guidance is also available to other ADIs as appropriate to help them develop recovery plans proportionate to their size and complexity.

Other activities

During 2016/17, APRA consulted on a number of other changes to the prudential framework for the banking sector which are briefly outlined below.

- APRA finalised revisions to its regulatory framework for securitisation. The revisions reflect the Basel Committee's updated securitisation framework, with appropriate Australian adjustments, and introduce a simpler and more transparent securitisation framework. The reforms, which become effective from 1 January 2018, provide for better alignment of capital requirements with underlying risk, establish more flexibility for ADIs in their funding arrangements and assist ADIs to pursue more stable sources of funding.
- In December 2016, after completing its consultation process, APRA published its final liquidity standard and guidance for the Net Stable Funding Ratio (NSFR). The NSFR supplements the Liquidity Coverage Ratio (LCR), introduced at the beginning of 2015, by establishing a minimum stable funding requirement for ADIs based on the maturity and liquidity characteristics of an ADI's assets and contingent commitments. The NSFR seeks to ensure less liquid assets are financed by a minimum amount of stable funding. APRA will apply the NSFR from 1 January 2018 to larger, more complex locally-incorporated ADIs that are required to meet the LCR.
- In September 2016, APRA released a consultation on its proposal to implement the Basel Committee's revisions to the international counterparty credit risk framework. APRA subsequently wrote to all ADIs advising the revisions would not take effect until 1 January 2019 at the earliest.

APRA also set out its intention to hold an additional consultation, including proposed reporting requirements and consideration of a simpler alternative methodology for measuring counterparty credit risk exposures for ADIs with an immaterial level of exposure.

- APRA reviewed its prudential requirements for traded market risk in response to the Basel Committee's revised market risk standard, commonly known as the Fundamental Review of the Trading Book. In March 2017, APRA wrote to all ADIs advising it does not envisage a new market risk standard before at least 2020.

New accountability measures

In the 2017 Federal Budget, the Australian Government announced a package of measures in relation to the financial sector, including the new Banking Executive Accountability Regime. This regime will make banks and their most senior executives and directors accountable for meeting heightened standards of behaviour and grant APRA stronger powers of disqualification, and powers for fines to be imposed on ADIs if they fail to live up to APRA's expectations.

Following the Budget announcement, the Government consulted with industry on the proposed changes and the final reforms are expected to go before Parliament later in 2017.

General insurance

CTP claims experience

APRA has been closely monitoring the significant increase in claims frequency reported in the NSW compulsory third party (CTP) motor scheme, and the reforms the NSW Government is planning to make to the scheme. These reforms, planned to take effect in December 2017, are intended to make premiums more affordable through reducing scheme costs, and include moving to a no fault structure with defined benefits for lower severity claims.

During 2016/17, APRA engaged with CTP insurers to assess the financial impact of the increase in claims frequency, and the management and controls which insurers have in place to manage the impact on claims reserves. APRA will continue to engage with CTP insurers and the NSW CTP scheme regulator as preparations take place to implement the scheme reforms. APRA has also been monitoring the potential for this adverse claims trend to emerge in the CTP schemes in other states and other long-tail classes of business and ensuring that insurers are also monitoring this risk.

Pricing risk in commercial lines

A continuing area of heightened supervisory focus for APRA is the strong competition in the commercial lines classes of business and associated risk that pricing levels may not adequately reflect the risks of the business being underwritten. Most of APRA's attention has centred on the fire and industrial special risks (ISR) class of business which has reported underwriting losses for the last three years, attributable to poor claims experience and strong competition hindering increases in premium rates to reflect the deterioration in experience.

The findings from an APRA review of the oversight and control of pricing decisions among a sample of commercial property insurers and reinsurers were communicated to the industry in *APRA Insight* Issue 3, 2016. APRA will follow up with the insurers covered by the review on a case-by-case basis as part of supervision activities and is also developing additional internal tools and guidance for supervisors to further strengthen their analysis of pricing risk in commercial lines.

Stress testing

APRA's first industry stress test of general insurers was conducted during the year, with the four largest direct insurers and two largest reinsurers participating in the test. The scenarios for the test included a severe market stress, earthquake stress and CTP claims stress.

Following analysis of the results, APRA provided written feedback to each participant and met with them to discuss APRA's observations and the insurer's learnings from the test. APRA also provided feedback to the industry as a whole on APRA's observations from the stress test, including areas where improvements in industry practices were needed.

Due to the heterogeneous nature of the participants, the stress test results varied according to their product and investment mix. Product diversification and robust reinsurance arrangements were key factors influencing the capital resilience of the participants to the capital stress arising from the different scenarios. The stress test also provided valuable perspectives on the effectiveness of the mitigating actions that participants would seek to employ in times of capital stress, which were generally well-considered and tailored appropriately to the different types of stresses.

Involvement in the test led to participants enhancing their stress-testing capabilities, and identifying areas for further development. Most needed to improve their modelling capabilities for APRA's multi-year scenarios and to accommodate the granular parameters supplied in the CTP claims stress. Insurers' governance arrangements for the stress test were found to be reasonably sound, with appropriate engagement evident from senior leadership teams.

Recovery planning

Recovery planning is critical for regulated institutions to be able to continue to meet their financial promises to the community while recovering from a period of severe adversity. As part of a strategic focus on building recovery planning capability across APRA-regulated industries, APRA has commenced a thematic review of recovery planning for insurers. This review includes those institutions that participated in the recent general insurance and life insurance industry stress tests.

Over 2017/18, APRA will provide draft guidance to these insurers and request submission of recovery plans based on that guidance. APRA will undertake a review and benchmarking of these plans, following which feedback will be provided to the insurers involved, and also to the industry as a whole, on sound practices and areas for improvement.

Role of the Appointed Actuary and actuarial advice

During the year APRA consulted on a package of proposed reforms in relation to the role of Appointed Actuaries. The proposals were aimed at making the requirements for Appointed Actuaries more principles-based, and included articulation of a purpose statement for the role, a new requirement for entities to develop an actuarial advice framework, and improvements to reporting requirements.

Submissions received from stakeholders across the general, life and private health insurance industries were broadly supportive of the intent and form of the proposals. As foreshadowed in the initial consultation, APRA intends to consult further on the proposed prudential amendments in 2017/18.

Life insurance and friendly societies

Group insurance arrangements

The 2016/17 year saw a more settled group life insurance market, characterised by less volatile premiums, greater reinsurance capacity, improved profitability and continued work by life insurers and trustees to improve claims experience for beneficiaries.

During the year APRA concluded its thematic review of the long-term sustainability of scheme benefit structures and the final report on APRA's group risk sustainability work will be released later in 2017.

The objective of this review was to encourage a group life market that is viable for insurers and meets the needs of fund members, while also reducing the likelihood of another significant period of price discontinuity such as was experienced in recent years. The review indicates that there has been improvement in insurers and trustees working together effectively to design group life benefit structures with sustainability as a clear objective, further evolution in the clarity and alignment of claims philosophy, and a strong focus on improving claims processes and procedures. Some trustees, however, continue to offer group risk cover to members with complex policy terms and definitions that have not been significantly revised for many years. Further, some tenders for group business restrict the scope for insurers to propose changes in these areas as part of their group cover terms. Further work by insurers and trustees is needed to address this.

APRA has concluded its thematic work in the group insurance space for the time being, however it will maintain a heightened focus on this segment of the market throughout 2017/18. In particular, 2016/17 has seen signs of a re-emergence of greater price competition in the group risk market, which is important in ensuring appropriate balance between insurers earning reasonable and sustainable profits while allowing trustees to provide appropriate insurance cover at a price that will not unduly erode members' retirement incomes.

APRA will be monitoring group risk tender activity for any indications of a return to the aggressive practices of the past that ultimately resulted in unsustainable outcomes and significant disruption to the market. Where appropriate, APRA supervisors will challenge insurers and reinsurers, and also trustees, to explain their approach to particular tenders, including how the tender design and process aligns with the insurance management framework the trustee has in place (as required under *Prudential Standard SPS 250 Insurance in Superannuation*).

Claims handling

In May 2016 APRA wrote to life insurers and trustees seeking information related to claims oversight and governance in the wake of public allegations of inappropriate and unfair treatment of a small number of claimants by The Colonial Mutual Life Assurance Society Limited (trading as CommInsure). Following a review of insurers' responses, in October 2016 APRA set out its findings in a letter to industry, highlighting the following key areas for improvement:

- review of insurance benefit design and definitions with a stronger focus on delivering insurance benefits appropriate for members at an appropriate level of cost;
- better sharing of information between insurers and trustees – for example, information on claims data and trends and regular reporting on key performance indicators;
- closer co-operation and alignment between trustees, insurers and reinsurers to optimise outcomes for beneficiaries; and
- clarifying the approach to claims in the claims philosophy of both the insurer and trustee to improve claimants' understanding of how claims will be managed.

From the perspective of the oversight and governance of claims, APRA has also examined 14 independent reviews of insurers that were required by ASIC and will release its views on these independent reviews later in 2017.

In response to the Comminsure matter and other allegations of unfair claims decisions, a number of Parliamentary inquiries into aspects of the life insurance industry were established. In November 2016 APRA lodged a submission with the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into the life insurance industry, and senior APRA executives attended a public hearing of the Committee in February 2017.

ASIC and APRA are also working co-operatively to develop a new data collection of key claims measures, to provide reliable, timely and consistent data on life insurance claims. This project will extend into 2018 and includes data collection on a trial basis prior to finalisation of an ongoing data collection, and consultation with industry and other stakeholders on the publication and public availability of the data that is collected.

Legacy products, processes and systems

In recent years APRA has highlighted in submissions to two Parliamentary inquiries on life insurance its view that complexity and legacy issues may lead to unsatisfactory outcomes for consumers. At the start of 2017 APRA commenced discussions with industry participants to ascertain:

- the extent to which legacy products, processes and systems may constrain life insurers from effectively and efficiently delivering insurance products to consumers; and

- the constraints that may limit the ability of insurers to address legacy issues – including consideration of the significant multi-year investment required and how benefits for consumers and insurers might justify this expenditure.

While aspects of legacy issues can only be addressed by legislative change, insurers themselves can take substantive further action to remediate the situation. The significant financial and reputational costs that have arisen from the issues that have emerged in the last year or so indicate that the cost/benefit equation for tackling legacy issues may have changed.

APRA will continue to develop its thinking and engage with industry on legacy issues, which constitute a growing and significant operational risk for insurers. If not adequately addressed, legacy issues may warrant consideration of further supervisory action, including higher capital requirements to reflect the higher risk profile, to provide stronger incentives for insurers to address such issues.

Individual Disability Income Insurance (DII)

Disability Income Insurance (DII) has generated losses for many insurers over recent years. As a result, in June 2017 APRA commenced a thematic review to obtain further information on the underlying causes of this ongoing poor experience and the actions being taken to address it. Initially APRA engaged with reinsurers to obtain a snapshot of experience across the DII segment; this work will continue into 2017/18 and include engagement with insurers as well as reinsurers. APRA will work constructively with industry to identify possible solutions to the poor performance for this line of business, but ultimately it will be up to industry to take appropriate action.

Private health insurance

During 2016/17, APRA continued its focus on integrating private health insurers (PHIs) into the policy and supervisory frameworks and processes applied to other APRA-regulated institutions, including APRA's PAIRS framework and data collection system.

Policy roadmap

In May 2016, APRA commenced consultation with PHIs and other stakeholders on its medium-term prudential policy roadmap for the industry. APRA indicated that the prudential framework for PHIs would be progressively reviewed in three phases over a three-to-five-year period as follows: risk management, governance and capital.

In December 2016, APRA commenced consultation on the main component of phase one – the application of APRA's cross-industry *Prudential Standard CPS 220 Risk Management* to PHIs. The responses to the consultation were generally supportive of APRA's proposals, with stakeholder submissions noting that the principles underpinning the standard were appropriate for the industry. APRA finalised CPS 220 in July 2017, with an implementation date of 1 April 2018 to enable an orderly transition for insurers.

APRA has recently commenced work on phase two of the roadmap and expects to consult with industry on governance proposals later in 2017. At this stage, APRA anticipates that, as with CPS 220, the principles underpinning APRA's cross-industry *Prudential Standard CPS 510 Governance* and *Prudential Standard CPS 520 Fit and Proper* will be broadly appropriate for the private health insurance industry.

Risk management thematic review

In May 2017, APRA concluded a thematic review of the risk management arrangements and practices of 33 private health insurers, which informed APRA's approach to the application of CPS 220 to private health insurers.

The review found the key challenges facing insurers in their risk management arrangements included:

- forming a view of risk culture and taking steps to address any desired changes;
- ensuring operational structures facilitate effective risk management;
- aligning risk management practices to business requirements rather than a particular risk register solution;
- assessing and managing the risks to strategic and business objectives; and
- establishing a Chief Risk Officer role with appropriate reporting lines and obtaining an adequately skilled and independent person to fill the role.

The thematic review provided APRA with the opportunity to assess the quality of risk management within PHIs, and provide feedback to individual insurers on areas for improvement in their risk governance and operational risk management. In addition APRA issued an industry wide report that shared high-level observations from the thematic review and noted common challenges facing PHIs in respect to their risk management. APRA will retain its focus on the risk management of individual PHIs through ongoing supervision activities.

Superannuation

Governance

Throughout 2016/17, APRA continued its focus on enhancing board governance and risk management in the superannuation industry, with particular emphasis on the importance of board culture.

To assist the industry with implementation of better practices, in November 2016, APRA concluded its consultation on amendments to *Prudential Standard SPS 510 Governance* and *Prudential Practice Guide SPG 510 Governance*. The amended standard now requires registrable superannuation entity (RSE) licensees to have in place a framework setting out policies on appointing, nominating and removing directors, with additional guidance provided in relation to director tenure and board size.

To gain a better understanding of how well industry is embedding sound governance practices, APRA also commenced further thematic reviews of board governance and conflicts management. These reviews are expected to be completed in the second half of 2017, and will enable APRA to highlight to the industry examples of better governance practices observed during the review, as well as potential areas for further improvement. The reviews have focused specifically on director appointment and nomination processes, board renewal and tenure, board size, the ongoing assessment of board performance and effectiveness, and the management of related-party arrangements.

Business and strategic planning and assessing outcomes for members

In its interactions with industry during 2016/17, APRA emphasised the importance of RSE licensees implementing robust strategic and business planning processes to ensure their funds deliver high quality, value-for-money outcomes for members over the medium to long term. Operating in what is an increasingly complex environment, RSE licensees need to be aware of, and proactively respond to, challenges and ensure their funds remain 'fit for purpose'. That, in turn, requires sound planning that takes into account a range of plausible scenarios, provides disciplined monitoring of progress against those plans, and takes prompt corrective action if underperformance is identified.

In the first edition of *APRA Insight* for 2017, APRA published an article highlighting its increased scrutiny of how RSE licensees are ensuring they have adequate focus on the quality and value they deliver to members of the funds they oversee. Stronger practices in business and strategic planning encompass a thorough consideration of the resources necessary to achieve strategic objectives, consideration of the material risks associated with the strategic objectives, and monitoring of a broad range of measurable indicators of performance on at least a quarterly basis.

APRA will continue its focus on strategic and business planning, and how RSE licensees are assessing the delivery of quality, value-for-money member outcomes, throughout 2017/18.[1] Particular supervisory focus will be placed on RSE licensees that appear not to be consistently delivering quality member outcomes or appropriately positioned for future effectiveness and sustainability. Those licensees will be expected to develop a robust and implementable strategy to address the identified weaknesses within a reasonably short period and engage with APRA more regularly to monitor implementation of that strategy.

Liquidity stress testing

During the year, APRA completed its thematic review on how RSE licensees were undertaking liquidity stress tests and using the test results. The review indicated that RSE licensees adopt a variety of practices for liquidity stress testing with differing degrees of sophistication. Although some trustees devote considerable effort and resources to their stress-testing activities, a substantial number fail to use the results to inform their investment decision-making in a meaningful way.

The review found that key determinants of the quality and effectiveness of liquidity stress testing were management attitude and operational culture. Better practice in undertaking and using the results of liquidity stress tests typically included RSE licensees:

- at least partly performing liquidity stress tests themselves, rather than fully relying on external suppliers;
- seeking and using data that was specific and relevant to their circumstances to enhance the insights provided; and
- applying the results of the stress tests in investment decision-making.

Conversely, those trustees that were less mature in their application of liquidity stress testing typically:

- treated it primarily as a compliance exercise;
- placed almost complete reliance on asset consultants to perform the stress tests; and
- did not incorporate the results of the stress tests into their investment decision-making.

The full details and conclusions of the review were published in *APRA Insight* Issue 4, 2016.

Successor fund transfers (SFT)

Over recent years, consolidation in the superannuation industry via successor fund transfers (SFT) has continued, albeit at a slower pace than previously and APRA expects such consolidation to continue.

To assist industry consideration of the specific requirements to be met in relation to SFTs, APRA released for consultation in November 2016 updated guidance relating to SFTs (including draft *Prudential Practice Guide SPG 227 Successor Fund Transfers and Wind-ups*). SPG 227 provides guidance for both RSE licensees that have decided to transfer some or all of their members to a different RSE via an SFT and RSE licensees that have decided to receive a transfer of members via an SFT. Existing APRA guidance that remained relevant was incorporated into draft SPG 227, together with APRA's expectations with regards to:

- the assessment of 'equivalent rights', including what is a 'right', accrued benefits and assessment on a 'bundle of rights' basis;
- the assessment of 'equivalent rights' when undertaking an SFT between MySuper products, including MySuper products with a single diversified investment strategy and a lifecycle investment strategy (or vice versa); and
- the equitable treatment of operational risk financial requirement (ORFR) financial resources when undertaking an SFT.

The submissions received were generally supportive of the proposed guidance, and SPG 227 was finalised and released to industry in July 2017.

1. APRA released a letter to all RSE licensees on 31 August 2017 to provide detailed information about assessing member outcomes.

Cross industry activities

Risk culture

APRA's prudential framework seeks to ensure that risk-taking in financial institutions is conducted within reasonable bounds and that risks are clearly identified and well managed. A sound risk culture is an integral component in achieving this, and is likely to reduce both the frequency and impact of behaviour that may otherwise jeopardise an institution's financial well-being and contribute to increased public trust in financial institutions and the financial sector more broadly.

In October 2016, APRA published its *Information Paper – Risk culture*, which provided a snapshot of industry practices in relation to risk culture across the deposit-taking, insurance and superannuation industries. The information paper highlighted that industry is at the early stages of developing its understanding of risk culture and approaches to managing it. The current focus across the industry is largely on assessing the state of risk culture, and while approaches continue to evolve, it has not yet reached the point where widespread expertise is readily available.

In 2017, APRA built on this work and commenced a cross-sectoral pilot program of risk culture reviews that will continue over the next 12 to 18 months. The focus of these reviews is on behavioural norms that reinforce or detract from the effective management of risk within a specific segment of an institution, and the drivers that underpin these norms. This program of work will further develop APRA's practical knowledge and experience in evaluating risk culture as a driver and lead indicator of risk outcomes. This insight will enhance our capability to identify issues that have the potential to threaten institutional viability and therefore beneficiary interests.

Remuneration review

In 2017, APRA commenced a review into industry remuneration practices. The focus of this review is on current industry practice and the extent to which remuneration practices meet the key principles set out in prudential standards: that performance-based components of remuneration are designed to encourage behaviour that supports long-term financial soundness and are aligned to the risk management framework. In June 2017 APRA requested detailed information on remuneration practices from a sample of ADIs, life insurers, general insurers and superannuation entities which will support this analysis.

Cyber security

Cyber attacks are increasing in frequency, sophistication and impact, with perpetrators continuously refining their efforts to compromise systems, networks and information worldwide. To date, no APRA-regulated entity has suffered material losses from a cyber incident, and security controls have held up against past attacks, however this should not provide grounds for complacency. APRA-regulated entities should expect to experience significant cyber security incidents and be prepared for an evolving range of threats.

APRA continues to be proactive in this area, taking action to lift supervisory activities and expectations for regulated entities to secure themselves against cyber attacks and implement improved mechanisms to quickly detect and respond to attacks when they occur. As recent incidents have shown, this includes ensuring basic operational security (such as effective access management and maintaining system health). In APRA's view, weaknesses in this area significantly undermine the work being undertaken at the strategic security management level and unnecessarily increase an entity's risk profile.

To assess industry progress in this important area, APRA is conducting a follow-up survey to the cyber security survey undertaken in 2016, the results of which were published in *APRA Insight* Issue 3, 2016. Work has also begun to develop a new information security prudential standard and to update the existing *Prudential Practice Guide CPG 234 Management of Security Risk in Information and Information Technology*.

Climate change risk

APRA increased its attention on the potential systemic and prudential impacts of climate change risk in 2017 and set out its views in a speech by APRA Member Geoff Summerhayes and an article in *APRA Insight* Issue 1, 2017. In recent years, APRA primarily considered climate change risks in terms of an insurer's exposure to losses from increasingly frequent and severe natural disasters, or 'physical risks'. However, APRA's focus has expanded to recognise potential flow-on or secondary impacts associated with climate change to banking institutions, insurers and superannuation funds. Given the significant uncertainty of policy and regulatory positions on climate change, financial institutions need to consider how to manage the additional risks of an uncertain timeframe for a transition to a low-carbon economy.

