



Response to Submissions

Financial Claims Scheme for authorised deposit-taking institutions

30 August 2010

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Preamble

In January this year, APRA released a Discussion Paper on proposals to implement the Financial Claims Scheme (FCS) for authorised deposit-taking institutions (ADIs).

This Response Paper provides responses to the key matters raised in submissions and provides further details on the proposed reporting standard and associated matters.

APRA will seek to ensure that the final form of reporting and any necessary ADI system changes for FCS purposes do not impose excessive costs on the ADI industry. The responses in this paper reflect APRA's desire to avoid excessive compliance and administration costs, while meeting the objectives set out in the *Banking Act 1959*.

In conjunction with this Response Paper, APRA is releasing a draft reporting standard for comment. APRA had sought views on the proposed data collection as part of the consultation process and the proposed data collection has not significantly changed from that proposed in the Discussion Paper. However, APRA notes the systems challenges for some ADIs in meeting the requirements for identifying depositors for FCS purposes. APRA has sought to address these concerns through modifications to the original proposals and by providing a transition period before reporting obligations commence.

Written submissions on APRA's approach and on the proposed reporting standard are to be forwarded not later than Friday 15 October 2010 by email to fcs@apra.gov.au. Any comments or questions may be directed to:

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Important

Submissions will be treated as public unless clearly marked as confidential and the confidential information contained in the submission is identified.

Submissions may be the subject of a request for access made under the *Freedom of Information Act 1982* (FOIA). APRA will determine such requests, if any, in accordance with the provisions of the FOIA.

Information in the submission about the regulated entity which is not in the public domain will be protected by section 56 of the *Australian Prudential Regulation Authority Act 1998* and therefore will ordinarily be exempt from production under the FOIA.

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Glossary

ADI	Authorised deposit-taking institution under the <i>Banking Act 1959</i>
APS 310	<i>Prudential Standard APS 310 Audit and Related Matters</i>
APRA	Australian Prudential Regulation Authority
CEO	Chief Executive Officer
CSV	Comma-separated values
EOD	End-of-day
FCS	Financial Claims Scheme
IT	Information Technology
RBA	Reserve Bank of Australia
SCV	Single Customer View

Chapter 1 – Introduction

In January 2010, APRA released a Discussion Paper, *Financial Claims Scheme for authorised deposit-taking institutions*, which sought comment from industry and other interested parties on the proposed framework for operating the FCS for ADIs. APRA received a number of submissions on the Discussion Paper, from ADIs and from ADI representative bodies. These submissions generally supported the proposed FCS arrangements, but also identified operational issues that may affect individual ADIs, and suggested changes to minimise compliance costs.

APRA has carefully considered submissions and proposes to slightly modify some proposals from the Discussion Paper. APRA now requests comments from industry and other interested parties on its revised approach and the reporting requirements set out in the accompanying reporting standard.

Chapter 2 – Responses to matters raised in submissions

Data requirements

Appropriate deposit data are critical to the successful implementation of the FCS in the event of the failure of an ADI. It is necessary that the data submitted by an ADI to APRA are timely, complete, accurate and reliable. A central requirement is for ADIs to be able to identify aggregated account balances for eligible products on the basis of a Single Customer View (SCV) (i.e. all deposit balances for eligible products are identified and aggregated for each account-holder). The proposed data requirements are designed to facilitate this outcome.

Comments received

The need for some form of unique account-holder identifier generated the largest number of comments on the proposed operation of the FCS. The overall tone of submissions was that a reasonable lead-time would be needed and that significant costs would be incurred in moving to such a system. Some ADIs expressed a preference for using data matching, rather than a dedicated SCV framework, which would go some way towards being able to identify each unique account-holder. However, it was acknowledged that the data produced using a data matching approach would be less accurate and reliable than an SCV, resulting in an increased probability, should the FCS be declared, of incorrect payments being made and the increased likelihood of multiple payments being made to an account-holder.

APRA's response

APRA accepts that there will be a cost involved in moving to an SCV. However, given that the effectiveness of the FCS depends on the ability of ADIs to generate aggregated deposit data on an SCV basis, it is essential that ADIs be able to do so. More holistic customer data will also benefit ADIs for their own commercial purposes. However, APRA is aware that a number of ADIs are not yet able to generate aggregated deposit data on an SCV basis and that a reasonable transition period will be needed to enable ADIs to develop an SCV.

In some cases, significant changes to information technology (IT) systems may be needed to facilitate the production of data that identifies individual customers with a high degree of certainty. APRA proposes to provide a minimum transition period of 12 months before reporting on an SCV basis is required. APRA further proposes that an extension of this transition period for up to two years will be available to an ADI on application, subject to the ADI satisfying APRA that it requires such a transition in order to be able to reasonably comply with the data requirements for the FCS. APRA envisages this longer transition applying where an ADI can demonstrate that it is not reasonably able to make the necessary system changes during the 12-month standard transition period.

Based on an anticipated commencement date of April 2011 for the reporting requirements, this would mean that ADIs would start reporting to APRA in early 2012, unless APRA had granted an ADI a further transition period. On this basis, all ADIs would commence reporting not later than early 2014.

Calculation of EOD balances – accrued interest, fees and charges

The production of end-of-day (EOD) balances and submission to APRA within 48 hours (as set out in the Discussion Paper) is essential if FCS balances are to be paid to account-holders within a reasonable period of time; that is, within seven calendar days of the FCS being declared. The *Banking Act 1959* requires that FCS payouts be on a gross basis (after adjusting for interest payable, less any applicable fees and charges associated with an account).

Comments received

A number of submissions noted potential difficulties in producing EOD balances incorporating accrued interest net of fees and charges. ADIs noted that they do not generally run daily accruals; rather, accruals are run as an end-of-month process. Submissions stated that, in the event of a failure, and for testing purposes, it would be preferable to provide an initial EOD balance to APRA comprising outstanding balances in all eligible products (excluding accrued interest, fees and charges) and then provide a final figure at a later time (when month-end processes can reasonably be run) that would include accrued interest, fees and charges. This would still allow the early payment of initial balances to account-holders with all outstanding amounts paid out in a second-tranche payment.

One submission sought clarification on the ability of ADIs to set-off accounts where there are 'limit facilities' in place that group accounts together and for which there is a legal right of set-off.

APRA's response

APRA notes industry concerns about producing EOD