APRA has placed increasing emphasis on institutions having robust stress-testing frameworks. Stress testing and scenario testing can be particularly useful for modelling the impacts of climate change risks given the uncertainty and range of future outcomes. Moving forward, APRA expects institutions will incorporate more sophisticated modelling of the impact of climate risk in their stress tests.

Non-centrally cleared derivatives

In December 2016, APRA finalised its new cross-industry *Prudential Standard CPS 226 Margining and risk mitigation for non-centrally cleared derivatives*. CPS 226 implements the internationally agreed margin requirements and risk mitigation standards for non-centrally cleared derivatives – an important component of the G20's post-crisis reforms aimed at reducing systemic risk in the OTC derivatives market. CPS 226 commenced in March 2017, subject to a multi-year phase-in timetable. In August 2017, APRA finalised its proposal to permit substituted compliance with respect to the margin requirements of seven foreign jurisdictions.

Conglomerates groups

In August 2016, APRA released the final requirements for the non-capital components of the framework for the supervision of conglomerate groups (the 'Level 3 framework'). APRA engaged with Level 3 groups throughout 2016/17 in preparation for the commencement of these requirements, which became effective on 1 July 2017.

Resolution and enforcement activities

One of APRA's core functions is to plan and implement prompt and effective responses to the failure of a regulated institution, or a crisis in the financial system. APRA further developed its resolution capabilities during the year, as well as working with industry to improve recovery planning practices. APRA does not operate a zero-failure prudential regime; to do so would require APRA to place severe limitations on risk-taking by APRA-regulated entities and within the financial system. Prudential supervision cannot guarantee against the occasional failure of a regulated institution; orderly exits are part of normal market dynamics in a competitive system.

Policy development

The legislative and prudential framework for failure and crisis management is critical to APRA's ability to act promptly and effectively in the event of disruption or the failure of an institution. During the year, substantial work was undertaken with Government on a legislative reform package to broaden and strengthen the scope of powers available to APRA in such circumstances.

Recovery and resolution planning also remained a key area of focus area for APRA over the year. APRA progressed development of its expectations for appropriate recovery planning for the life and general insurance industries, and also development of a credible framework for resolution planning, including the initial methodology for identification of critical functions in regulated entities. In line with the proposed legislative reforms, APRA intends that these requirements will in due course be more formally reflected in the prudential framework.

Operational readiness

APRA's internal governance structures were revised during the year to provide clearer escalation pathways for regulated entities that may be at risk of failure, or that warrant heightened attention by APRA. The timely identification of such entities is important for robust contingency planning and decision-making. A number of crisis management exercises were undertaken during the year both within APRA and with the Council of Financial Regulators (CFR) agencies to further develop, trial and improve policies and procedures that may need to be used in a failure scenario.

Other work included significant ongoing involvement with CFR and Trans-Tasman Banking Council working groups on crisis management-related policies and procedures, including crisis communications.

Financial Claims Scheme

The Financial Claims Scheme (FCS) is an Australian Government scheme that protects deposits in locally incorporated banks, building societies and credit unions, as well as general insurance policies, in the unlikely event an APRA-regulated institution fails. The FCS is an important safety net for dealing with financial failure, and APRA is responsible for administering the FCS once it is activated by the Australian Government. To achieve a prompt payout of protected deposits to account holders, ADIs must be operationally ready to meet the payment, reporting and communication requirements for the FCS.

APRA, in consultation with industry and other agencies, carried out a number of activities over the past 12 months to improve FCS operational readiness. APRA developed and conducted a series of pilot reviews of ADIs aimed at identifying and addressing entity-specific and industry-wide FCS issues, as well as gauging industry readiness for the FCS. A simulation of a full FCS payout test was also conducted during the year. Other activities included the development and release of an FCS testing schedule to be followed by all ADIs, updating material to support the auditing of FCS systems, and engagement and presentations to the audit industry on FCS operational readiness.

APRA will continue to focus on achieving an appropriate level of industry readiness for the FCS through benchmarking and review-based activities. APRA also intends to continue to explore means of lifting public awareness and appreciation of the FCS during the 2017/18 financial year.

Forensic analysis and enforcement

APRA's supervisory approach is aimed at identifying and evaluating potential risks in regulated institutions at an early stage, and seeking to have these risks appropriately mitigated before they pose a threat to the institution's viability. Should a regulated institution be unwilling or unable to take the necessary corrective action, APRA will use its formal enforcement powers to protect the interests of depositors, policyholders and superannuation fund members.

During 2016/17, APRA's enforcement resources continued to support frontline supervision in developing and executing appropriate responses to supervisory concerns, so as to minimise the need for more intrusive intervention at a later stage. APRA's enforcement function provided support regarding issues arising out of the allegations made by a whistleblower at The Colonial Mutual Life Assurance Society Limited, trading as CommInsure. In particular, APRA considered the matter for adherence to the whistleblowing provisions in the *Life Insurance Act 1995*, designed to prevent the identification and victimisation of whistleblowers. These issues are also being canvassed in civil proceedings.

APRA's enforcement team also inquired into and took appropriate action on instances of unauthorised activity on the perimeters of APRA's regulated industries, overseeing the authorisation and operation of Foreign Bank Representative Offices, and fulfilling APRA's obligations to enforce the use of restricted words and phrases under relevant legislation.

APRA continues to strengthen its network of information-sharing with other regulators and law enforcement agencies to ensure its supervisors have access to, and can assess the impact of, any relevant information on their regulated institutions.

STATISTICAL ACTIVITIES

APRA acts as a national statistical agency for the Australian financial sector. In that role, APRA collects and publishes data from prudentially regulated and other financial institutions to support its primary mission, and for other public sector agencies such as the Reserve Bank of Australia (RBA) and the Australian Bureau of Statistics (ABS).

In the 2016 Federal Budget, APRA received additional funding to modernise its data capabilities. This includes modernising APRA's digital data-collection platforms, enhancing its in-house analytic and publication capabilities and increasing the openness and accessibility of data to the public. As a result, during 2016/17 APRA began four key projects to transform how it collects, stores, accesses and delivers data. These are longer term projects that will enable greater transparency and confidence in APRA's data processes and also provide greater agility for APRA to react to changes in data needs. APRA expects to start engagement with industry on changes to the data collection platforms before the end of 2017.

Data collections for APRA's primary activities

During 2016/17, APRA made improvements to its reporting requirements and processes, including steps to reduce the reporting burden on institutions and enhance the quality and timeliness of data submitted.

APRA's primary data collection system, 'Direct to APRA' (or D2A), is the reporting system that over 500 ADIs, general and life insurers, private health insurers, superannuation entities and other APRA-reporting entities use to submit data to APRA. As part of integrating private health insurers into APRA's processes, these entities commenced reporting via D2A for the first time in 2016/17. D2A allows reporting entities to securely and electronically download, complete, validate and submit data to APRA. Institutions that create and import Standard Business Reporting format reports can also save time and effort in data quality assurance and in data entry.

In October 2016, APRA proposed to introduce a new reporting form, *Reporting Form ARF 223.0 Residential Mortgage Lending*, to better enable APRA's supervisory monitoring and oversight of residential mortgage lending and reduce the reliance on *ad hoc* information requests. These changes will enable APRA to maintain its supervisory intensity of residential mortgage lending and address emerging risks, while reducing some reporting burden on ADIs.

APRA also introduced a significant number of new data validation rules within D2A for all reporting industries. These new rules helped institutions identify and fix data errors and explain anomalies at the time they submit data to APRA; they also ensure that submitted data are immediately fit for use by APRA supervisors. During the year, APRA also removed or relaxed over 150 validation rules that were no longer effective at identifying errors.

Statistical publications

APRA introduced a number of improvements to its regular statistical publications during 2016/17, primarily in response to feedback from users for more statistics to be made publicly available. These improvements are also in line with the Government's Public Data Policy to extend the value of public data for the benefit of the Australian public.

Following consultation with industry, APRA expanded its ADI statistics in November 2016 to include information on the liquidity of ADIs. APRA introduced liquidity statistics for banks, and expanded the liquidity statistics published for credit unions and building societies. This improvement followed the implementation of an updated version of *Prudential Standard APS 210 Liquidity* and the associated reporting framework.

In February 2017, APRA introduced, and commenced publication of, new industry-level statistics for ADI commercial property exposure limits to supplement the existing actual exposure statistics and enhance stakeholder understanding of credit risks arising from ADIs' commercial property lending.

APRA also expanded its general insurance statistics in February 2017, following consultations with industry, to improve their relevance to users. APRA introduced new industry-level statistics and modernised its statistical segmentation to promote a better understanding of the industry and enhance the ability of insurers to benchmark themselves. In May 2017, APRA also introduced new general insurance institution-level statistics in an improved format.

Data collections for other agencies

APRA collects data from regulated and unregulated institutions to assist the RBA, ABS, Australian Securities and Investments Commission (ASIC), Australian Taxation Office (ATO) and the Department of Health to fulfil their respective roles.

The data that APRA collects from ADIs and registered financial corporations (RFCs) on behalf of the RBA and the ABS are used by these agencies for their policymaking and statistical roles in relation to the Australian economy. In January 2017, APRA released a discussion paper on behalf of the RBA and ABS, proposing changes to the existing data collected from ADIs and RFCs. Following broad consultation with stakeholders, the collection was finalised in August 2017 with reporting to commence in multiple phases over 2018 and 2019. The modernised collection ensures it continues to meet the needs of the RBA and ABS and remove unnecessary reporting burden.

In March 2017, APRA released a discussion paper proposing to collect data from ADIs and RFCs on behalf of the Department of Agriculture and Water Resources (DAWR) to contribute to informed public debate on lending to the agricultural industry. The reporting requirements were finalised in August 2017. The data will also be used to provide accurate and detailed agricultural lending data to assist the Australian Government better target its support for farmers and assist in developing and implementing assistance measures for individuals and communities.

In July 2016, APRA released a discussion paper on the proposed changes to banks' international exposures reporting requirements to enable APRA to implement the Bank for International Settlements' (BIS) enhancements to the International Banking Statistics (IBS). In response to feedback, APRA announced it will implement the proposed changes to reporting requirements, albeit with a deferred commencement of 31 December 2017.

DOMESTIC LIAISON ACTIVITIES

APRA has strong working relationships with Australia's key financial regulatory agencies – the RBA and ASIC. APRA also maintains a close and cooperative working relationship with the Commonwealth Treasury. The four agencies cooperate on a multilateral basis through their shared membership of the CFR. Beyond the members of the CFR, APRA also has active engagement with a range of other domestic bodies (see table on page 55). APRA also engages closely with the ATO on a range of matters, particularly in relation to the superannuation industry. APRA's engagement with other agencies is typically guided by a Memorandum of Understanding (MoU) which, while not legally binding, signifies a commitment to cooperate and share relevant information, and establishes the practical arrangements by which this will occur (see table on page 54). Many of these MoUs are available on APRA's website.

List of domestic MoUs

Agency
Australian Bureau of Statistics
Australian Competition and Consumer Commission
Australian Crime Commission
Australian Federal Police
Australian Securities and Investments Commission
Australian Taxation Office
Australian Transaction Reports and Analysis Centre
Commonwealth Treasury
Council of Financial Regulators
Department of Health
Motor Accident Insurance Commission of Queensland
Motor Accidents Authority of NSW
Office of Fair Trading
Reserve Bank of Australia
WorkCover Authority of NSW[2]
WorkCover Tasmania

2. On 1 September 2015, the State Insurance Regulatory Authority (SIRA) assumed the regulatory functions of WorkCover NSW. Work is currently underway to establish an MoU between APRA and SIRA.

APRA also liaises with professional and industry associations for each industry sector that APRA regulates.

List of domestic agencies and organisations with whom APRA met during 2016/17

Public Sector	Private Sector
Australian Accounting Standards Board	Actuaries Institute
Australian Auditing and Assurance Standards Board	Association of Superannuation Funds of Australia
Australian Competition and Consumer Commission	Australian Bankers' Association
Australian Reinsurance Pool Corporation	Australian Financial Markets Association
Australian Securities and Investments Commission	Australian Institute of Superannuation Trustees
Australian Taxation Office	Banking and Finance Sector Group
Australian Transaction Reports and Analysis Centre	Corporate Superannuation Association
Board of Taxation	Customer Owned Banking Association
Commonwealth Treasury	Financial Services Council
Compulsory Third Party Insurance Regulator (SA)	Health Insurance Restricted Membership Association of Australia
Council of Financial Regulators	Industry Super Australia
Department of Foreign Affairs and Trade	Insurance Council of Australia
Department of Health	Private Healthcare Australia
Motor Accident Insurance Commission of Queensland	
Productivity Commission	
Reserve Bank of Australia	
State Insurance Regulatory Authority	

INTERNATIONAL ACTIVITIES

APRA's primary international activities take two main forms:

- liaison with overseas home and host supervisory agencies on the activities of internationally active firms, including through participation in supervisory colleges; and
- participation in global standard-setting bodies to ensure relevant characteristics of the Australian financial system are taken into account in the development of relevant international standards and guidance.

During 2016/17, APRA signed three new MoUs with international agencies, taking to 32 the number of overseas regulatory agencies with which APRA has established formal bilateral information sharing arrangements. APRA signed MoUs with the Abu Dhabi Global Market – Financial Services Regulatory Authority in December 2016, the Central Bank of Jordan in February 2017 and the Government of New Caledonia in May 2017.

APRA is one of 63 signatories to the International Association of Insurance Supervisors (IAIS) multilateral MoU arrangements that now cover agencies supervising insurers which write around 70 per cent of global premiums. APRA also participates in institution-specific multilateral arrangements to support the sharing of confidential information in supervisory colleges involving internationally active financial institutions, including those headquartered in Australia.

APRA's engagement with international agencies and standard-setting bodies is summarised in the lists below.

International organisations that APRA was a member of during 2016/17:

- Asian Forum of Insurance Regulators
- Basel Committee on Banking Supervision
- Executives' Meeting of East Asia-Pacific Central Banks (Working Group on Banking Supervision)
- Financial Stability Board (Standing Committee on Supervisory and Regulatory Cooperation and Working Group on Governance Frameworks)
- International Association of Deposit Insurers
- International Association of Insurance Supervisors
- International Credit Union Regulators Network
- International Forum of Insurance Guarantee Schemes
- International Organisation of Pension Supervisors
- South East Asia, New Zealand and Australia Forum of Banking Supervisors
- Trans-Tasman Council on Banking Supervision

International organisations APRA liaised with or assisted during 2016/17:

- Asian Development Bank
- Asia-Pacific Economic Cooperation – Financial Regulators Training Initiative
- Association of Financial Supervisors of Pacific Countries
- Financial Stability Institute
- International Monetary Fund
- Organisation for Economic Co-operation and Development – Working Party on Private Pensions
- South East Asian Central Banks
- South Pacific Central Bank Governors
- World Bank

In addition to these activities, APRA receives visits from international delegations for a range of core business and other purposes. Over 2016/17, APRA received visits from 40 international delegations from 15 countries, most commonly from Indonesia. Interest was focused on APRA's risk-based supervision model, enforcement, policy developments, financial technology and Australia's retirement income arrangements.

Technical assistance

In support of 'whole of Government' engagement with development partner countries, APRA undertakes targeted technical assistance activities, primarily in the Asia-Pacific region. These activities provide valuable interaction with the partner countries involved, including in respect of Australian institutions operating in those jurisdictions. Most of these activities are funded under programs agreed with agencies responsible for administering international aid, particularly the Department of Foreign Affairs and Trade (DFAT) and, to a lesser extent, the International Monetary Fund (IMF) and the World Bank. As APRA is otherwise funded by levies on the institutions it supervises, it is considered inappropriate for more than incidental amounts of industry levies to be used for technical assistance purposes.

With very limited staff resources available for these activities, APRA favours multilateral initiatives and can only accommodate a small number of the requests it receives without unduly impacting core business priorities. Nevertheless, these activities assist to strengthen the prudential frameworks and activities of the partner agencies involved and provide valuable development opportunities for APRA staff.

Engagement with Indonesia is with the integrated regulator Otoritas Jasa Keuangan (OJK) and Bank Indonesia (BI) under the Government Partnership Fund (GPF II). During 2016/17, this engagement was primarily through APRA hosting seven secondments comprising four staff from OJK and three from BI, which focused on risk-based prudential supervision, on- and off-site review techniques, including risk-rating procedures, crisis management, recovery and resolution planning, conglomerates, APRA's data collection methodologies and industry analysis techniques. APRA also hosted three visits by OJK staff and one from BI. Over 2016/17, APRA hosted a total of 32 secondees and other visitors from OJK and BI.

In the Pacific region APRA supported several training programs under the multilateral Government Partnerships for Development (GPFD) program with local and visiting Pacific prudential regulators. Over the past year, the on-site training programs ranged across banking, superannuation and general insurance. In addition to the on-site program, APRA hosted two officers from the Central Bank of Solomon Islands for short-term secondments.

APRA also plays its part in supporting the training activities of the Financial Stability Institute and various regional groups in the Asia Pacific region such as the Asian Development Bank, SEACEN and SEANZA. Over the year, APRA provided speakers to two regional conferences in Singapore and Fiji.

CH/5

APRA'S RESOURCES AND RISK MANAGEMENT

APRA'S RESOURCES AND RISK MANAGEMENT

FINANCIAL RESOURCES

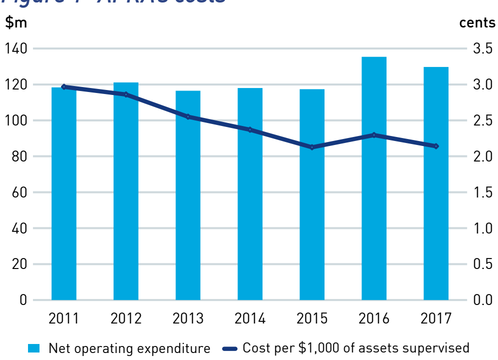
APRA's income is sourced primarily from annual levies on supervised institutions. APRA's expenditure is directed towards its ongoing supervisory and enforcement activities, as well as implementing and enhancing Australia's prudential regulatory framework.

APRA's expenditure

APRA's total operating expenditure for the 12 months to 30 June 2017 was $129.7 million, against an updated budget of $131.9 million[1]. The under-expenditure primarily arose across non staff-related expenditure categories as internal restructuring activities impacted training, travel and other discretionary activities in the second half of the financial year.

Due to a decline in APRA's cost base in 2016/17, combined with an increase in value of supervised assets from 2015/16, the cost per $1,000 of assets supervised has declined to approximately 2.1 cents in 2016/17. This compared with approximately 3.0 cents per $1,000 of assets supervised in 2010/11 .

Figure 1- APRA's costs



APRA's income

APRA's total income in 2016/17 was $128.7 million, as against an updated budget of $130.3 million. The income deficit was primarily driven by a small under-collection in industry levies, combined with lower fees charged.

Industry levies are raised according to the *Financial Institutions Supervisory Levies Collection Act 1998*, the *Supervisory Levy Imposition Acts 1998* relevant to each of APRA's regulated industries, and the *Private Health Insurance Supervisory Levy Imposition Act 2016*. Following consultation with industry, the relevant Minister determines the levy rates for each regulated industry prior to the beginning of each financial year. Industry levies are based on the costs incurred by APRA in discharging its duties with respect to each sector. For industries APRA regulates other than private health insurance, the levy rate is applied on the appropriate institution's total assets, subject to a minimum and maximum amount per institution. Exceptions to this are non-operating holding companies and small APRA-regulated superannuation funds, which are levied at a flat rate. For private health insurers, the levies are based on the number of policies held by each insurer at 30 June.

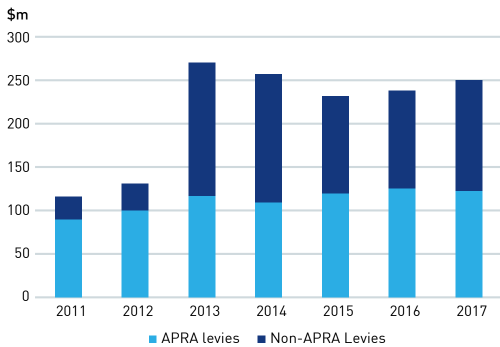
Levies are also collected to cover the costs of the National Claims and Policies Database (NCPD); in this case a rate is applied to the gross earned premiums of general insurers that contribute to this database. The amount raised for NCPD purposes in 2016/17 was $1.0 million.

The total levies collected by APRA also cover certain costs attributable to ASIC, the ATO, the Department of Human Services and the

1. The updated budget differs to the original budget presented in the financial statements as it incorporates changes approved during the year.

Government's SuperStream initiative. Total levies collected by APRA, including on behalf of these agencies, in 2016/17 were $250.2 million.

Figure 2 - Financial industry levies



On an annual basis, APRA releases a Cost Recovery Implementation Statement to provide further transparency on the APRA component of the levies collected from industry.

APRA also administers the Risk Equalisation Special Account whereby revenue collected by APRA for the purposes of risk equalisation across the private health insurance industry is treated by the Government as revenue and expenses. Total Risk Equalisation collections and payments in 2016/17 were $458.3 million.

Reserves

The components of APRA's reserves were subject to the following changes during the year:

- APRA's retained surpluses fell by $1.1 million to $17.9 million, attributable entirely to an operating deficit from ordinary activities of $1.1 million; and
- the revaluation of assets conducted every three years resulted in a $0.2 million decrease in the Asset Revaluation Reserve to $7.2 million.

With these items, total reserves decreased to $47.8 million. This included a $6.0 million Contingency Enforcement Fund to support large unexpected investigation and enforcement activities and contributed equity of $16.7 million, both of which were unchanged over the year.

STAFFING RESOURCES

At 30 June 2017, APRA's total permanent staffing was 600 on a full-time equivalent (FTE) basis, which was a decrease from 607.7 at 30 June 2016 (Figure 3). APRA's voluntary turnover rate decreased from 8.5 per cent in 2015/16 to 7.3 per cent during 2016/17 (Figure 4).

Figure 3 - APRA's staffing (as at end June)

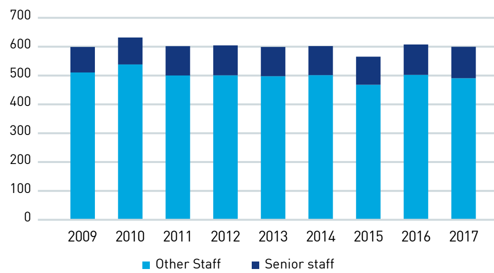
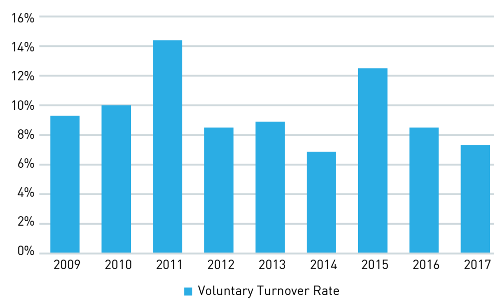


Figure 4 - Voluntary turnover rate



A supervision-led regulator such as APRA relies heavily on the judgement and experience of its staff to achieve sound prudential outcomes. APRA has therefore continued to focus on maintaining a highly skilled workforce that comprises a strong blend of supervisory and industry expertise. While APRA has been reasonably successful in building and retaining supervisory experience within its staff (Figure 5), maintaining the level of industry expertise remains an ongoing challenge given the competition for high quality staff with solid financial sector experience.

Figure 5 - Staff supervisory experience levels

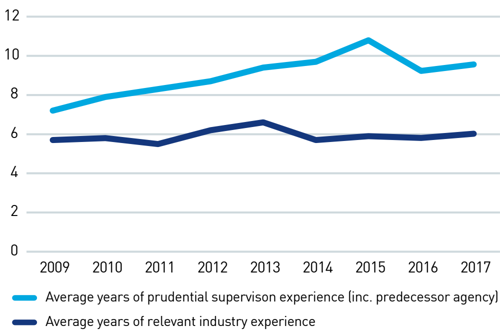
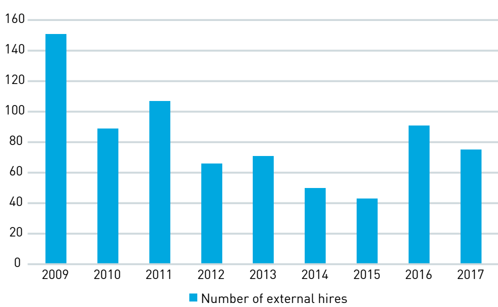


Figure 6 - External recruitment



Developing the capabilities of employees has remained a priority for APRA during 2016/17. Learning and development activities included a wide range of internal and external programs focused on the professional development of staff through building technical skills and effectively applying these in the workplace. In 2016/17, APRA also maintained a strong emphasis on providing learning and development opportunities to enhance the leadership and management capabilities of current and future APRA leaders. While expenditure on training per employee fell during 2016/17, the number of sessions per employee rose. This was largely the result of an increase in the delivery of internal technical training and seminars over the year, which attracted a lower per capita cost (Table 1).

Support for staff undertaking formal postgraduate study continued in 2016/17, with 44 staff members participating in APRA's studies support program. APRA also maintained its graduate recruitment program, employing 16 graduates in 2016/17 as a supplement to general recruitment. As in previous years, the 2017 graduate cadre undertook five weeks of dedicated training on commencement, and these employees will continue to receive targeted development opportunities throughout their first two years of employment with APRA.

Table 1 – Training activities

Training by type (%)	2016	2017
Internal technical training and seminars	55	79
External training	41	3
Management training	4	18

Key training metrics	2016	2017
Training spend per employee	$4088	$2982
Per cent of staff provided with training (%)*	100	100
Training sessions per employee	11.8	14.1
Training days per employee	5.5	4.1
Number of internal classroom courses offered	440	393
Employees undertaking formal post-graduate studies	43	44

**This figure is for all training, including mandatory annual compliance training such as online Fraud and Security Awareness training for all staff*

APRA ASSURANCE

Risk management, internal audit and compliance

APRA has specialist independent functions that provide support and assurance to the APRA Members.

The risk management function, led by APRA's Chief Risk Officer, is the custodian of APRA's Enterprise Risk Management (ERM) framework. This framework includes a clear statement of APRA's risk appetite and covers material risks to APRA's mandate and strategic objectives. APRA's executives have responsibility for the ownership of key risks as well as the ongoing review, management and reporting of them. Key risks are reassessed periodically and reported to APRA's Executive Board and the Risk Management Committee.

During 2016/17, APRA further enhanced its ERM framework, taking account of developments within both peer regulators and APRA-regulated industry sectors, in order to incorporate good practice where appropriate. This included developing a new Risk Management Strategy to support a more strategic and integrated outlook to risk management and foster a sound risk culture.

The internal audit team, led by APRA's Chief Internal Auditor, conducts a broad-ranging program of internal audits each year. The program is developed following consultation with APRA's senior executive and Audit Committee, and an assessment of APRA's strategies and key risks. The risk-based program covers specific aspects of APRA's supervisory and operational processes and its financial systems. Audit reviews identify and rate risks, and make recommendations aimed at improving APRA's internal control environment and processes.

During 2016/17, the program of internal audits included an increased focus on supervisory processes to provide assurance over the effectiveness of APRA's risk-based supervision practices. A three-year audit program was also developed, with enhanced assurance coverage of APRA's core supervisory, policy and resolution functions.

APRA has an ongoing focus on fraud risk management, and has in place a fraud control framework. This framework was subject to an independent review in 2016/17 to confirm alignment with Australian Government requirements. All relevant internal audits assess whether potential fraud exposures are appropriately addressed by APRA's processes and controls. All staff are required to complete online fraud awareness training annually.

APRA has a Compliance Policy to support adherence with its compliance obligations. This framework includes compliance attestations by senior management. The Chief Risk Officer is responsible for monitoring and developing this framework.

CH/6
APRA'S PERFORMANCE

APRA'S PERFORMANCE

APRA protects the financial interests of Australia's depositors, policyholders and superannuation fund members by prudentially supervising ADIs, insurance and reinsurance companies, including private health insurers, and most superannuation funds. APRA's prudential powers are enabled primarily by the *Australian Prudential Regulation Authority Act 1998* which grants APRA the ability to regulate financial sector entities by administering the following industry-based Acts: the *Banking Act 1959*, *Insurance Act 1973*, *Life Insurance Act 1995*, *Private Health Insurance (Prudential Supervision) Act 2015* and the *Superannuation Industry (Supervision) Act 1993*.

In addition, the APRA Act empowers APRA to collect data from the institutions it supervises in its role as a national statistical collections agency for the financial sector. The legislation governing APRA's data collection activities is the *Financial Sector (Collection of Data) Act 2001*.

Like all Commonwealth Government entities, APRA's performance framework and governance and accountability requirements are set out in the *Public Governance, Performance and Accountability Act 2013* (PGPA Act). The PGPA Act requires APRA to publish accountability requirements each year in its Annual Report, including the Annual Performance Statement, which is included at the end of this chapter. APRA must also publish a Corporate Plan setting out information on APRA's key strategies and activities over a rolling four-year period. APRA's *Corporate Plan 2017-2021* was published in August 2017 and is available on the APRA website.

APRA'S ROLE AS A PRUDENTIAL REGULATOR

The APRA Act requires that, in performing and exercising its functions and powers, APRA must balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and, in doing so, promote financial stability. With this guidance in mind, APRA indicated in its 2014 Statement of Intent that it does not seek to establish a regulatory regime that targets a zero rate of failure amongst regulated institutions. APRA's policy development work is therefore largely directed towards achieving an appropriate balance between financial safety and other considerations, including regulatory costs. APRA's supervisors are tasked with enforcing the prudential policy framework in a risk-based manner, focusing supervisory attention on areas of greater risk and applying a proportionate approach that considers the scale, complexity and nature of each regulated institution.

Given APRA's role to protect the interests of depositors, policyholders and superannuation fund members (which APRA refers to collectively as its beneficiaries), there are two important indicators of APRA's performance:

- The Performing Entity Ratio (PER) – the PER is an indicator of the incidence of failure amongst regulated institutions. It is determined as the number of regulated institutions that met their commitments to beneficiaries in a given year divided by the total number of regulated institutions. The higher the percentage, the lower the incidence of failure.
- The Money Protection Ratio (MPR) – the MPR is an indicator of the incidence of loss

in the financial sector. It is determined as the dollar value of liabilities to beneficiaries held in Australia in regulated institutions less any prudential losses to beneficiaries in a given year, divided by the total dollar value of liabilities to beneficiaries in Australia in regulated institutions. Again, the higher the percentage, the lower the incidence of loss.

Since APRA's inception in 1998, the annual PER has averaged 99.93 per cent, and the annual MPR has averaged 99.97 per cent.

Table 1 - Performing Entity Ratio (PER) and Money Protection Ratio (MPR)

Financial year	Number of failures[1]	Losses ($million)	Number of institutions[2]	Protected Accounts[3] ($million)	Annual PER %	Annual MPR %
1999	4	11	4,473	$886,640	99.91	100.00
2000	3	308	4,407	$993,369	99.93	99.97
2001	8	5,341[4]	4,350	$947,923	99.82	99.44
2002	6	140	3,803	$1,006,845	99.84	99.99
2003	5	19	3,252	$1,066,480	99.85	100.00
2004	1	0[5]	2,744	$1,207,241	99.96	100.00
2005	0	0	2,099	$1,347,813	100.00	100.00
2006	0	0	1,596	$1,546,338	100.00	100.00
2007	1	0[5]	1,244	$1,832,609	99.92	100.00
2008	0	0	1,129	$1,923,369	100.00	100.00
2009	0	0	1,028	$2,048,163	100.00	100.00
2010	1	1	965	$2,231,887	99.90	100.00
2011	4	72	832	$2,462,275	99.52	100.00
2012	0	0	780	$2,650,832	100.00	100.00
2013	0	0	724	$2,972,844	100.00	100.00
2014	0	0	673	$3,313,942	100.00	100.00
2015	0	0	661	$3,623,012	100.00	100.00
2016	0	0	627	$3,864,976	100.00	100.00
2017	0	0	565	$4,094,208	100.00	100.00

1. In the case of superannuation, failures refer to the number of funds affected and include failures due to employer sponsors.
2. The number of institutions excludes small APRA Funds, representative offices of foreign banks and non-operating holding companies.
3. Protected Accounts is an estimate of the funds protected by APRA as defined by relevant legislation and is less than the total assets held by APRA-regulated institutions, which were $6,061.5 billion at end-June 2017.
4. Includes HIH Group's estimated $5.3 billion loss incurred by creditors and policyholders, based on liquidator's advice to creditors in April 2002.
5. Losses incurred due to the failure of an employer sponsor in a superannuation fund were less than $0.5 million.

APRA continues to develop its performance assessment and accountability framework, taking account of Commonwealth Government initiatives to promote improvements in regulator accountability more generally. During 2016/17, APRA implemented improvements to its internal performance reporting framework, designed to establish closer linkages to APRA's strategic plan.

Indicators of risk, impact and rectification

APRA's objective is to maintain a low (but not zero) incidence of failure of supervised institutions while not impeding continued improvements in efficiency or hindering competition within the broader industry. To achieve this outcome, APRA seeks to identify likely failures early enough so corrective action can be initiated to prevent the failure, or that appropriate wind-up or other exit strategies can be undertaken that minimise losses to beneficiaries.

APRA's risk assessment and response systems — the Probability and Impact Rating System (PAIRS) and the Supervisory Oversight and Response System (SOARS) — are the main tools APRA uses for identifying institutions that may be at a higher risk of failure. Monitoring PAIRS and SOARS outcomes is an important indicator of the extent to which APRA identifies material risks and achieves rectification of problem issues or, where appropriate, facilitates orderly exit from the industry.

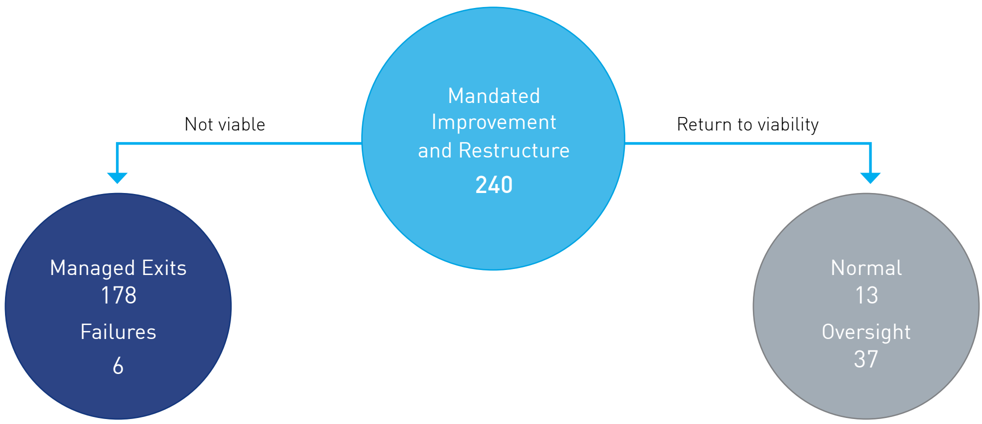
During 2016/17, APRA recalibrated its measure of impact of failure with reference to each entity's liabilities (or for RSE licensees, sum of net assets of underlying RSEs), and then adjusted further to better reflect the potential impact of entity failure on beneficiaries and the wider financial system.

Beyond the recalibrated impact measure, APRA may elect to adjust an impact rating into a higher range if the failure of the entity would have an impact disproportionate to its liabilities – for example, if the entity has market dominance in a particular type of business, or if the failure of the entity would have significant spill-over effects on the broader financial system. In rare circumstances, APRA may adjust an impact rating downward where a regulated entity does not take money from the public and where the impact of failure is disproportionately low compared to liabilities.

Of the eight institutions that began the financial year in APRA's two highest categories (Mandated Improvement and Restructure), one institution exited the industry and three moved to an improved supervision stance. As a result of two new institutions being added to the Mandated Improvement population during the year, six remained in those categories at year-end. The PAIRS/SOARS framework was introduced in 2003. Over the 14 years since, a total of 240 institutions have been in Mandated Improvement and/or Restructure. Of that total, 50 institutions have returned to Normal or Oversight supervision stance, 178 have exited without loss to beneficiaries and six institutions have failed (four of which moved through both Mandated Improvement and Restructure during that period).

It is not possible to compare these outcomes with what would have happened had APRA not intervened. However, the overall direction of movement of institutions in these two supervisory stances, and the relatively low proportion of failures, is consistent with timely and effective intervention on APRA's part.

Figure 1 - Outcome for institutions in Mandated Improvement/Restructure, 2003–2017



Office of Best Practice Regulation

The Office of Best Practice Regulation (OBPR) has established a rigorous cost-benefit framework for analysing the impact of any proposed new regulation (as well as potential alternatives) on different groups in the Australian community and on the community as a whole.

Adhering to OBPR processes provides an important indicator of whether APRA has been able to achieve an appropriate balance across the objectives of its mandate, and provides for open and transparent consideration of stakeholder views, including the publication of stakeholder submissions and APRA response papers. During 2016/17, APRA continued to meet the OBPR requirements in its policy development activities.

For further information on the OBPR, see page 140 in Chapter 8 – Statutory report.

Regulator Performance Framework

The Commonwealth Government has developed the Regulator Performance Framework (RPF) as a means of assessing regulators' performance when interacting with business, the community and individuals while carrying out their respective functions. The RPF principally relates to the regulatory burden arising from the administration of regulation, rather than the process for, and outcomes of, regulatory policy-making. In accordance with the timetable required by the Government, APRA published its 2015/16 self-assessment in December 2016, and will publish its self-assessment for 2016/17 in December 2017.

APRA'S ROLE AS A NATIONAL STATISTICAL AGENCY

APRA performs an important role as the central repository of statistical information on the Australian financial system. APRA collects and publishes data from prudentially regulated and other financial institutions to support its core prudential mission, as well as its ancillary mission as a national statistical agency for the Australian financial sector.

Data collections for APRA's primary mission

APRA collects a broad range of financial and risk data that are an essential input to its core mission of the prudential supervision of regulated institutions. Almost all of APRA's data collections are legal requirements of institutions under the *Financial Sector (Collection of Data) Act 2001* (FSCODA) and APRA's reporting standards. APRA therefore closely monitors both the timeliness and quality of data submissions.

For regulated institutions, APRA targets a rate of 95 per cent of returns submitted by the statutory due date, with the remainder to be submitted within the following week. In 2016/17, 98 per cent of submissions were received by their due dates and 100 per cent were submitted within a week of the due dates.

Statistical publications to assist APRA's ancillary mission

APRA endeavours to publish as much of the data it collects that are useful in industry-level and individual institution-level publications, subject to confidentiality obligations under the FSCODA. This fulfils APRA's ancillary mission as a national statistical agency for the Australian financial sector.

The publication of these statistics promotes understanding of the industries APRA regulates and assists research, public discussion and well-informed decision-making by regulated institutions, policy-makers, other regulators, market analysts and researchers.

APRA seeks to adhere to international statistical standards in developing, producing and managing its statistics (except in the few cases where doing so would conflict with APRA's primary role as a prudential regulator). By acting consistently with these standards, APRA balances the need to protect commercially sensitive information provided by institutions, whilst providing statistics that are useful, trustworthy and meet the needs of users.

Table 2 - Statistics key performance indicators

	Target	Year end June 2016	Year end June 2017
Number of forms expected per quarter	—	17,948	20,432
Proportion of (quarterly) forms submitted and validated by due date	≥ 95%	98%	98%
Proportion of (quarterly) forms submitted and validated within one week of due date	≥ 99%	100%	100%
Number of statistical publications released	—	73	80
Proportion of statistics publications released according to pre-disclosed timetable	100%	100%	100%
Number of requests for customised statistics	—	243	226
Proportion of requests for custom statistics fulfilled as agreed	≥ 95%	100%	100%
Number of requests for reporting advice	—	512	724

APRA'S ENGAGEMENT WITH STAKEHOLDERS

APRA Stakeholder Survey

During 2017, APRA conducted its fifth biennial Stakeholder Survey of regulated institutions and other industry representatives. These surveys assist in APRA's understanding of the impact and effectiveness of its supervision and other activities.

The 2017 survey was conducted by Orima Research, which noted the results of the first four APRA surveys had been consistently strong. This continued to be the case in the most recent survey. While some results showed slight variations from earlier surveys, in general the 2017 survey results were broadly consistent with previous surveys.

As with previous stakeholder surveys, APRA will use the results of the 2017 survey as an important input into its strategic and business planning and in setting supervisory priorities. APRA will publish the full statistical results of the survey on its website later in 2017.

The table below provides the results for the top five and bottom five rated items from the 2017 survey of regulated institutions.

Highest scoring items (n=286-320)	2017 mean
APRA's supervision of your industry helps protect the financial well-being of the Australian community	4.3
The APRA supervisory team responsible for your organisation has a good understanding of your organisation	4.2
APRA's supervision of the financial services sector benefits your industry in general	4.2
APRA is effective in communicating the findings of supervisory visits to your institution	4.2
A single supervisory team responsible for all group companies is an appropriate way to supervise groups	4.2

Lowest scoring items (n=302-318)	2017 mean
Usefulness of guidance – Other information on APRA's website, such as policy papers and FAQs	3.3
Usefulness of guidance – Interactions with other APRA staff	3.3
Usefulness of guidance – Speeches by senior APRA representatives	3.3
In the past 12 months, how useful has your entity found the articles in APRA Insight?	3.3
Changes to APRA's prudential framework sufficiently consider the costs of regulation imposed on industry	2.8

Scale legend: 1=strongly disagree, 2=disagree, 3=neutral, 4=agree, 5=strongly agree

Mechanisms for engagement

APRA engages with a variety of stakeholders including regulated institutions, industry bodies, government departments, other regulatory agencies, media and the general public. APRA uses a diverse range of channels to communicate various policy, statistical and other announcements with stakeholder groups, as shown in the table below.

Activity during 2016/17	2015/16	2016/17
Policy consultations conducted	26	22
Policy papers issued (for above consultations)	30	14
Information letters issued to industry	26	40
Presentations at formal speaking engagements	89	73
Media releases issued	42	57
Parliamentary hearings attended	9	9
Submissions to formal inquiries	2	4

For further information on APRA's engagement with government, other regulatory agencies and industry associations, see the sections on domestic and international liaison in Chapter 4.

ANNUAL PERFORMANCE STATEMENT

I, Wayne Byres, as the accountable authority of the Australian Prudential Regulation Authority (APRA), present the annual performance statement of APRA for 2016/17, as required under paragraph 39(1)(a) of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act). This annual performance statement accurately reflects the performance of APRA in accordance with subsection 39(2) of the PGPA Act.

Purpose

APRA is an independent statutory authority established for the purposes of prudential supervision of financial institutions and for promoting financial stability in Australia. APRA enhances public confidence in Australia's financial institutions through a framework of prudential regulation which balances financial safety and efficiency, competition, contestability and competitive neutrality and, in balancing these objectives, promotes financial system stability in Australia [*Outcome 1: Portfolio Budget Statement 2016/17*].

Results

Performance criterion

Key indicators of APRA's performance include the extent to which the Australian community is exposed to loss from the failure of an APRA-regulated institution and the extent to which failures impact financial stability in Australia. APRA uses the following key performance criterion to measure its effectiveness in achieving its purpose.

- The **Performing Entity Ratio (PER)**. The PER is an indicator of the incidence of failure amongst regulated institutions. It is determined as the number of regulated institutions that met their commitments to beneficiaries in a given year divided by the total number of regulated institutions. The higher the percentage, the lower the incidence of failure.
- The **Money Protection Ratio (MPR)**. The MPR is an indicator of the incidence of loss in the financial sector. It is determined as the dollar value of liabilities to beneficiaries held in Australia in regulated institutions less any prudential losses to beneficiaries in a given year, divided by the total dollar value of liabilities to beneficiaries in Australia in regulated institutions. Again, the higher the percentage, the lower the incidence of loss.

APRA has measured the PER and MPR as performance indicators since inception in 1998.

Criterion source

2016/17 Portfolio Budget Statement; 2016-2020 Corporate Plan.

Results against performance criteria

APRA takes a risk-based approach to identifying and assessing areas of greatest risk to regulated institutions meeting their obligations to beneficiaries and financial stability in Australia and directing resources to address those risks.

APRA endorses the view expressed in the Government's Statement of Expectations[1] that '... it is not possible or efficient to eliminate all risks and that trade-offs in risk reductions are necessary.' As such, APRA does not pursue a zero failure objective.[2] APRA seeks to maintain a low incidence of failure of APRA-regulated institutions while not impeding continued improvement in efficiency or hindering competition. APRA aims to identify likely failures early enough so that corrective action can be promptly initiated or orderly exit achieved.

Throughout 2016/17, APRA's performance has continued to support the protection of the interests of beneficiaries including depositors, policyholders and superannuation fund members as evidenced by the PER and MPR. For the 2016/17 year, the PER was 100 per cent and the MPR was 100 per cent.

1. Statement of Expectations (2014)
2. Statement of Intent (2014).

Table 1 in Chapter 6 of this year's Annual Report provides a summary of the number of failures, the dollar value of losses, the dollar value of protected accounts[3] and the annual PER and MPR by financial year. Since APRA's inception in 1998 the annual PER has averaged 99.93 per cent and the annual MPR has averaged 99.97 per cent. Averages since 1998 include losses associated with HIH Insurance in 2001. Following 2002, the annual MPR has consistently averaged 100 per cent and, over the last six years, the annual PER has averaged 100 per cent. While the incidence of loss has declined since APRA's formation, the value of protected accounts has considerably increased reflecting the strong growth in the size of the Australian financial system.

Analysis of performance against purpose

Factors that have contributed to the strength of the annual PER and MPR for 2016/17 include an Australian financial system that is broadly in good health. This is due not only to the strength of the domestic economy but is also reflective of APRA's proactive supervision and the continuous evolution of the prudential framework across all regulated industries in a number of important areas in response to idiosyncratic risks and broader vulnerabilities to financial stability. These include risks in residential and commercial property markets, poor experience in some segments of the insurance market and the need to further strengthen governance and transparency in regulated sectors as foreshadowed in APRA's 2016-2020 Corporate Plan.

In line with the 2016-2020 Corporate Plan, APRA continued to strengthen its core supervision, policy and resolution functions and underlying capabilities (people and culture, organisational effectiveness and infrastructure) through delivery of strategic initiatives to enhance leadership, culture and opportunities for APRA staff; honing internal governance and workplace effectiveness; sharpening risk-based management; and building recovery and resolution capability – all of which are focused on enabling APRA to continue to deliver on its purpose.

In 2016/17, APRA maintained its proactive onsite and offsite supervision activities to identify and evaluate material risks in regulated institutions at an early stage and ensure that these risks were appropriately mitigated. Key outcomes from supervision activities in 2016/17 include the release of quantitative measures and updated guidance to reinforce sound residential mortgage lending practices across authorised deposit-taking institutions (ADIs); publication of the results of APRA's thematic review on commercial property lending by ADIs; the completion of a stress test of the life insurance industry; and release of an information paper on current practice in risk culture across all regulated industries. APRA also commenced a review of remuneration policies and practices among regulated institutions during the year to examine how these interact with risk culture.

APRA continued to deliver reforms to the prudential framework across all regulated industries through a thorough and consultative policy process consistent with the Office of Best Practice Regulation (OBPR) principles. In 2016/17, APRA set out the prudential policy roadmap for private health insurers, and delivered key prudential reforms for ADIs including revised requirements on securitisation and liquidity, guidance on capital buffers and the release of 'unquestionably strong' capital benchmarks.[4] APRA also published prudential guidance for superannuation entities on successor fund transfers and wind ups.[5] In doing so, APRA achieved 100 per cent compliance with OBPR requirements.

3. Protected accounts are an estimate of the funds protected by APRA as defined by relevant legislation.
4. Published July 2017.
5. As per footnote 4.

In delivering policy reforms, APRA retained an active role in relevant international groups and forums for banking, insurance and superannuation to bring an Australian perspective to efforts to strengthen the global financial system, to remain informed on international developments and to determine how they should be applied in the Australian context. APRA also continued its close and effective collaboration with other domestic agencies in drafting policy reforms.

Throughout 2016/17, APRA continued work with Treasury to progress crisis-related legislative reform to improve the Australian statutory framework for managing crises and failures, taking into account international lessons and policy developments, as recommended by the Financial System Inquiry. While the legislative reforms are not yet finalised, the proposed changes will be a key enabler for effective crisis management and lay the foundation for the evolution of the prudential framework.

APRA also progressed its internal readiness to resolve failures and near-failures and continued to assess and provide feedback to regulated institutions on the credibility and proportionality of recovery plans. APRA continued engagement with the Council of Financial Regulators (CFR) agencies and other key agencies such as through the Trans-Tasman Banking Council to ensure co-ordination with other agencies in the event of a crisis is effective.

Following the move to new Sydney premises in June 2016, APRA relocated to new premises in Melbourne, Adelaide and Canberra this year. APRA also benefited from the rollout of upgraded technology in all premises and successfully released core infrastructure to support electronic information management to support enhanced collaboration and workplace efficiencies, complementing the rollout of advanced technology. APRA also planned for its multi-year data program to transform the way it collects and uses data to support the core function of supervision and commenced work on enhancing systems that support the management of APRA's human resources.

In 2016/17, extensive changes were also made to APRA's organisational structure, leadership team and governance arrangements to improve the ability of APRA to deliver on its strategy and best respond to current and future developments. APRA also refreshed its core organisational 'Values' which underpin APRA's culture. Work has also continued on further elaborating APRA's risk appetite and internal quality assurance framework and practices.

Importantly, APRA continued to invest in its people this year with the launch internally of the 'Inclusion and Diversity' strategy to promote diversity of thinking and a high performing culture.

Progress against APRA's strategy continues to be monitored by APRA's Executive Board supported by its Risk Management Committee. This annual performance statement, together with other information included in the Annual Report, provides an informative summary of APRA's annual performance to Parliament and the public on how APRA continues to strengthen its ability to meet its purpose.

CH/7
FINANCIAL STATEMENTS

FINANCIAL STATEMENTS

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* Administered items are distinguished from departmental items throughout these financial statements by background shading.

STATEMENT BY MEMBERS AND THE EXECUTIVE GENERAL MANAGER – CORPORATE SERVICES

In our opinion, the attached financial statements for the year ended 30 June 2017 comply with subsection 42(2) of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act), and are based on properly maintained financial records as per subsection 41(2) of the PGPA Act.

In our opinion, at the date of this statement, there are reasonable grounds to believe that the Australian Prudential Regulation Authority will be able to pay its debts as and when they fall due.

MR WAYNE BYRES
Chairman
17 August 2017

MRS HELEN ROWELL
Deputy Chairman
17 August 2017

MR GEOFF SUMMERHAYES
Member
17 August 2017

MR STEVE MATTHEWS
Executive General Manager
Corporate Services
17 August 2017

STATEMENT OF COMPREHENSIVE INCOME

for the year ended 30 June 2017

	Notes	2017 $'000	2016 $'000
Expenses			
Employee benefits	1.1A	99,109	98,188
Suppliers	1.1B	22,188	29,850
Grants and scholarships	1.1C	135	119
Depreciation and amortisation	2.2A	8,285	6,795
Finance costs	1.1D	13	395
Losses from asset disposals	1.1E	14	64
Total expenses		129,744	135,411
Own-source revenue			
Rendering of services	1.2A	3,756	3,735
Rental income		41	42
Other revenue	1.2B	849	909
Total own-source revenue		4,646	4,686
Gains			
Other gains	1.2C	148	–
Total own-source income		4,794	4,686
Net cost of services		124,950	130,725
Revenue from Government	1.2D	123,860	126,466
Operating deficit		(1,090)	(4,259)
Other comprehensive income			
Items not subject to subsequent reclassification to net cost of services			
Changes in asset revaluation reserve		(196)	20
Total comprehensive loss		(1,286)	(4,239)

The above statement should be read in conjunction with the accompanying notes.

STATEMENT OF FINANCIAL POSITION

as at 30 June 2017

	Notes	2017 $'000	2016 $'000
Assets			
Financial assets			
Cash and cash equivalents	2.1A	71,635	59,232
Trade and other receivables	2.1B	4,277	16,327
Total financial assets		75,912	75,559
Non-financial assets			
Property, plant and equipment	2.2A/B	22,398	22,027
Intangibles	2.2A/B	15,706	17,974
Prepayments		1,863	1,858
Total non-financial assets		39,967	41,859
Total assets		115,879	117,418
Liabilities			
Payables			
Suppliers	2.3A	1,538	2,991
Other payables	2.3B	25,851	21,344
Total payables		27,389	24,335
Provisions			
Employee provisions	4.1A	37,514	39,185
Other provisions	2.4	3,219	4,855
Total provisions		40,733	44,040
Total liabilities		68,122	68,375
Net assets		47,757	49,043
Equity			
Contributed equity		16,657	16,657
Reserves		13,216	13,412
Retained surpluses		17,884	18,974
Total equity		47,757	49,043

The above statement should be read in conjunction with the accompanying notes.

STATEMENT OF CHANGES IN EQUITY

for the year ended 30 June 2017

	Notes	2017 $'000	2016 $'000
Contributed equity			
Opening balance		16,657	16,657
Closing balance as at 30 June		16,657	16,657
Asset revaluation reserve			
Opening balance		7,412	7,136
Contributions by owners			
Machinery of Government change (Private health insurance)	6.2	–	256
Total contributions by owners		–	256
Comprehensive income / (loss)			
Increase / (decrease) in revaluation reserve		(196)	20
Total comprehensive income / (loss)		(196)	20
Closing balance as at 30 June		7,216	7,412
Contingency Enforcement Fund			
Opening balance		6,000	6,000
Closing balance as at 30 June		6,000	6,000
Retained surpluses			
Opening balance		18,974	20,668
Contributions by owners			
Machinery of Government change (Private health insurance)	6.2	–	2,565
Total contributions by owners		–	2,565
Comprehensive loss			
Deficit for the period		(1,090)	(4,259)
Total comprehensive loss		(1,090)	(4,259)
Closing balance as at 30 June		17,884	18,974
Total Equity			
Opening balance		49,043	50,461
Contributions by owners			
Machinery of Government change (Private health insurance)		–	2,821
Total contributions by owners		–	2,821
Comprehensive loss			
Increase / (decrease) in revaluation reserve		(196)	20
Deficit for the period		(1,090)	(4,259)
Total comprehensive loss		(1,286)	(4,239)
Closing balance as at 30 June		47,757	49,043

The above statement should be read in conjunction with the accompanying notes.

CASH FLOW STATEMENT

for the year ended 30 June 2017

	Notes	2017 $'000	2016 $'000
Operating activities			
Cash received			
Appropriations		144,069	137,279
Rendering of services		4,287	4,956
Net GST received		–	3,925
Other		658	843
Total cash received		149,014	147,003
Cash used			
Employees		(100,416)	(95,821)
Suppliers		(21,128)	(29,164)
Net GST paid		(203)	–
Section 74 receipts transferred to Official Public Account (OPA)		(21,902)	(8,609)
Total cash used		(143,649)	(133,594)
Net cash from operating activities		5,365	13,409
Investing activities			
Cash received			
Proceeds from sales of property, plant and equipment		36	–
Total cash received		36	–
Cash used			
Purchase of property, plant and equipment		(3,712)	(16,445)
Purchase/development of software intangibles		(2,885)	(7,291)
Total cash used		(6,597)	(23,736)
Net cash (used by) investing activities		(6,561)	(23,736)
Financing activities			
Cash received			
Lease incentive receipt		13,599	1,296
Machinery of Government change (Private health insurance)	6.2	–	2,821
Net cash from financing activities		13,599	4,117
Net increase/(decrease) in cash held		12,403	(6,210)
Cash and cash equivalents at the beginning of the reporting period		59,232	65,442
Cash and cash equivalents at the end of the reporting period	2.1A	71,635	59,232

The above statement should be read in conjunction with the accompanying notes.

The 2016 comparatives have been restated to include the APRA special account as a cash equivalent and to reclassify lease incentive receipts in that year from suppliers.

ADMINISTERED SCHEDULE OF COMPREHENSIVE INCOME

for the year ended 30 June 2017

	Notes	2017 $'000	2016 $'000
Net cost of services			
Expenses			
Supervisory levy waivers		–	7
Lloyds Security Trust Deposit interest expense		55	75
Risk equalisation payments		458,343	440,872
Total expenses administered on behalf of Government	7.1	458,398	440,954
Income			
Levy revenue			
Financial Institutions Supervisory Levies	7.2	250,156	237,734
Risk equalisation levy collections	7.2	458,343	440,872
Total levy revenue		708,499	678,606
Other revenue			
Lloyds Security Trust Deposit interest income	7.4	55	75
Total other revenue		55	75
Surplus		250,156	237,727

The above schedule should be read in conjunction with the accompanying notes.

The 2016 comparatives have been restated to include the Lloyds Security Trust Deposit interest income and expense.

ADMINISTERED SCHEDULE OF ASSETS AND LIABILITIES

as at 30 June 2017

	Notes	2017 $'000	2016 $'000
Assets			
Financial assets			
Cash and cash equivalents	7.3	835	835
Receivables	7.3	2,348	2,318
Total assets administered on behalf of Government		3,183	3,153
Liabilities			
Lloyds Security Trust Deposit	7.5	2,000	2,000
Total liabilities administered on behalf of Government		2,000	2,000
Net assets administered on behalf of Government		1,183	1,153

The above schedule should be read in conjunction with the accompanying notes.

The 2016 comparatives have been restated to include the Lloyds Security Trust Deposit held in trust by APRA, and the Financial Claims Scheme special account administered by APRA.

ADMINISTERED RECONCILIATION SCHEDULE

as at 30 June 2017

	2017 $'000	2016 $'000
Opening administered assets less administered liabilities as at 1 July	1,153	1,208
Administered income	708,554	678,681
Administered expenses	(458,398)	(440,954)
Transfers to/from Australian Government:		
Appropriation transfers from Official Public Account	458,349	440,887
Transfers to Official Public Account	(708,475)	(678,669)
Closing administered assets less administered liabilities as at 30 June	1,183	1,153

The above schedule should be read in conjunction with the accompanying notes.

The 2016 comparatives have been restated to include the Lloyds Security Trust Deposit interest income and expense; the Financial Claims Scheme special account; and notional remittance and drawdown of Risk equalisation receipts and payments.

ADMINISTERED CASH FLOW STATEMENT

for the year ended 30 June 2017

	2017 $'000	2016 $'000
Operating activities		
Cash received		
Financial Institutions Supervisory Levies	250,126	237,784
Risk equalisation levy collections	458,343	440,872
Total cash received	708,469	678,656
Cash used		
Risk equalisation levy payments	(458,343)	(440,872)
Total cash used	(458,343)	(440,872)
Net cash flows from operating activities	250,126	237,784
Net increase in cash held	250,126	237,784
Cash at the beginning of the reporting period	835	835
Cash from Official Public Account for:		
APRA Special Account: Supervisory Levies	4	15
Risk equalisation collections	458,343	440,872
	459,182	441,722
Cash to Official Public Account for:		
Financial Institutions Supervisory Levies	(250,130)	(237,799)
Risk equalisation payments	(458,343)	(440,872)
	(708,473)	(678,671)
Cash at the end of the reporting period	835	835

The above statement should be read in conjunction with the accompanying notes.

The 2016 comparatives have been restated to include the Financial Claims Scheme special account and the notional remittance and drawdown of Risk equalisation receipts and payments.

OVERVIEW

Objectives of the Australian Prudential Regulation Authority (APRA)

APRA's mission is to establish and enforce prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by institutions APRA supervises are met within a stable, efficient and competitive financial system. APRA also acts as a national statistical agency for the Australian financial sector and plays a role in preserving the integrity of Australia's retirement incomes policy. In performing and exercising its functions and powers, APRA is to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and, in balancing these objectives, is to promote financial system stability in Australia.

APRA's activities contributing toward these outcomes are classified as either 'departmental' or 'administered'. Departmental activities involve the use of assets, liabilities, revenues and expenses controlled or incurred by APRA in its own right. Administered activities involve the management or oversight by APRA, on behalf of the Government, of items controlled or incurred by the Government.

APRA's continued existence in its present form and with its present programs is dependent on Government policy and on continuing appropriations from Parliament.

Basis of preparation of the financial statements

The financial statements and notes are required by section 42 of the *Public Governance, Performance and Accountability Act 2013* and are general purpose financial statements.

In the 2017 financial statements APRA's accounting policies have been distributed throughout the relevant notes to the accounts to enhance readability and useability.

The financial statements and notes have been prepared in accordance with:

- the *Public Governance, Performance and Accountability (Financial Reporting) Rule 2015 (FRR)* for reporting periods ending on or after 1 July 2015; and
- Australian Accounting Standards and Interpretations – Reduced Disclosure Requirements issued by the Australian Accounting Standards Board (AASB) that apply for the reporting period.

The financial statements have been prepared on an accrual basis and in accordance with the historical cost convention, except for certain assets and liabilities that are recognised at fair value. Except where stated, no allowance is made for the effect of changing prices on the results or the financial position.

New Accounting Standards

All new standards and interpretations that were issued prior to the sign-off date and are applicable to the current reporting period did not have a material effect on the entity's financial statements.

Taxation

APRA is exempt from all forms of taxation except Fringe Benefits Tax (FBT) and Goods and Services Tax (GST).

OVERVIEW (CONTINUED)

Reporting of administered activities

Administered revenues, expenses, assets, liabilities and cash flows are disclosed in the Administered Schedules and related notes. These administered items are distinguished from departmental items throughout these financial statements by background shading.

Except where otherwise stated below, administered items are accounted for on the same basis and using the same policies as for departmental items, including the application of Australian Accounting Standards.

Events after the reporting period

There were no significant events occurring after the balance sheet date that have the potential to significantly affect the ongoing structure or financial activities of APRA.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2017

1. DEPARTMENTAL FINANCIAL PERFORMANCE

1.1 Expenses

	2017 $'000	2016 $'000
1.1A Employee benefits		
Salaries and wages	82,024	76,828
Superannuation		
Defined benefit plans	1,679	2,006
Superannuation guarantee contribution	6,884	6,405
Leave and other entitlements	6,819	10,102
Separation and redundancies	1,532	2,162
Other employee benefits	171	685
Total employee benefits	99,109	98,188

Accounting policy

Employee benefits

Accounting policies for employee-related expenses are detailed in section 4: People and Relationships.

	2017 $'000	2016 $'000
1.1B Suppliers		
Services supplied or rendered		
Contractors	1,303	1,571
Travel-related	2,355	2,763
Administrative	2,106	2,483
Information, communication and technology	3,875	4,561
Professional services & consultants	3,075	2,781
Property	1,655	3,447
Training and conferences	1,414	1,947
Other	25	23
Total services supplied or rendered	15,808	19,576
Other supplier expenses		
Operating lease rentals to external parties – minimum lease payments[1]	5,958	9,760
Workers compensation premiums	422	514
Total other supplier expenses	6,380	10,274
Total suppliers	22,188	29,850

Leasing commitments

[1] APRA has leasing commitments for all its offices. Office leases, with expiry dates shown in brackets are current for space in: Sydney (2026), Melbourne (2024), Brisbane (2018), Adelaide (2024) and Canberra (2020).

1. DEPARTMENTAL FINANCIAL PERFORMANCE (CONTINUED)

1.1 Expenses (continued)

	2017 $'000	2016 $'000
Commitments for minimum lease payments in relation to non-cancellable operating leases are payable as follows*		
Within 1 year	2,322	1,168
Between 1 to 5 years	33,740	24,922
More than 5 years	40,315	43,128
Total operating lease commitments	76,377	69,218

* Commitments are stated inclusive of GST where relevant. The prior year figures differ to those in the 2016 financial statements due to a change from straight line to a cash accounting methodology.

Accounting policy

Leases

Payments under an operating lease (minimum lease payments) are recognised as an expense over the lease term on a straight-line accounting basis.

1.1C Grants and scholarships

	2017 $'000	2016 $'000
Scholarships granted	135	119
Total grants and scholarships	135	119

1.1D Finance costs

	2017 $'000	2016 $'000
Adjustment to discount on restoration provisions	–	377
Banking fees	13	18
Total finance costs	13	395

1.1E Losses from asset disposals

	2017 $'000	2016 $'000
Losses from asset disposals	14	64
Total losses from asset disposals	14	64

1. DEPARTMENTAL FINANCIAL PERFORMANCE (CONTINUED)

1.2 Own-source revenue and gains

	2017 $'000	2016 $'000
1.2A Rendering of services		
Rendering of services	3,756	3,735
Total rendering of services	3,756	3,735
1.2B Other revenue		
Licence fees from finance sector entities	240	377
Superannuation trustee application fees	61	15
Fees from foreign bank representative offices	211	196
Resources received free of charge	196	196
Other	141	125
Total other revenue	849	909

Accounting policies

Rendering of services and other revenue

Revenue from rendering of services is recognised by reference to the stage of completion of contracts at the reporting date. The revenue is recognised when:

- the amount of revenue, stage of completion and transaction costs incurred can be reliably measured; and
- the probable economic benefits associated with the transaction will flow to APRA.

The stage of completion of contracts at the reporting date is determined by how the proportion of costs incurred to date relate to the estimated total cost of the transaction.

Revenue and receipts from sources other than an appropriation Act are classified as Section 74 receipts.

Receivables for goods and services, which have 30-day terms, are recognised at the nominal amounts due less any impairment allowance. Collectability of debts is reviewed at balance date. Allowances are made when collectability of the debt is no longer probable.

Resources received free of charge

Resources received free of charge are recognised as revenue or gains when, and only when, a fair value can be reliably determined and the services would have been purchased if they had not been donated. Use of those resources is recognised as an expense. Resources received free of charge are recorded as either revenue or gains depending on their nature. The only resources received free of charge by APRA are audit services from the ANAO of $196,000 (2016: $196,000).

1. DEPARTMENTAL FINANCIAL PERFORMANCE (CONTINUED)

1.2 Own-source revenue and gains (continued)

	Notes	2017 $'000	2016 $'000
Gains			
1.2C Other gains			
Adjustment to discount on restoration provisions		148	–
Total other gains		148	–
1.2D Revenue from Government			
Appropriations:			
Special appropriation	6.1	122,317	125,227
Departmental appropriation		1,543	1,239
Total revenue from Government		123,860	126,466

Accounting policy

Revenue from Government

Amounts appropriated for departmental appropriations for the year (adjusted for any formal additions and reductions) are recognised as Revenue from Government when the entity gains control of the appropriation, except for certain amounts that relate to activities that are reciprocal in nature, in which case revenue is recognised only when it has been earned.

Appropriations receivable are recognised at their nominal amounts.

2. DEPARTMENTAL FINANCIAL POSITION

2.1 Financial assets

	2017 $'000	2016 $'000
2.1A Cash and cash equivalents		
APRA official bank accounts	2,353	1,901
Cash with the Official Public Account (OPA)	69,282	57,329
Cash on hand	–	2
Total cash and cash equivalents	71,635	59,232

Accounting policy

Cash

Change in Accounting Policy

In 2016/17, the *Public Governance, Performance and Accountability (Financial Reporting) Rule 2015* was amended to include that where an amount standing to the credit of a special account is held by a reporting entity, the amount must be disclosed in the entity's financial statement as cash. In 2015/16 these amounts were held as a receivable. The current year and prior year figures in the financial statements have been amended to reflect the change in accounting policy.

Cash is recognised at its nominal amount. Cash includes cash on hand, cash at bank and includes APRA's special account with the Official Public Account (OPA).

2. DEPARTMENTAL FINANCIAL POSITION (CONTINUED)

2.1 Financial assets (continued)

	2017 $'000	2016 $'000
2.1B Trade and other receivables		
Goods and services receivable		
Goods and services	2,337	11,638
Total goods and services receivable	2,337	11,638
Appropriations receivable:		
Special appropriations	37	7
Other appropriations	1,684	–
Total appropriations receivable	1,721	7
Other receivables:		
GST receivable from the Australian Taxation Office	192	–
Other	27	4,682
Total other receivables	219	4,682
Total trade and other receivables	4,277	16,327

Credit terms for goods and services were within 30 days (2016: 30 days).

Accounting policies

Financial assets

APRA classifies its financial assets as trade and other receivables. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition. Financial assets are recognised and derecognised upon trade date.

Receivables

Trade receivables, and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as 'receivables'. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. Receivables are measured at amortised cost using the effective interest method less impairment. Interest is recognised by applying the effective interest rate.

Impairment of financial assets

Financial assets are individually assessed for impairment at each balance date. Where there is sufficient evidence to suggest that an impairment loss has been incurred, the carrying amount is reduced by way of an allowance account. The loss is recognised in the *Statement of Comprehensive Income*.

2. DEPARTMENTAL FINANCIAL POSITION (CONTINUED)

2.2 Non-financial assets

2.2A: Reconciliation of the opening and closing balances of property, plant and equipment and intangibles – 2017

	Leasehold improvements $'000	Computer hardware and office equipment $'000	Total property plant and equipment $'000	Computer software internally developed $'000	Computer software purchased $'000	Total intangibles $'000	Grand Total $'000
As at 1 July 2016							
Gross book value	20,455	5,399	25,854	41,464	8,166	49,630	75,484
Accumulated depreciation, amortisation and impairment	(3,094)	(733)	(3,827)	(25,174)	(6,482)	(31,656)	(35,483)
Net book value 1 July 2016	**17,361**	**4,666**	**22,027**	**16,290**	**1,684**	**17,974**	**40,001**
Additions:							
By purchase	3,221	491	3,712	–	52	52	3,764
Internally developed	–	–	–	2,833	–	2,833	2,833
Revaluation	2	(198)	(196)	–	–	–	(196)
Depreciation:							
Depreciation and amortisation expense	(2,029)	(1,117)	(3,146)	(4,543)	(596)	(5,139)	(8,285)
Disposals:							
Write-off (at cost)	(2,216)	(7)	(2,223)	(65)	(37)	(102)	(2,325)
Write-off (accumulated depreciation)	2,216	7	2,223	51	37	88	2,311
Net book value 30 June 2017	**18,556**	**3,842**	**22,398**	**14,567**	**1,140**	**15,706**	**38,103**
Net book value as of 30 June 2017 represented by:							
Gross book value	21,166	3,855	25,022	44,233	8,181	52,413	77,434
Accumulated depreciation, amortisation and impairment	(2,611)	(13)	(2,624)	(29,666)	(7,041)	(36,707)	(39,331)
Net book value 30 June 2017	**18,556**	**3,842**	**22,398**	**14,567**	**1,140**	**15,706**	**38,103**

Revaluations of non-financial assets

Revaluations are conducted in accordance with the revaluation policy stated in Note 2.2. The latest revaluation was undertaken by an independent valuer in May 2017. The revalued assets were valued as at 30 June 2017.

2. DEPARTMENTAL FINANCIAL POSITION (CONTINUED)

2.2 Non-financial assets (continued)

2.2B: Reconciliation of the opening and closing balances of property, plant and equipment and intangibles – 2016

	Leasehold improvements $'000	Computer hardware and office equipment $'000	Total property plant and equipment $'000	Computer software internally developed $'000	Computer software purchased $'000	Total intangibles $'000	Grand Total $'000
As at 1 July 2015							
Gross book value	5,355	3,732	9,087	34,901	8,040	42,941	52,028
Accumulated depreciation, amortisation and impairment	(3,414)	(350)	(3,764)	(21,214)	(6,203)	(27,417)	(31,181)
Net book value 1 July 2015	**1,941**	**3,382**	**5,323**	**13,687**	**1,837**	**15,524**	**20,847**
Additions:							
By purchase	14,515	1,930	16,445	6,909	382	7,291	23,736
By additional restoration asset creation	2,628	–	2,628	–	–	–	2,628
Revaluation of restoration asset	(727)	–	(727)	–	–	–	(727)
Machinery of Government change (Private health insurance)	233	157	390	204	114	318	708
Depreciation:							
Depreciation and amortisation expense	(1,139)	(803)	(1,942)	(4,291)	(562)	(4,853)	(6,795)
Machinery of Government change (Private health insurance)	(90)	–	(90)	(173)	(70)	(243)	(333)
Disposals:							
Write-off (at cost)	(1,549)	(420)	(1,969)	(551)	(370)	(921)	(2,890)
Write-off (accumulated depreciation)	1,549	420	1,969	504	353	857	2,826
Net book value 30 June 2016	**17,361**	**4,666**	**22,027**	**16,290**	**1,684**	**17,974**	**40,001**
Net book value as of 30 June 2016 represented by:							
Gross book value	20,455	5,399	25,854	41,464	8,166	49,630	75,484
Accumulated depreciation, amortisation and impairment	(3,094)	(733)	(3,827)	(25,174)	(6,482)	(31,656)	(35,483)
Net book value 30 June 2016	**17,361**	**4,666**	**22,027**	**16,290**	**1,684**	**17,974**	**40,001**

2. DEPARTMENTAL FINANCIAL POSITION (CONTINUED)

2.2 Non-financial assets (continued)

Accounting policies

Acquisition of assets

Assets are recorded at cost on acquisition, except as stated below. The cost of acquisition includes the fair value of assets transferred in exchange and liabilities undertaken. Financial assets are initially measured at their fair value plus transaction costs where appropriate.

Assets acquired at no cost, or for nominal consideration, are initially recognised as assets and income at their fair value at the date of acquisition, unless acquired as a consequence of restructuring of administrative arrangements. In the latter case, assets are initially recognised as contributions by owners at the amounts at which they were recognised in the transferor's accounts immediately prior to the restructuring.

Asset recognition threshold

Purchases of leasehold improvements and computer hardware/software are initially recognised at cost in the *statement of financial position*, except for purchases costing less than $5,000, which are expensed in the year of acquisition (other than where they form part of a group of similar items that are significant in total).

The initial cost of an asset includes an estimate of the cost of dismantling and removing the item and restoring the site on which it is located. This is particularly relevant to restoration provisions in property leases taken up by APRA where there exists an obligation to restore the property to its original condition. These costs are included in the value of APRA's leasehold improvements with a corresponding provision for the restoration recognised.

Depreciation

Depreciable computer hardware/software assets are written-off over their estimated useful lives to APRA using, in all cases, the straight-line method of depreciation. Leasehold improvements are depreciated on a straight-line basis over the lesser of the estimated useful life of the improvements or the unexpired period of the lease.

Depreciation rates (useful lives) and residual values and methods are reviewed at each reporting date and necessary adjustments are recognised in the current, or current and future reporting periods, as appropriate.

	2017	2016
Leasehold improvements	**Lesser of 10 years or lease term**	Lesser of 10 years or lease term
Computer hardware	**3 to 5 years**	3 to 5 years

Impairment

All assets were assessed for indications of impairment as at 30 June 2017. Where indications of impairment exist, the asset's recoverable amount is estimated and an impairment adjustment made if the asset's recoverable amount is less than its carrying amount.

The recoverable amount of an asset is the higher of its fair value less costs of disposal and its value in use. Value in use is the present value of the future cash flows expected to be derived from the asset. Where the future economic benefit of an asset is not primarily dependent on the asset's ability to generate future cash flows, and the asset would be replaced if APRA were deprived of the asset, its value in use is taken to be its depreciated replacement cost.

Derecognition

Leasehold improvements or computer hardware/software are derecognised upon disposal or when no further future economic benefits are expected from its use or disposal.

2. DEPARTMENTAL FINANCIAL POSITION (CONTINUED)

2.2 Non-financial assets (continued)

Accounting policies (continued)

Revaluation of assets

Following initial recognition at cost, property, plant and equipment are carried at fair value, less subsequent accumulated depreciation and accumulated impairment losses. Valuations are conducted with sufficient frequency such that the carrying amount of each class of asset is not materially different, at the reporting date, from its fair value. Valuations are undertaken every three years as at 30 June (last valuation in 2017).

Revaluation adjustments are made on a class basis. Any revaluation increment is credited to equity in the asset revaluation reserve except to the extent that it reverses a previous revaluation decrement of the same asset class that was previously recognised in the surplus/deficit.

Intangibles

APRA's intangibles comprise internally developed software and purchased software for internal use. These assets are carried at cost less accumulated amortisation and accumulated impairment losses.

Software is amortised on a straight-line basis over its anticipated useful life. The useful lives of APRA's software are 3 to 5 years (2016: 3 to 5 years).

All software assets were assessed for indications of impairment as at 30 June 2017.

2.3 Payables

	2017 $'000	2016 $'000
2.3A Suppliers		
Trade creditors and accruals	1,538	2,991
Total suppliers	1,538	2,991

Suppliers are expected to be settled in less than 12 months.

	2017 $'000	2016 $'000
2.3B Other payables		
Salaries and wages	723	358
Minimum lease liabilities	9,647	3,660
Lease incentives	14,179	16,204
GST payable to the Australian Taxation Office	286	297
Unearned revenue	951	777
Other	65	48
Total other payables	25,851	21,344
Total payables	27,389	24,335

2. DEPARTMENTAL FINANCIAL POSITION (CONTINUED)

2.3 Payables (continued)

Accounting policy

Financial Liabilities

APRA classifies its financial liabilities as 'payables'. Financial liabilities are recognised and derecognised upon trade date. Supplier and other payables are recognised at amortised cost. Liabilities are recognised to the extent that the goods or services have been received, irrespective of having been invoiced.

A distinction is made between finance leases and operating leases. Finance leases effectively transfer from the lessor to the lessee substantially all the risks and rewards incidental to ownership of leased assets. APRA has no finance leases. In operating leases, the lessor effectively retains substantially all such risks and benefits.

Minimum lease liabilities arise due to the impact of straight line accounting for multi-year leases, which have binding rental increases included in the term of the contract. Such liabilities unwind by the end of the contractual term. Option periods are excluded until it is certain the option will be exercised.

Lease incentives, such as lessor contributions to the cost of fit-out, are recognised in the balance sheet as liabilities in full upon receipt of the incentive, and are amortised on a straight line basis over the life of the lease.

2.4 Other provisions

	2017 $'000	2016 $'000
2.4 Provision for restoration		
Carrying amount 1 July	4,855	2,596
Additional provisions made	130	2,628
Revaluation	–	(746)
Payments	(1,618)	–
Change in rate	(148)	377
Closing balance 30 June	3,219	4,855

At 30 June 2017, APRA leased premises in Sydney, Melbourne, Brisbane, Canberra and Adelaide.

In the lease conditions of all locations (excluding Adelaide and the new Canberra office) there is a requirement for APRA, upon expiration of the lease, to restore the premises to the condition they were in at the commencement of the lease. The required level of restoration provision is being accumulated for each location over the terms of the various leases.

Accounting Judgements and Estimates

Estimated cost per square metre ($ sqm) to restore the leased properties to their original condition are:

Sydney – $350 sqm; Melbourne, Brisbane – $250 sqm; and Canberra – $100 sqm.

2. DEPARTMENTAL FINANCIAL POSITION (CONTINUED)

2.4 Other provisions

Accounting policy

Provision for restoration

Provisions for restoration are initially measured at fair value, net of transaction costs. These are adjusted each year using an effective interest rate method to estimate the present value of the future obligation at the end of the reporting period. The effective interest rate is the rate that exactly discounts the estimated future cash payments at the end of the expected life of the provision.

The annual adjustment to the provision is recognised in income statement as an expense or gain as required.

3. FUNDING

3.1 Appropriations

3.1A Annual appropriations ('recoverable GST exclusive')

Annual Appropriations for 2017

	Annual appropriation $'000	Section 74 $'000	Total appropriation $'000	Appropriation applied in 2017 (current and prior years) $'000	Variance[1] $'000
Departmental					
Ordinary annual services	1,543	21,902	23,445	21,761	1,684
Total departmental	1,543	21,902	23,445	21,761	1,684
Administered					
Other services					
New administered outcomes	–	–	–	–	–
Total administered	–	–	–	–	–

3. FUNDING (CONTINUED)

3.1 Appropriations (continued)

Annual Appropriations for 2016

	Annual appropriation $'000	Section 74 $'000	Total appropriation $'000	Appropriation applied in 2016 (current and prior years) $'000	Variance[1] $'000
Departmental					
Ordinary annual services	1,237	8,609	9,846	11,023	(1,177)
Total departmental	1,237	8,609	9,846	11,023	(1,177)
Administered					
Other services					
New administered outcomes	–	–	–	–	–
Total administered	–	–	–	–	–

[1] The variance between the total appropriation and the appropriation applied is undrawn appropriations at year end relating to section 74 receipts submitted to the Official Public Account.

There were no determinations under section 51 of the PGPA Act that constitute a permanent loss of control in 2017 or in 2016.

3.1B: Unspent annual appropriations ('recoverable GST exclusive')

Authority	2017 $'000	2016 $'000
Departmental		
Appropriation Act (No. 1) 2016-17	1,684	–
Total	1,684	–

3.1C Special appropriations applied ('recoverable GST exclusive')

Authority	Type	Purpose	Appropriation applied 2017 $'000	Appropriation applied 2016 $'000
Australian Prudential Regulation Authority Act 1998 – section 50, Departmental	Unlimited	To provide an appropriation for levy money received that exceeds the amount determined by the Minister under section 50(1) of the *Australian Prudential Regulation Act 1998*.	122,312	125,295
Total			122,312	125,295

3 FUNDING (CONTINUED)

3.2 Special Accounts

	APRA Special Account (Departmental)[1]		Financial Claims Scheme Special Account (Administered)[2]		Risk Equalisation Special Account (Administered)[3]		Lloyd's Deposit Trust Special Account (Administered)[4]	
	2017 $'000	2016 $'000	2017 $'000	2016 $'000	2017 $'000	2016 $'000	2017 $'000	2016 $'000
Balance brought forward from previous period	59,232	65,441	835	835	–	–	–	–
Increases:								
Departmental								
Total departmental increases	162,649	137,614	–	–	–	–	–	–
Restructuring								
Machinery of Government change – Private health insurance (cash)	–	3,794	–	–	–	–	–	–
Total restructuring increases	–	3,794	–	–	–	–	–	–
Administered								
Special appropriation for reporting period	–	–	–	–	458,343	440,872	–	–
Total administered increases	–	–	–	–	458,343	440,872	–	–
Available for payments	221,881	206,849	835	835	458,343	440,872	–	–
Decreases:								
Departmental								
Total departmental decreases	(150,246)	(144,796)	–	–	–	–	–	–
Restructuring								
Machinery of Government change – Private health insurance (equity)	–	(2,821)	–	–	–	–	–	–
Total restructuring decreases	–	(2,821)	–	–	–	–	–	–
Administered								
Repayments made from the Special Account	–	–	–	–	(458,343)	(440,872)	–	–
Total administered decreases	–	–	–	–	(458,343)	(440,872)	–	–
Balance represented by								
Cash in APRA official bank accounts	2,353	1,901	–	–	–	–	–	–
Cash with the Official Public Account (OPA)	69,282	57,329	835	835	–	–	–	–
Cash on hand	–	2	–	–	–	–	–	–
Total balance carried to the next period	71,635	59,232	835	835	–	–	–	–

The prior year comparative figures have been restated to reclassify the lease incentive receipt in that year between departmental decreases and departmental increases.

3 FUNDING (CONTINUED)

3.2 Special Accounts (continued)

[1] Appropriation: *Public Governance, Performance and Accountability Act 2013, section 80.*

Establishing Act: *Australian Prudential Regulation Authority Act 1998, section 52.*

Purpose: To pay the costs and other obligations incurred by APRA in the performance of its functions or the exercise of its powers; to pay any remuneration or allowances payable to persons appointed or engaged under the APRA Act; and to make any other payments that APRA is authorised or required to make under the APRA Act or any other law of the Commonwealth (refer subsection 54(1) of the *Australian Prudential Regulation Authority Act 1998*).

[2] Appropriation: *Public Governance, Performance and Accountability Act 2013, section 80*.

Establishing Act: *Australian Prudential Regulation Authority Act 1998, section 54A*.

There were no transactions debited or credited to the Financial Claims Scheme Special Account in the current reporting period.

Purpose: To meet account-holders' entitlements under Subdivision C (Payment of account-holders with declared ADI) of Division 2AA of Part II of the Banking Act 1959; meet persons' entitlements under Division 3 (Early payment of claims) of Part VC of the Insurance Act 1973; pay APRA's agents or delegates amounts equal to the entitlements the agents or delegates meet on APRA's behalf or in the performance of APRA's delegated functions; and repayment of principal, interest and other costs connected with the borrowings under Part 5, Division 2 of the APRA Act (refer to section 54C of the *Australian Prudential Regulation Authority Act 1998*).

[3] Appropriation: *Public Governance, Performance and Accountability Act 2013, section 80*.

Establishing Act: *Private Health Insurance Act 2007, section 318-1*.

There were 137 transactions debited and credited to the Risk Equalisation Special Account in the current reporting period.

Purpose: To make payments to private health insurers in accordance with the Private Health Insurance (Risk Equalisation Policy) Rules (refer to section 318-10 of the *Private Health Insurance Act 2007*).

[4] The *Financial Management and Accountability Determination 2006/26 – Lloyd's Deposit Trust Special Account Establishment 2006* was repealed on 1 October 2016. The Lloyds special account established under this determination was closed and has not been replaced. The Lloyds security is held outside of the special account in trust by APRA as an administered asset, the comparatives have been restated to reflect this. Refer to note 7.4 for further details.

Collapsed Insurer Special Account

Appropriation: *Public Governance, Performance and Accountability Act 2013, section 80*.

Establishing Act: *Australian Prudential Regulation Authority Act 1998,section 54F*.

There were no transactions debited or credited to the Collapsed Insurer Special Account in the current reporting period, so keeping the account with a $nil balance.

Purpose: To make payments to help meet a collapsed insurer's liabilities to the people insured under its complying health insurance policies that the collapsed insurance is unable to meet itself; to make payments by way of refund of amounts paid by way of the collapsed insurer levy or late payment penalty in respect of unpaid amounts of the collapsed insurer levy; and to meet APRA's associated administrative costs under subsection 54H(1) of the *Australian Prudential Regulation Authority Act 1998*.

3. FUNDING (CONTINUED)

3.3 Regulatory charging summary

	2017 $'000	2016 $'000
Amounts applied		
Departmental		
Special appropriations (including special accounts)	122,317	125,227
Own source revenue	4,325	4,354
Administered		
Special appropriations (including special accounts)	250,156	237,734
Total amounts applied	376,798	367,315
Expenses		
Departmental	128,201	134,172
Administered	–	–
Total expenses	128,201	134,172
External revenue		
Departmental	125,099	128,342
Administered	–	–
Total revenue	125,099	128,342

Regulatory charging activities:

- Financial industry supervisory levies
- Statistical information provided to RBA
- Statistical information provided to ABS
- Assessment of models-based capital adequacy requirements for ADIs – Basel II
- Committed Liquidity Facility (CLF) reviews, assessment, size determination and approvals for ADIs – Basel III

Cost recovery implementation statements for the above activites, excluding charges to the RBA and ABS as these are intra-governmental, are available at:

http://www.apra.gov.au/adi/Levies/Pages/ADI-levies.aspx

4. PEOPLE AND RELATIONSHIPS

4.1 Employee provisions

	2017 $'000	2016 $'000
4.1A Employee provisions		
Leave	31,153	32,194
Bonus	5,901	5,422
Separations and redundancies	334	1,303
Other employee provisions	126	266
Total employee provisions	37,514	39,185

Accounting policies

Employee benefits

Liabilities for 'short-term employee benefits' (as defined in AASB 119 Employee Benefits) and termination benefits expected within 12 months of the balance date are measured at their nominal amounts. The nominal amount is calculated with regard to the rates expected to be paid on settlement of the liability.

All other long-term employee benefits are measured as the present value of the estimated future cash outflows to be made in respect of services provided by employees up to the reporting date.

Leave

The liability for employee benefits includes provision for annual leave and long service leave. No provision has been made for sick leave as all sick leave is non-vesting and the average sick leave taken in future years is estimated to be less than the annual entitlement for sick leave.

The annual and long service leave liabilities are calculated on the basis of employees' remuneration at the estimated salary rates that will be applied at the time the leave is taken, including APRA's employer superannuation contribution rates, assuming that the leave is likely to be taken during service rather than paid out on termination.

Bonus

Bonuses are awarded to staff who meet a minimum performance criteria; staff performing below this standard do not receive a bonus. The provision recognised at the balance date represents the liability for bonuses awarded for the 2016/17 financial year, but are yet to be paid to staff.

Separations and redundancies

Provision is made for separation and redundancy benefit payments in cases where APRA has developed a detailed formal plan for the terminations, and has informed those employees affected that it will carry out the terminations.

4 PEOPLE AND RELATIONSHIPS (CONTINUED)

4.1 Employee provisions (continued)

Accounting policies (continued)

Superannuation

Certain employees of APRA are members of the Commonwealth Superannuation Scheme (CSS) and the Public Sector Superannuation Scheme (PSS). The CSS and PSS are defined benefit schemes for the Australian Government. The liability for defined benefits is recognised in the financial statements of the Australian Government and is settled by the Australian Government in due course. This liability is reported in the Department of Finance's administered schedules and notes. APRA makes employer contributions to the employees' superannuation scheme at rates determined by an actuary to be sufficient to meet the current cost to the Government of the superannuation entitlement of APRA's employees. APRA accounts for the contributions as if they were contributions to defined contribution plans.

APRA also makes employer contributions to the Reserve Bank Officers' Superannuation Fund and to State-based superannuation schemes for former employees of the Reserve Bank of Australia and State-based regulators respectively. These are defined benefit schemes and the liability for the defined benefits are recognised in the financial statements of the relevant fund.

For all other employees, employer contributions are made to the PSS accumulation plan or other superannuation (accumulation) funds as nominated by the employee.

The liability for superannuation recognised at the balance date represents outstanding contributions for the remaining days following the last payroll in June 2017.

4. PEOPLE AND RELATIONSHIPS (CONTINUED)

4.2 Key management personnel remuneration

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity. APRA has determined the key management personnel to be the Federal Treasurer and Cabinet, the APRA Members, the APRA Executive General Managers (EGMs) and the APRA Chief Risk Officer. Key management personnel are a smaller group than senior management personnel that were reported in the prior year.

Key management personnel remuneration is reported in the table below:

	2017 $'000
Short-term employee benefits	4,017
Post-employment benefits	413
Other long-term benefits	448
Total key management personnel remuneration expenses[1]	4,878

The total number of key management personnel that are included in the above table are: 10

APRA Key Management Role	Held By	Period
Chairman	Wayne Byres	Full Year
Deputy Chairman	Helen Rowell	Full Year
Member	Geoff Summerhayes	Full Year
EGM Diversified Institutions	Brandon Khoo	Full Year
EGM Specialised Institutions	Keith Chapman	1 July 2016– 31 March 2017
EGM Specialised Institutions	Louis Serret	1 April 2017– 30 June 2017
EGM Supervisory Support[2]	Charles Littrell	1 July 2016– 17 March 2017
EGM Policy and Advice	Pat Brennan	Full Year
EGM Corporate Services	Steve Matthews	Full Year
Chief Risk Officer	Ben Gully	Full Year

[1] The above key management personnel remuneration excludes the remuneration and other benefits of the Federal Treasurer and Cabinet. Their remuneration and other benefits are set by the Remuneration Tribunal and are not paid by APRA.

[2] The role of EGM Supervisory Support was restructured and covered by other EGMs for the remainder of the financial year.

4. PEOPLE AND RELATIONSHIPS (CONTINUED)

4.3 Related party disclosures

Related party relationships

APRA is an Australian Government controlled entity. Related parties for APRA are the Federal Treasurer and Cabinet, the APRA Members, the APRA Executive General Managers, the APRA Chief Risk Officer and other Australian Government entities.

Transactions with related parties

Given the breadth of Government activities, related parties may transact with the government sector in the same capacity as ordinary citizens. Such transactions include the payment or refund of taxes, receipt of a Medicare rebate or higher education loans. These transactions have not been separately disclosed in this note.

Refer to Note 4.1 Employee provisions for details on superannuation arrangements in the Commonwealth Superannuation Scheme (CSS), the Public Sector Superannuation Scheme (PSS), and the PSS accumulation plan.

APRA transacts with other Australian Government controlled entities consistent with normal day-to-day business operations provided under normal terms and conditions, including the payment of workers compensation and insurance premiums and payment of superannuation contributions. These are not considered individually significant to warrant separate disclosure as related party transactions.

Accounting policy

Related party disclosures

No comparative figures have been disclosed for the initial period of adoption per *AASB 124 – Related Party Disclosures*.

5. MANAGING UNCERTAINTIES

5.1 Contingent assets and liabilities

Significant remote contingent liabilities and assets

APRA has no significant contingent liabilities or assets as at the balance date (2016: Nil).

Quantifiable contingencies (APRA departmental)

APRA has no quantifiable contingencies as at balance date (2016: Nil).

Unquantifiable contingencies (APRA departmental)

APRA has no unquantifiable contingencies as at balance date (2016: Nil).

Accounting policy

Contingent assets and contingent liabilities

Contingent assets and contingent liabilities are not recognised in the *Statement of Financial Position* but are reported in the relevant notes. They may arise from uncertainty as to the existence of an asset or liability, or represent an asset or liability in respect of which the amount cannot be reliably measured. Contingent assets are disclosed when settlement is probable but not virtually certain and contingent liabilities are disclosed when the probability of settlement is greater than remote.

5. MANAGING UNCERTAINTIES (CONTINUED)

5.2 Financial instruments

	Notes	2017 $'000	2016 $'000
Categories of financial instruments			
Financial assets			
Cash and cash equivalents	2.1A	71,635	59,232
Trade receivables	2.1B	4,277	16,327
Total financial assets		75,912	75,559
Financial liabilities			
At amortised cost:			
Trade creditors and accruals	2.3	1,538	2,991
Total financial liabilities		1,538	2,991

The carrying amounts of the financial instruments are a reasonable representation of their fair value.

The APRA Special account has been re-categorised as a cash equivalent in 2017, requiring a corresponding re-categorisation of the 2016 comparative figure.

Accounting policy

Financial instruments

Financial assets

APRA classifies its financial assets as 'cash or cash equivalents' or 'trade receivables'. See Note 2.1 for further details.

Financial liabilities

APRA classifies its financial liabilities as 'payables'. See Note 2.3 for further details.

5. MANAGING UNCERTAINTIES (CONTINUED)

5.3 Fair value measurements

		Fair value measurements at the end of the reporting period	
		2017	2016
	Notes	$'000	$'000
Non-financial assets			
Computer hardware and office equipment	2.2A	3,842	4,666
Leasehold improvements	2.2A	18,556	17,361
Total non-financial assets		22,398	22,027

Accounting policy

Fair value measurement

Accounting policies for fair value measurements of tangible non-financial assets are included in note 2.2.

6. OTHER INFORMATION

6.1 Calculation of APRA Special Appropriation

The APRA Special Appropriation is calculated in accordance with the provisions of s50 of the *Australian Prudential Regulation Authority Act 1998*.

	2017 $'000	2016 $'000
Table 1: Summary of APRA levy funding		
Current year levies and penalties (see Note 7.2, Table 1)	250,156	237,734
Risk equalisation receipts	458,343	440,872
Less: Waivers and doubtful debts (see Note 7.1)	–	(7)
Net current year levies and penalties (see Table 2 below)	708,499	678,599
Less: Amount retained in the Consolidated Revenue Fund (see Table 3 below)	(127,839)	(112,500)
Less: Risk equalisation payments to private health insurers	(458,343)	(440,872)
Total APRA levy funding (see Table 4 below)	122,317	125,227
Table 2: Net current year levies and penalties by levy type		
Superannuation funds	110,340	124,074
Authorised deposit-taking institutions	79,167	65,152
Life insurers and friendly societies	22,042	16,101
General insurers	34,471	26,169
Private health insurers	4,136	6,231
Risk equalisation receipts from private health insurers	458,343	440,872
Total	708,499	678,599
Table 3: Amounts retained in the Consolidated Revenue Fund by levy type[1] or returned to industry		
Superannuation funds	(81,939)	(94,600)
Authorised deposit-taking institutions	(22,200)	(11,000)
Life insurers and friendly societies	(10,500)	(3,000)
General insurers	(13,200)	(3,900)
Total	(127,839)	(112,500)
Table 4: Amounts of levy payable to APRA under the APRA Special Appropriation by levy type[2]		
Superannuation funds	28,401	29,474
Authorised deposit-taking institutions	56,967	54,152
Life insurers and friendly societies	11,542	13,101
General insurers	21,271	22,269
Private health insurers	4,136	6,231
Total	122,317	125,227
This is represented by:		
Special Appropriation	122,317	125,227
Total	122,317	125,227

[1] Including amounts as determined by the Minister in accordance with subsection 50(1) of the Australian Prudential Regulation Authority Act 1998.

[2] Table 4 above represents the total amount of levies payable to APRA for its operations.

6. OTHER INFORMATION (CONTINUED)

6.1 Calculation of APRA Special Appropriation (continued)

Accounting policy

APRA is funded primarily through levies imposed on the industries it supervises. These levies, known as the Financial Institutions Supervisory Levies, are administered transactions collected on behalf of the Government and paid into the Consolidated Revenue Fund (CRF). An amount equal to the net levy revenue, less an amount specified by the Minister in an annual determination made under subsection 50(1) of the *Australian Prudential Regulation Authority Act 1998* (APRA Act), is credited to the APRA Special Account as a Special Appropriation, in accordance with subsections 50(2), (3) and (5) of the APRA Act. The amounts specified in the Minister's Determinations are retained in the CRF to cover: the costs of activities of the Australian Taxation Office (ATO) for unclaimed monies, lost member functions and for the implementation of the Stronger Super – SuperStream reforms; the Australian Securities and Investments Commission (ASIC) for consumer protection and market integrity functions; and the Department of Human Services (DHS) for the administration of claims for early release of superannuation benefits on compassionate grounds.

APRA administers the collection of Financial Institutions Supervisory Levies and Financial Assistance Levies on behalf of the Government. While the revenues from Financial Institutions Supervisory Levies are in part used to fund the operations of APRA, they are not directly available to APRA for its own purposes. The revenues from the Financial Assistance Levy are not available to APRA for its own purposes. All administered collections are remitted to the Official Public Account. Transactions and balances relating to levies are reported in Note 7.2: Administered income.

APRA also administers the Risk Equalisation Special Account whereby revenue collected by APRA for the purposes of risk equalisation across the private health insurance industry is treated by the Government as revenue and expenses. The transactions to and from this account are recorded within the Official Public Account (OPA) by way of notional receipts and payments.

6. OTHER INFORMATION (CONTINUED)

6.2 Restructuring

	2017 $'000	2016 $'000
Machinery of Government (Private health insurance)		
Financial assets recognised		
Cash and cash equivalents	–	3,794
Trade and other receivables	–	63
Total financial assets	–	3,857
Non-financial assets recognised		
Land and buildings	–	123
Property, plant and equipment	–	177
Intangibles	–	75
Other non-financial assets	–	82
Total non-financial assets	–	457
Total assets recognised	–	4,314
Payables recognised		
Suppliers	–	(161)
Other payables	–	(127)
Total payables	–	(288)
Provisions recognised		
Employee provisions	–	(1,099)
Other provisions	–	(106)
Total provisions	–	(1,205)
Total liabilities recognised	–	(1,493)
Net assets recognised	–	2,821
Equity assumed		
Revaluation reserve	–	256
Retained surplus	–	2,565
Total equity recognised	–	2,821

6. OTHER INFORMATION (CONTINUED)

6.3 Budgetary reports and explanations of major variances

The following tables provide a comparison of the original budget as presented in the 2016/17 Portfolio Budget Statements (PBS) to the 2016/17 final outcome as presented in accordance with Australian Accounting Standards. The Budget is not audited.

6.3 Departmental budgetary reports

Summary of key variances to budget

Overall APRA under-spent its available expense budget by a total of $1.6 million. The underspend primarily arose across non people-related expenditure categories as internal restructuring activites impacted training, travel and other discretionary activities in the second half of the financial year.

In addition, a lower than assumed June 2016 quarter growth in superannuation industry assets resulted in an under-collection in revenue from government (levy revenue) of $0.7 million which, combined with $0.3 million lower own source income due to slightly less fees charged to the larger banks for accreditation of their Internal Capital Models (Basel II) resulted in a total of $1.0 million less income than budgeted.

	Actual	Budget estimate	
		Original	Variance
Statement of comprehensive income *for the year ended 30 June 2017*	2017 $'000	2017 $'000	2017 $'000
Expenses			
Employee benefits	99,109	98,350	(759)
Suppliers	22,350	24,976	2,626
Depreciation and amortisation	8,285	7,992	(293)
Total expenses	129,744	131,318	1,574
Less:			
Own-source income			
Rendering of services	3,756	4,000	(244)
Other revenue and gains	1,038	1,056	(18)
Total own-source income	4,794	5,056	(262)
Net cost of services	124,950	126,262	1,312
Revenue from Government	123,860	124,609	(749)
Operating deficit	(1,090)	(1,653)	563
Other comprehensive income			
Items not subject to subsequent reclassification to profit or loss			
Changes in asset revaluation reserve	(196)	–	(196)
Total comprehensive loss	(1,286)	(1,653)	367

6. OTHER INFORMATION (CONTINUED)

6.3 Budgetary reports and explanations of major variances (continued)

6.3 Departmental budgetary reports (continued)

Summary of key variances to budget

The largest variances to budget in the statement of financial position arise from the restatement of the APRA special account (Cash with the Official Public Account (OPA) in Note 2.1A) to cash and cash equivalents which has altered the basis upon which the balance sheet is constructed, with $69.3 million (actual) reclassified to a cash equivalent.

The Property, plant and equipment variance relates to the finalisation of the accounting treatment for APRA's relocation of its Sydney, Melbourne, Canberra and Adelaide offices. These relocations increased leasehold assets (and corresponding liabilities) significantly. In addition, project delays have resulted in lower intangible assets than budgeted.

Total payables and other provisions are larger than budget reflecting the impact of the property accounting noted above.

Finally employee provisions are lower than budget due to a rise in the 10 year government bond rate that is used in valuing employee leave liabilities.

6. OTHER INFORMATION (CONTINUED)

6.3 Budgetary reports and explanations of major variances (continued)

6.3 Departmental budgetary reports (continued)

	Actual	Budget estimate	
		Original	Variance
Statement of financial position *as at 30 June 2017*	2017 $'000	2017 $'000	2017 $'000
Assets			
Financial assets			
Cash	71,635	1,311	70,324
Trade and other receivables	4,277	74,925	(70,648)
Total financial assets	75,912	76,236	(324)
Non-financial assets			
Property, plant and equipment	22,398	7,041	15,357
Intangibles	15,706	23,055	(7,349)
Other non-financial assets	1,863	2,482	(619)
Total non-financial assets	39,967	32,578	7,389
Total assets	115,879	108,814	7,065
Liabilities			
Payables and other provisions			
Suppliers	1,538	9,349	7,811
Other payables / provisions	29,070	9,467	(19,603)
Total payables and other provisions	30,608	18,816	(11,792)
Provisions			
Employee provisions	37,514	38,369	855
Total liabilities	68,122	57,185	(10,937)
Net assets	47,757	51,629	(3,872)
Equity			
Contributed equity	16,657	16,657	–
Reserves	13,216	13,392	(176)
Retained surpluses	17,884	21,580	(3,696)
Total equity	47,757	51,629	(3,872)

6. OTHER INFORMATION (CONTINUED)

6.3 Budgetary reports and explanations of major variances (continued)

6.3 Departmental budgetary reports (continued)

Summary of key variances to budget

Equity and Reserves variances dissimilar to budget largely due to income statement performances in the current and prior years compared to budget.

Statement of changes in equity *as at 30 June 2017*	Actual 2017 $'000	Budget estimate Original 2017 $'000	Budget estimate Variance 2017 $'000
Contributed equity			
Opening balance	16,657	16,657	–
Closing balance as at 30 June	16,657	16,657	–
Retained surpluses			
Opening balance	18,974	23,233	(4,259)
Comprehensive loss			
Deficit for the period	(1,090)	(1,653)	563
Closing balance as at 30 June	17,884	21,580	(3,696)
Asset revaluation reserve			
Opening balance	7,412	7,392	20
Comprehensive loss			
Decrease in revaluation reserve	(196)	–	(196)
Total comprehensive loss	(196)	–	(196)
Closing balance as at 30 June	7,216	7,392	(176)
Contingency Enforcement Fund			
Opening balance	6,000	6,000	–
Closing balance as at 30 June	6,000	6,000	–
Total Equity			
Opening balance	49,043	53,282	(4,239)
Comprehensive loss			
Decrease in revaluation reserve	(196)	–	(196)
Deficit for the period	(1,090)	(1,653)	563
Total comprehensive loss	(1,286)	(1,653)	367
Closing balance as at 30 June	47,757	51,629	(3,872)

6. OTHER INFORMATION (CONTINUED)

6.3 Budgetary reports and explanations of major variances (continued)

6.3 Departmental budgetary reports (continued)

Summary of key variances to budget

The $12.4 million net increase in cash held in 2016/17 is mainly due to capital incentive receipts relating to APRA's Sydney office fit-out. APRA made the majority of payments for the office fit-out in 2015/16; the corresponding incentive receipts were received in 2016/17. These receipts are remitted to the OPA and subsequently drawn down as additional appropriations in during the year. In addition, project delays reduced capital expenditure cash outflows.

Finally the restatement of the APRA special account (Cash with the Official Public Account (OPA) in Note 2.1A) to cash and cash equivalents has altered the basis upon which the cashflow is constructed, with $57.3 million reclassified to a cash equivalent.

6. OTHER INFORMATION (CONTINUED)

6.3 Budgetary reports and explanations of major variances (continued)

6.3 Departmental budgetary reports (continued)

Cash flow statement *for the year ended 30 June 2017*	Actual 2017 $'000	Budget estimate Original 2017 $'000	Variance 2017 $'000
Operating activities			
Cash received			
Appropriations	144,069	124,609	19,460
Rendering of services	4,287	4,000	287
Receipts from Government	–	5,056	(5,056)
Other	658	1,056	(398)
Total cash received	149,014	134,721	14,293
Cash used			
Employees	(100,416)	(98,350)	(2,066)
Suppliers	(21,128)	(19,916)	(1,212)
Net GST paid	(203)	–	(203)
Section 74 receipts transferred to Official Public Account (OPA)	(21,902)	(5,056)	(16,846)
Total cash used	(143,649)	(123,322)	(20,327)
Net cash from operating activities	5,365	11,399	(6,034)
Investing activities			
Cash received			
Proceeds from sales of property, plant and equipment	36	–	36
Total cash received	36	–	36
Cash used			
Purchase of property, plant and equipment	(3,712)	(2,149)	(1,563)
Purchase/development of software intangibles	(2,885)	(9,250)	6,365
Total cash used	(6,597)	(11,399)	4,802
Net cash (used by) investing activities	(6,561)	(11,399)	4,838
Financing activities			
Cash received			
Lease incentive receipt	13,599	–	13,599
Net cash from financing activities	13,599	–	13,599
Net increase/(decrease) in cash held	12,403	–	12,403
Cash at the beginning of the reporting period	59,232	1,311	57,921
Cash at the end of the reporting period	71,635	1,311	70,324

7. ADMINISTERED NOTES

7.1 Administered expenses

	Notes	2017 $'000	2016 $'000
7.1 Expenses			
Supervisory levy waivers		–	7
Lloyd's security deposit interest expense	7.4	55	75
Risk equalisation levy payments	6.1	458,343	440,872
Total administered expenses		458,398	440,954
Levies and late payment penalties waived by levy type			
Authorised deposit-taking institutions		–	7
Total waivers		–	7

The 2016 comparatives have been restated to include the Lloyds Security Trust Deposit interest expenses.

Accounting policy

Expenses

Administered expenses arising from waivers of levy debts are recognised at the time of approval by delegated APRA officials.

Waivers generally occur due to a change of status of a supervised entity during the year, resulting in the annual levy being wholly or partly waived.

Private health insurance risk equalisation expenses reflecting amounts returned to relevant industry participants are recognised at the time of payment as administered expenses.

7. ADMINISTERED NOTES (CONTINUED)

7.2 Administered income

	2017 $'000	2016 $'000
7.2 Income		
Levy revenue		
Financial Institutions Supervisory Levies and penalties (see Table 1)[1]	250,156	237,734
Risk equalisation levy receipts	458,343	440,872
Total levy revenue	708,499	678,606

Accounting policy

Revenue

All administered revenues relate to the ordinary activities performed by APRA on behalf of the Government. These revenues are not directly available to be used by APRA for its own purposes and are remitted to the OPA, or in the case of the private health insurance risk equalisation levies, returned to the relevant industry participants in accordance with the Private Health Insurance (Risk Equalisation Policy) Rules 2015 (the Rules).

APRA undertakes the collection of certain levies on behalf of the Government. These comprise Financial Institutions Supervisory Levies, Financial Assistance Levies and late payment penalties collected under the *Financial Institutions Supervisory Levies Collection Act 1998*.

Administered revenue arising from levies (including Financial Assistance Levies) is recognised on an accrual basis, in line with the Minister's regulations and determinations. The collectability of debts is reviewed at balance date. Provisions are made when collection of the debt is judged to be less, rather than more likely.

[1] Financial institutions supervisory levies are detailed in the annual consultation paper released by Treasury. In addition, APRA publishes a Cost Recovery Implementation Statement in relation to its component of the financial institutions supervisory levies.

7. ADMINISTERED NOTES (CONTINUED)

7.2 Administered income (continued)

	2017 $'000	2016 $'000
7.2 Income (continued)		
Table 1: Financial Institutions Supervisory Levies revenue by type		
Levy:		
Superannuation funds	110,326	124,063
Authorised deposit-taking institutions	79,167	65,159
Life insurers and friendly societies	22,042	16,101
General insurers	34,471	26,169
Private health insurers	4,136	6,231
Total Financial Industry Supervisory Levies	250,142	237,723
Late payment penalties:		
Superannuation funds	14	11
Total late payment penalties	14	11
Total current year financial industry levies and penalties	250,156	237,734

The Financial Institutions Supervisory Levies are set to recover the operational costs of APRA, and other specific costs incurred by certain Commonwealth agencies and departments. The proportion of total current year levies and penalties attributable to APRA is set out in Note 6.1.

The risk equalisation levy receipts are set to equalise risk across the private health insurance industry, and are returned to relevant industry participants in accordance with the Rules shortly after they are collected.

	2017 $'000	2016 $'000
Other revenue		
Lloyd's security deposit interest income	55	75
Total other revenue	55	75

The 2016 comparatives have been restated to include Lloyds Security Trust Deposit interest income.

7. ADMINISTERED NOTES (CONTINUED)

7.3 Administered financial assets

	2017 $'000	2016 $'000
Cash and cash equivalents		
Financial Claims Scheme	835	835
Total cash and cash equivalents	835	835
Receivables		
Financial Institutions Supervisory Levies	37	7
Lloyds security held in trust	2,000	2,000
Financial Assistance Levy	311	311
Total receivables	2,348	2,318
Receivables were aged as follows:		
Not overdue	2,037	2,007
Overdue by:		
0 to 30 days	–	–
31 to 60 days	–	–
more than 90 days	311	311
Total receivables	2,348	2,318

There is no impairment allowance in 2017 (2016: Nil). The receivables greater than 90 days relate to the previous Financial Assistance Levy (FAL) that were charged to superannuation funds that were no longer APRA-regulated institutions at the levy date. This outstanding amount will be added to the next FAL and collected at that point.

The 2016 comparative administered assets and liabilities have been restated to include the Lloyds Security Trust Deposit, and the Financial Claims Scheme special account administered by APRA.

7. ADMINISTERED NOTES (CONTINUED)

7.4 Administered assets held in trust

Monetary assets

The Lloyd's Security Deposit is held by APRA in trust. Responsibility for the administration of the Lloyd's Security Deposit Trust was transferred from the Department of Treasury to APRA on 26 May 2008. The purpose is to disburse amounts in accordance with section 92Q of the *Insurance Act 1973*.

	2017 $'000	2016 $'000
Lloyd's Deposit Trust Security		
Total amount held at the beginning of the reporting period	2,000	2,000
Receipts	55	75
Payments	(55)	(75)
Total amount held at the end of the reporting period	2,000	2,000
Total	2,000	2,000

The market valuation as at 30 June 2017 for the Lloyd's Security Deposit Trust is $2,052,124 (2016: $2,087,351).

Non-monetary assets

APRA has no non-monetary assets held in trust.

7.5 Administered liabilities

	2017 $'000	2016 $'000
Other payables		
Lloyds Security Trust Deposit	2,000	2,000
Total other payables	2,000	2,000

The 2016 comparative administered liabilities have been restated to include the Lloyds Security Trust Deposit.

7. ADMINISTERED NOTES (CONTINUED)

7.6 Administered contingent assets and liabilities

Unquantifiable administered contingencies

APRA is responsible for the administration of the Financial Claims Scheme (FCS). The FCS provides depositors of authorised deposit-taking institutions (ADIs) and claimants of general insurers (GIs) with timely access to their funds in the event of a financial institution failure.

Under the *Banking Act 1959* the scheme provides a mechanism for making payments to depositors under the Government's guarantee of deposits in ADIs. Payments are capped at $250,000 per account-holder per ADI. As at 31 December 2016, deposits eligible for coverage under the Scheme were estimated to be $850 billion, compared to $810 billion* as at 31 December 2015, reflecting overall deposit growth in the financial system.

Under the *Insurance Act 1973* the scheme provides a mechanism for making payments to eligible beneficiaries with a valid claim against a failed GI. It is not possible to estimate these claims.

In the very unlikely event of an ADI or GI failure, any payments made under the FCS would be recovered through the liquidation of the failed institution. If there was a shortfall in the amount recovered through the liquidation of the failed institution, a levy could be applied to the relevant industry to recover the difference between the amount expended and the amount recovered in the liquidation.

Under the FCS, any payments to account-holders with protected accounts or eligible claimants would be made from APRA's FCS Special Account. Under the legislation, initial amounts available to meet payments, in the event of activation, are up to $20 billion per institution and up to $100 million for administration.

It is not possible to estimate the amounts of any eventual payments that may be required in relation to either the ADI FCS or GI FCS and as such no amount is included in this note.

** Note, in the 2016 APRA financial statements the amount quoted for the FCS administered contingent liability as at 31 December 2015 was $777 billion, which was the amount for 30 June 2015.*

7. ADMINISTERED NOTES (CONTINUED)

7.7 Administered budgetary reports and explanations of major variances

7.7 Administered budgetary reports

Summary of key variances to budget

The budgeted growth in the risk equalisation levy, which was based on a historical growth profile, did not fully materialise in 2017. This difference drives the overall magnitude of the risk equalisation levy collections and payments across the industry.

The small Financial Institutions Supervisory Levies under-collection against budget is due to a lower than expected June quarter assets growth in the superannuation industry. This caused a small over-estimation in the size of the industry at the superannuation levy date and therefore a small under-estimation in the required levy rate.

	Actual	Budget estimate	
		Original	Variance
Administered schedule of comphrehensive income *for the year ended 30 June 2017*	2017 $'000	2017 $'000	2017 $'000
Expenses			
Lloyd's security interest expense	55	–	55
Risk equalisation levy payments	458,343	532,737	(74,394)
Total expenses administered on behalf of Government	458,398	532,737	(74,339)
Less:			
Income			
Lloyd's security interest income	55	–	55
Financial Institutions Supervisory Levies	250,156	251,655	(1,499)
Risk equalisation levy collections	458,343	532,737	(74,394)
Total income	708,554	784,392	(75,838)
Net contribution by services	250,156	251,655	(1,499)

7. ADMINISTERED NOTES (CONTINUED)

7.7 Administered budgetary reports and explanations of major variances (continued)

7.7 Administered budgetary reports (continued)

Summary of key variances to budget

Restatement of Administered balance sheet to include the Lloyds Security Trust Deposit.

Administered schedule of assets and liabilities *as at 30 June 2017*	Actual 2017 $'000	Budget estimate Original 2017 $'000	Variance 2017 $'000
Assets			
Financial assets			
Cash and cash equivalents	835	835	–
Receivables	2,348	373	1,975
Total assets administered on behalf of Government	3,183	1,208	1,975
Liabilities			
Liabilities administered on behalf of Government	2,000	–	2,000
Total liabilities administered on behalf of Government	2,000	–	2,000
Net assets administered on behalf of Government	1,183	1,208	(25)

Australian National Audit Office

INDEPENDENT AUDITOR'S REPORT

To the Treasurer

Opinion

In my opinion, the financial statements of the Australian Prudential Regulation Authority for the year ended 30 June 2017:

(a) comply with Australian Accounting Standards – Reduced Disclosure Requirements and the *Public Governance, Performance and Accountability (Financial Reporting) Rule 2015*; and

(b) present fairly the financial position of the Australian Prudential Regulation Authority as at 30 June 2017 and its financial performance and cash flows for the year then ended.

The financial statements of the Australian Prudential Regulation Authority, which I have audited, comprise the following statements as at 30 June 2017 and for the year then ended:

- Statement by Members and the Executive General Manager – Corporate Services;
- Statement of comprehensive income;
- Statement of financial position;
- Statement of changes in equity;
- Cash flow statement;
- Administered schedule of comprehensive income;
- Administered schedule of assets and liabilities;
- Administered reconciliation schedule;
- Administered cash flow statement; and
- Notes to the financial statements, comprising a Summary of Significant Accounting Policies and other explanatory information.

Basis for Opinion

I conducted my audit in accordance with the Australian National Audit Office Auditing Standards, which incorporate the Australian Auditing Standards. My responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of my report. I am independent of the Australian Prudential Regulation Authority in accordance with the relevant ethical requirements for financial statement audits conducted by the Auditor-General and his delegates. These include the relevant independence requirements of the Accounting Professional and Ethical Standards Board's APES 110 *Code of Ethics for Professional Accountants* to the extent that they are not in conflict with the *Auditor-General Act 1997* (the Code). I have also fulfilled my other responsibilities in accordance with the Code. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Accountable Authority's Responsibility for the Financial Statements

As the Accountable Authority of the Australian Prudential Regulation Authority the Chairman is responsible under the *Public Governance, Performance and Accountability Act 2013* for the preparation and fair presentation of annual financial statements that comply with Australian Accounting Standards – Reduced Disclosure Requirements and the rules made under that Act. The Chairman is also responsible for such internal control as the Chairman determines is necessary to enable the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Chairman is responsible for assessing the Australian Prudential Regulation Authority's ability to continue as a going concern, taking into account whether the entity's operations will cease as a result of an administrative restructure or for any other reason. The Chairman is also responsible for disclosing matters related to going concern as applicable and using the going concern basis of accounting unless the assessment indicates that it is not appropriate.

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Auditor's Responsibilities for the Audit of the Financial Statements

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Australian National Audit Office Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with the Australian National Audit Office Auditing Standards, I exercise professional judgement and maintain professional scepticism throughout the audit. I also:

- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control;
- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Accountable Authority;
- conclude on the appropriateness of the Accountable Authority's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the entity to cease to continue as a going concern; and
- evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

I communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

Australian National Audit Office

Jodi George

Acting Executive Director

Delegate of the Auditor-General

Canberra

17 August 2017

CH/8
STATUTORY REPORT

STATUTORY REPORT

STATUTORY REPORTING REQUIREMENTS

APRA reports in accordance with the following Commonwealth legislation and other requirements:

- *Australian Prudential Regulation Authority Act 1998;*
- *Environment Protection and Biodiversity Conservation Act 1999;*
- *Equal Employment Opportunity (Commonwealth Authorities) Act 1987;*
- *Freedom of Information Act 1982;*
- *Public Governance, Performance and Accountability Act 2013;*
- *Work Health and Safety Act 2011;*
- Commonwealth Fraud Control Framework; and
- Requirements for Annual Reports for Departments, Executive Agencies and other Non-corporate Commonwealth Entities.

Australian Prudential Regulation Authority Act 1998 (APRA ACT)

Section 59 of the APRA Act requires APRA to report on:

- the activities of ADI statutory managers within the meaning of the *Banking Act 1959* and persons conducting investigations under Division 2 of Part II and section 61 of that Act;
- the operation of Division 2AA (Financial Claims Scheme for account-holders with insolvent ADIs) of Part II of the *Banking Act 1959*;
- the operation of Part VC (Financial Claims Scheme for policyholders with insolvent general insurers) of the *Insurance Act 1973*;
- the number of times during the year that APRA determined, under subsection 13(1) of the *Financial Sector (Collection of Data) Act 2001*, a reporting standard that is not a legislative instrument; and
- the exercise during the year of APRA's powers under Part 15 of the *Retirement Savings Accounts Act 1997* (RSA Act) and Part 29 of the *Superannuation Industry (Supervision) Act 1993* (SIS Act).

APRA did not appoint any ADI statutory managers or persons to conduct an investigation under Division 2 of Part II or section 61 of the *Banking Act 1959* during 2016/17. There were no continuing appointments during the year.

There were no schemes in operation under Division 2AA of Part II of the *Banking Act 1959*.

On 15 October 2009, the Minister made a declaration under section 62ZZC of the *Insurance Act 1973* that Division 3 of Part VC of that Act applied in relation to one general insurer[1]. No payments were made from the Financial Claims Scheme Special Account in 2016/17 to satisfy claims against this general insurer.

APRA did not determine any reporting standards under subsection 13(1) of the *Financial Sector (Collection of Data) Act 2001* during 2016/17 that were not legislative instruments.

APRA did not exercise its powers under Part 15 of the RSA Act in 2016/17.

1. Australian Family Assurance limited (in liquidation).

APRA exercised its powers under Part 29 of the SIS Act in relation to particular entities or persons as set out below:

Exemption Number	Date	Provision of SIS Act / regulations exempted
A6 of 2016	30/08/2016	r.9.04D(1)
A7 of 2016	19/08/2016	r.9.04D(1)
A8 of 2016	15/09/2016	s.89(2)
A9 of 2016	15/09/2016	s.93(3)
A10 of 2016	20/09/2016	r.9.04I(1)
A11 of 2016	12/10/2016	r.9.08, 9.09, 9.17, 9.23, 9.24 and 9.25
A12 of 2016	30/11/2016	r.6.17(2)
A13 of 2016	25/11/2016	r.9.04I
A14 of 2016	13/01/2017	r.6.17(2)
A15 of 2016	21/12/2016	s.93(3)
A1 of 2017	03/02/2017	s.9.04I(1)
A2 of 2017	14/02/2017	r.9.04D(1)
A3 of 2017	14/02/2017	r.9.04I
A4 of 2017	14/02/2017	s.93(3)
A5 of 2017	30/06/2017	s.93(3)
A6 of 2017	30/06/2017	6.17(2)

Modification Number	Date	Provision of SIS Act / regulations modified
A3 of 2016	12/10/2016	r.6.42A
A4 of 2016	21/10/2016	r.1.06(8)(d)
A1 of 2017	08/02/2017	r.1.03
A2 of 2017	12/04/2017	r.1.03

Environment Protection and Biodiversity Conservation Act 1999

Ecologically sustainable development and environmental performance

APRA's Environmental Policy Statement reinforces its commitment to operating in an ecologically sustainable manner. APRA actively takes steps to reduce its environmental impact and adopts environmentally friendly options where practical. Measures include: sensor-controlled lighting; energy-efficient power management settings on office equipment; recycling of paper, cardboard, office furniture and printer cartridges; reducing waste; the use of mobile devices and 'follow-me' printing; and fostering staff awareness of environmental issues including considering the need to print documents.

Equal Employment Opportunity (Commonwealth Authorities) Act 1987 (EEO ACT)

Inclusive diversity at APRA

APRA is dedicated to ensuring it creates an environment that fosters inclusivity and respect for all its staff. APRA believes that diverse and inclusive teams are critical for its success because they broaden the range of thinking that supports strong judgments that are the foundation of supervisory authorities. For APRA to be successful in fulfilling its mission for the Australian community, all staff in the agency need to be able to contribute to their full potential.

In late 2016, APRA launched its *'Inclusion and Diversity Strategy for 2017 and Beyond'* which is founded on an inclusive vision for the organisation:

> *We embrace differences and work together to achieve great outcomes for APRA and the Australian community.*

APRA's Inclusion and Diversity Strategy is aligned with APRA's overall strategic plan. It supports APRA's objective to attract and retain people with a diversity of experience, qualifications, aptitude and an alignment to APRA's culture. In addition, the goal to enhance leadership, culture and opportunities for APRA staff includes building an inclusive leadership that inspires outcomes and fosters the desired culture where staff feel valued, engaged and safe.

Strategic areas of focus

APRA's Inclusion and Diversity Strategy is based on four key areas of priority:

- ***Sharpen APRA's inclusion and diversity focus*** – to ensure APRA has the appropriate governance, structure and reporting in place to drive the strategy forward and support sustainable change.
- ***Attract, grow and engage diverse talent*** – in line with APRA's strategic plan to ensure it continues to attract and retain high calibre staff with a focus on ensuring APRA harnesses diversity of thought.
- ***Inclusive leadership*** – to ensure leaders lead by example and are held accountable for their behaviours and the impact they have upon the organisation.
- ***Living the APRA Values*** – to ensure APRA has a well-articulated set of values and that staff understand the application of these values in the context of workplace inclusion and diversity.

Current state of diversity

Women now occupy 28 per cent of senior positions within APRA, and 35 per cent of APRA employees come from culturally and linguistically diverse backgrounds (June 2016: 24 per cent and 35 per cent respectively).

*APRA diversity as at 30 June 2017**

Level	Female	Male	ATSI	CALD	PWD
Level 1	17	12	2	8	0
Level 2	49	35	0	27	1
Level 3	76	68	0	71	0
Level 4	80	154	1	85	3
Senior	24	61	0	15	3
Executive	7	17	0	4	0
Total	253	347	3	210	7

ATSI Aboriginal and Torres Strait Islander **CALD** Culturally and Linguistically Diverse **PWD** People with disability

**Includes permanent and fixed-term staff but excludes casuals.*

National Disability Strategy

Since 1994, Commonwealth departments and agencies have reported on their performance as policy adviser, purchaser, employer, regulator and provider under the Commonwealth Disability Strategy. In 2007/08, reporting on the employer role was transferred to the Australian Public Service Commission's State of the Service Report and the APS Statistical Bulletin. These reports are available at www.apsc.gov.au. APRA is no longer required to report on its performance under these various roles.

The National Disability Strategy 2010-2020, which has applied since 2010/11, sets out a 10-year national policy framework to improve the lives of people with disability, promote participation and create a more inclusive society. A high-level two-yearly report will track progress against each of the six outcome areas of the Strategy and present a picture of how people with disability are faring. These reports can be found at www.dss.gov.au.

Freedom of Information Act 1982 (FOI ACT)

The FOI Act provides the public with a general right of access to documents held by Commonwealth agencies, including APRA. This general right is limited by exemptions needed to protect essential public interests or the privacy and business affairs of those who give information to APRA or the Commonwealth.

In 2016/17, APRA dealt with 34 applications for access to documents under the FOI Act, including six applications that were on hand from the preceding year. During the year, 30 applications were determined and four remained on hand at 30 June 2017. One application for internal review was ongoing from the previous year, which was revised on review. In addition, three reviews were conducted by the Information Commissioner and all were finalised in APRA's favour.

During the year, the FOI applications for access were dealt with as follows:

FOI application	Number
Grant in full	4
Grant in part	4
Access refused	19
Withdrawn	3
Transferred to another agency	0
Ongoing at 30 June 2017	4
Total	**34**

Charges collected for FOI requests in 2016/17 amounted to $30, while the estimated cost of handling initial FOI requests, along with internal and Information Commissioner reviews, was $34,264.

Information Publication Scheme

Part II of the FOI Act requires APRA to publish information as part of the Information Publication Scheme. APRA's Information Publication Plan shows the information APRA publishes in accordance with the Scheme requirements and is accessible on APRA's website.

Work Health and Safety Act 2011 (WHS ACT)

Details of investigations and other matters as prescribed

In compliance with reporting obligations under Schedule 2, Part 4 of the WHS Act, there were:

- no notifiable incidents arising out of the conduct of business of APRA;
- one investigation conducted during the year that related to undertakings carried out by APRA;
- no tests conducted on any plant, substance or thing in the course of such investigations;
- no directions to APRA by an investigator that the workplace not be disturbed; and
- no prohibition or improvements and provisional notices given to APRA.

Work health and safety measures

APRA continued to undertake a number of measures during 2016/17 to safeguard the health and safety of its staff and visitors. These included:

- availability of comprehensive health assessments for all staff, including more detailed assessments for senior staff and staff aged over 40;
- availability of cardiac-risk assessments for all other staff;
- an annual flu vaccination program;
- ergonomic assessments;
- an employee assistance program;
- provision of first-aid services in all APRA offices;
- mental health awareness training for people managers;
- mental health ambassadors;
- staff-elected Work Health and Safety Representatives; and
- an active and responsive Work Health and Safety Committee.

WHS policies including establishment of staff committees and selection of health and safety representatives

APRA has arrangements for consultation on all work health and safety issues, including maintenance of the WHS Committee with four staff and four management representatives. The WHS Committee satisfies legislative requirements, including meeting at least every three months and providing all staff with access to minutes of the meetings.

Health and safety outcomes

The number of workers' compensation claims submitted by current employees remained low at just one claim in 2016/17, with one other claim continuing from 2015/16. APRA's health and wellbeing program has helped to ensure that personal sick leave is not taken beyond a reasonable level. In the 2016 calendar year, APRA staff were absent on personal sick leave for an average of 5.87 days per person, which has decreased slightly from 6.5 days in 2015. APRA compares favourably to the overall public sector average and 'all-industry' averages on metrics for staff absences.

Statistics requiring the giving of notice under Part 3 of the WHS Act

During the year there were no incidents notified to APRA that required a report to Comcare under Part 3 of the WHS Act.

OTHER REPORTING

Advertising and market research

Under the *Commonwealth Electoral Act 1918*, APRA is required to report annually on the amounts paid to advertising agencies, market research and media advertising organisations.

In 2016/17, APRA paid $39,692 for recruitment advertising, of which $28,348 was incurred to Dentsu Mitchell Media Australia Pty Ltd. APRA also paid $49,420 to Orima for two Stakeholder Surveys. APRA did not conduct any advertising campaigns during the year.

Auditor-general activities

The Australian National Audit Office (ANAO) undertook the required statutory financial audit of APRA for 2016/17. The ANAO also completed and tabled a performance audit, *Prudential Regulation of Superannuation Entities*. The recommendations of the report were accepted by APRA, and actions have been taken to address the issues raised in the report.

Collective agreements and common law contracts

As at 30 June 2017, 511 staff were covered by the terms of the *APRA Employment Agreement, 2015*. In addition, 110 senior staff were covered by common-law agreements.

All staff are appointed under the APRA Act. APRA applies a total remuneration package (TRP) approach whereby all salary, superannuation and 'salary-sacrifice' benefits are included in an employee's TRP.

The TRP pay ranges for non-executive staff as at 30 June 2017 were:

Level	Range
Level 4	$124,744 - $207,976
Level 3	$ 87,810 - $146,280
Level 2	$ 60,551 - $100,919
Level 1	$ 40,159 - $67,002

The APRA Employment Agreement 2015 commenced on 8 December 2015 for a three-year term.

Commonwealth fraud control guidelines

The Chairman of APRA certifies that he is satisfied that:

- a fraud risk assessment and fraud control plan has been prepared and complies with the Commonwealth Fraud Control Guidelines;
- appropriate fraud prevention, detection, investigation, recording and reporting procedures are in place to meet the specific needs of APRA; and
- all reasonable measures to appropriately deal with fraud relating to APRA have been taken.

Commonwealth Ombudsman

The Commonwealth Ombudsman did not conduct any investigation into APRA's conduct in 2016/17.

Commonwealth procurement rules

The APRA Chairman's Finance Instructions and APRA Financial Policies, and associated operational procedures, ensure that APRA's procurement process complies with the Commonwealth Procurement Rules (CPRs). In particular, they ensure that the core procurement principle of value-for-money is observed.

APRA conducts its procurement processes within the CPRs, including but not limited to:

- engaging Indigenous suppliers for procurements between $80,000 and $200,000 as required under the Indigenous Procurement Policy;
- conducting open tenders for procurement activities of more than $200,000 (unless otherwise exempted under the CPRs);
- reporting all procurements over $10,000 on AusTender; and
- providing a link on APRA's website to the AusTender report on all purchases over $100,000.

In 2016/17, APRA had no AusTender-exempt contracts. As required under the CPRs, all APRA competitively-tendered contracts over $100,000 provided for the Auditor-General to have access to the contractor's premises.

Procurement initiatives to support small business

APRA supports small business participation in the Commonwealth Government procurement market. Small and medium enterprises (SMEs) and small enterprise participation statistics are available on the Department of Finance's website: www.finance.gov.au/procurement/statistics-on-commonwealth-purchasing-contracts/

APRA's procurement activities that support small business are consistent with paragraph 5.4 of the CPRs and include:

- using the Commonwealth Contracting Suite for low risk procurements valued under $200,000;
- prequalified panels with SME providers;
- payments via electronic systems; and
- meeting the objective of paragraph 5.5 of the CPRs on sourcing over 10 per cent of procurements through SME providers.

Consultancies

The APRA Chairman's Finance Instructions and APRA Financial Policies, and associated operational procedures, include specific provisions on consultants.

APRA engages consultants where it lacks specialist expertise or when independent research, review or assessment is required. Consultants are typically engaged to investigate or diagnose a defined issue or problem, carry out defined reviews or evaluations, or provide independent advice, information or solutions to assist APRA's decision-making.

Prior to engaging consultants, APRA takes into account the skills and resources required for the task, the skills available in-house, and the cost-effectiveness of engaging external expertise. The decision to engage a consultant is made in accordance with legislation, CPRs and internal policies.

During 2016/17, APRA entered into five new consultancy contracts involving a total actual expenditure of $185,638. In total there were 12 consultancy contracts active during the 2016/17 year, involving total actual expenditure of $605,475.

Information on the value of contracts and consultancies is available on the AusTender website www.tenders.gov.au.

Consultative arrangements

APRA consults extensively with regulated entities, industry bodies and other interested parties prior to formulating or amending prudential policies or finalising prudential standards or reporting standards.

APRA complies with the Government's policy on best practice regulation. During 2016/17 APRA finalised three Regulation Impact Statements and completed one Independent Review. In addition, APRA completed 15 preliminary assessments; of these, the Office of Best Practice Regulation (OBPR) advised that further regulatory impact analysis was required for two.

Courts and tribunals

Over 2016/17, there were no judicial decisions that had, or may have, a significant effect on APRA's operations, nor any court and tribunal decisions relating to enforcement action taken by APRA during the year.

Executive committees

Executive Board

The Executive Board comprises the APRA Members and meets formally on a monthly basis, and more frequently as required, to discuss and resolve the major prudential policy, supervisory and strategic issues.

Attendance at Executive Board meetings from 1 July 2016 to 30 June 2017

Member	Meetings	Attended
Wayne Byres	12	12
Helen Rowell	12	12
Geoff Summerhayes	12	11

To aid its day-to-day management of APRA, the Executive Board has established a number of committees and steering groups. During 2016/17, these groups are set out below.

Risk Management Committee

APRA's risk management is overseen by the Risk Management Committee. Further information on APRA's governance is provided in Chapter 2 - Governance.

Attendance at Risk Management Committee meetings from 1 July 2016 to 30 June 2017

Member	Meetings	Attended
Fiona Bennett (Chair, external)	5	5
Sam Lewis (external)	5	5
Helen Rowell	5	5

Audit Committee

The Audit Committee is responsible for providing independent assurance and advice to the APRA Chairman on APRA's financial and performance reporting responsibilities, systems of internal control and compliance with applicable laws and regulations.

Attendance at Audit Committee meetings from 1 July 2016 to 30 June 2017

Member	Meetings	Attended
Sam Lewis (Chair, external)	5	5
Fiona Bennett (external)	5	5
Helen Rowell	5	5

Executive Management Meeting (EMM)

Responsible for high-level information-sharing and decisions on routine organisational matters, meeting on a weekly basis.

Organisational Effectiveness and Infrastructure Committee (OEIC)

Responsible for discussion and coordination of organisational effectiveness and infrastructure. The Committee has accountability and decision-making authority for major policies, frameworks and projects that pertain to the effectiveness and efficiency of the operations of APRA.

People and Culture Committee (PCC)

Responsible for providing direction and guidance on APRA's people strategy and supporting frameworks and policies, and overseeing their effective implementation across APRA.

Prudential Policy Committee (PPC)

Responsible for discussing and directing the development of prudential policy.

Supervision Resolution Committee (SRC)

Responsible for discussion and coordination of supervision and resolution-related matters.

Other committees and groups

Reporting to the above governance committees are other more focused committees and groups, typically chaired by a General Manager. These include:

Data and Information Governance Group

Reporting to the OEIC, the Group is responsible for strategy and policy relating to the architecture and management of information and data management within APRA.

Enforcement and Escalation Committee (EEC)

Reporting to the SRC, this committee is responsible for overseeing the management of problematic institutions and using APRA's coercive powers, whether contemplated or being undertaken, in relation to an institution.

Industry groups

Reporting to the SRC, there are industry groups comprising representatives of the various divisions of APRA, covering each of APRA's regulated industries: ADIs; superannuation; general insurance; life insurance (including friendly societies); and private health insurance.

These groups monitor industry developments to identify emerging risks and issues and act as a sounding board for prudential policy issues in the different industries.

Inclusion and Diversity Council

Reporting to the PCC, the Council promotes awareness of workplace inclusion and diversity and is responsible for implementing and monitoring certain aspects of the strategy for APRA.

International committees

Reporting to the PPC, two committees coordinate APRA's involvement with international bodies — one for banking and one for insurance. Their purpose is to: prioritise the allocation of resources for APRA's involvement in international activities; coordinate consistent and timely responses to issues raised in the relevant international forums; and ensure information from international sources is communicated effectively within APRA.

Licensing Group

Reporting to the SRC, this Group provides APRA-wide guidance on licensing submissions and, after considering and overseeing the application process, provides recommendations to the relevant delegate.

Staff Consultative Group

Reporting to the PCC, this Group facilitates communication and consultation with all APRA staff below the senior management level on the terms and conditions of their employment (including the Human Resources Policy Manual) and the impact of these on APRA's organisational culture and values.

Work Health and Safety Committee

Reporting to the PCC, this Committee focuses on issues to do with the health, safety and wellbeing of staff, and ensures these are integrated into broader management systems and practices.

Grant programs

The Commonwealth Grants Rules and Guidelines require agencies to publish details of grants on their websites within 14 working days after the funding agreement for the grant takes place. Details must remain on the website for at least two financial years. Grant programs, including discretionary grant programs, that APRA either jointly administered or participated in during 2016/17, including previous recipients of the Brian Gray Scholarship and the University of New South Wales Cooperative Actuarial Scholarship, are available on APRA's website at: www.apra.gov.au/AboutAPRA/WorkingAtAPRA/Pages/brian-gray-scholarship-program.aspx

Information on grants awarded by APRA during 2016/17 is available at: www.apra.gov.au/AboutAPRA/Documents/APRA-grant-reporting-table.pdf

Indemnities and insurance premiums

APRA Members and officers are covered by the professional indemnity insurance cover of the Commonwealth-managed insurance scheme, Comcover. The generic terms and conditions of the insurance cover provided by Comcover to Commonwealth agencies are available on the Comcover website www.finance.gov.au/comcover. Under the conditions of the cover, APRA has an obligation not to disclose the nature and limits of liability and the amount of the premium.

Legal Services Directions 2017

The *Legal Services Directions 2017* require Commonwealth agencies to make publicly available information on records of their legal services expenditure for the previous financial year. During 2016/17, APRA's total expenditure on external legal advice and litigation services was $319,072 (excluding GST).

Parliamentary committees

Avenues through which APRA is accountable to the Parliament include Parliament's *ad hoc* and standing committees, and specific references on legislation or issues of particular interest to parliamentary committees.

During 2016/17, APRA Members and officers made themselves available for public hearings before the:

- House of Representatives Standing Committee on Economics reference on APRA's Annual Report (14 October 2016);
- Senate Economics Legislation Committee (sitting as Senate Estimates) (20 October 2016, 2 March 2017 and 30 May 2017);
- Senate Economics References Committee Inquiry into the impact of non-payment of the Superannuation Guarantee (3 March 2017); Inquiry into Carbon Risk Disclosure (8 March 2017); Inquiry into Australia's general insurance industry (12 April 2017); and
- Parliamentary Joint Committee on Corporations and Financial Services Inquiry into the life insurance industry (24 February 2017).

Copies of Opening Statements of APRA's appearances delivered by APRA Members may be downloaded from APRA's website www.apra.gov.au, and transcripts of APRA's appearances and copies of its submissions to parliamentary committees are available from the Parliamentary website www.aph.gov.au.

Performance pay

APRA has a performance bonus system, designed in consultation with staff and management and covering all eligible employees. For 2016/17, the aggregate bonus pool was $6.09 million. Under deferred bonus arrangements introduced in the APRA Employment Agreement, 2016/17 bonuses are only paid to eligible staff still in APRA's employ at the payment date, or to eligible leavers during the year, such as upon retirement.

Privacy Commission

There were no investigations by the Privacy Commissioner under section 40 of the *Privacy Act 1988* during 2016/17. No reports were served under section 30 of the Act. The Privacy Commissioner made no determinations under section 52, nor did APRA seek any under section 73. There were no adverse or favourable comments made by the Privacy Commissioner in respect of APRA's operations.

Privacy inquiries relating to APRA sent by post should be addressed to:

Freedom of Information Coordinator
Australian Prudential Regulation Authority
GPO Box 9836
Sydney NSW 2001

Or by phone: 02 9210 3000; fax: 02 9210 3424; or email: foi@apra.gov.au

Responsible Ministers

The Hon Scott Morrison MP, Treasurer of the Commonwealth of Australia, has portfolio responsibility for APRA. He is assisted in this role by the Hon Kelly O'Dwyer MP, Minister for Revenue and Financial Services.

STAFF STATISTICS

Additional statistics on APRA's staffing are presented in Chapter 5 - APRA's resources and risk management.

Staff by location and full-time/part-time as at 30 June 2017

Location	Full-time	Part-time	Total
Adelaide	6	2	8
Brisbane	13	1	14
Canberra	6	0	6
Melbourne	53	7	60
Sydney	476	57	533
Total	**554**	**67**	**621**

Staff by division and full-time/part-time as at 30 June 2017

Division*	Full-time	Part-time	Total
Corporate Services	105	7	112
Diversified Institutions	98	13	111
Policy and Advice	75	15	90
Specialised Institutions	125	21	146
Supervisory Support	132	11	143
Governance	19	0	19
Total	**554**	**67**	**621**

Full-time equivalent (FTE) staff strength as at 30 June 2017

Employment Type	Total
Permanent	595.8
Fixed-term	3.8
Casual	0
Total	**599.6**

AGENCY RESOURCES AND EXPENSES BY OUTCOME

Under the *Requirements for annual reports for departments, executive agencies and other non-corporate commonwealth entities*, issued by the Department of Prime Minister and Cabinet, APRA must provide information outlining its various funding sources during the financial year and total expenses for each Agency outcome. To this end, APRA's Agency Resource Statement and Expenses by Outcome Statement for 2016/17 are set out below.

Agency Resources Statement

		Actual available appropriation $'000	Payments made $'000	Balance remaining $'000
		(a)	(b)	(a)-(b)
Ordinary annual services				
Departmental appropriation		23,445	21,761	1,684
Total		**23,445**	**21,761**	**1,684**
Total available annual appropriations and payments	A	**23,445**	**21,761**	**1,684**
Special Accounts				
Opening balance		59,232		
Special appropriation receipts		122,312		
Payments made			109,909	
Total Special Account	B	**181,544**	**109,909**	**71,635**

Agency Resources Statement (continued)

	Actual available appropriation $'000	Payments made $'000	Balance remaining $'000
	(a)	(b)	(a)-(b)
Total resources and payments			
A+B	204,989	131,670	73,319
Less appropriation drawn from annual or special appropriations above and credited to special accounts	23,445	21,761	1,684
Total net resourcing and payments for APRA	**181,544**	**109,909**	**71,635**

Expenses by Outcome Statement

Outcome 1: Enhanced public confidence in Australia's financial institutions through a framework of prudential regulation which balances financial safety and efficiency, competition, contestability and competitive neutrality.

	Budget $'000	Actual expenses $'000	Variation $'000
	(a)	(b)	(a)-(b)
Program 1.1: Australian Prudential Regulation Authority			
Departmental expenses			
Departmental appropriation[1]	6,599	23,445	(16,846)
Special Accounts	124,719	106,299	18,420
Other services (Appropriation Act No. 2)	-	-	-
Total expenses for Outcome[1]	**131,318**	**129,744**	**1,574**

	Actual 2016/17	Actual 2015/16	Variation
Average staffing level (number)	**606**	**599**	**7**

1 Departmental appropriation combines 'Ordinary annual services (Appropriation Act No.1)', 'Supply Act No. 1' and 'Revenue from independent sources'.

LIST OF REQUIREMENTS

The following list of mandatory annual reporting requirements, as outlined in the *Resource Management Guide No. 135 - Annual Reports for Non-corporate Commonwealth Entities*, has been annotated with the location of the information in this Report.

Part of Report	Description	Location or applicability
	Letter of transmittal	Page 4
	Table of contents	Page 5
	Index	Pages 148-49
	Glossary	Page 7
	Contact officer(s)	Page 150
	Internet home page address and internet address for report	Page 150
Review by Chairman		Chapter 1
Overview of Authority	Overview	Chapter 6
	Role and functions	Chapter 4 and Chapter 6
	Organisational structure	Page 20
	Outcome and program structure	Chapter 4 and Chapter 6
Report on performance	Review of performance in relation to programs and contribution to outcomes	Chapter 6
	Actual performance in relation to deliverables and KPIs	Chapter 6
	Narrative discussion and analysis of performance	Chapters 4-6
	Trend information	Chapters 4-6
	Discussion and analysis of the Authority's financial performance	Chapter 5 and Chapter 7
	Authority's resource statement and summary resource tables by outcomes	Pages 144-45
Corporate governance	Compliance with the Commonwealth Fraud Control Guidelines	Chapter 8
	Statement of the main corporate governance practices in place	Chapter 2

Part of Report	Description	Location or applicability
External scrutiny	Significant developments in external scrutiny	Chapter 6
	Judicial decisions and decisions of administrative tribunals	Chapter 8
	Reports by the Auditor-General, a Parliamentary Committee or the Commonwealth Ombudsman	Chapter 8
Management of human resources	Assessment of effectiveness in managing and developing human resources to achieve the Authority's objectives	Chapter 5
	Statistics on staffing	Chapter 5 and Chapter 8
	Statistics on employees who identify as Indigenous	Chapter 8
	Enterprise or collective agreements, determinations and common law contracts	Chapter 8
	Performance pay	Chapter 8
Assets management	Assessment of effectiveness of assets management	Chapter 8
Purchasing	Assessment of purchasing against core policies and principles	Chapter 8
Consultants	Summary statement detailing consultancy arrangements and confirming that information on contracts and consultancies is available through the AusTender website.	Chapter 8
Australian National Audit Office access clauses	Absence of provisions in contracts allowing access by the Auditor-General	Chapter 8
Exempt contracts	Contracts exempt from the AusTender process	Chapter 8
Financial statements		Chapter 7
Other information	Schedule 2 Part 4 of the *Work Health and Safety Act 2011*	Chapter 8
	Advertising and market research (Section 311A of the *Commonwealth Electoral Act 1918*) and statement on advertising campaigns	Chapter 8
	Ecologically sustainable development and environmental performance (Section 516A of the *Environment Protection and Biodiversity Conservation Act 1999*)	Chapter 8
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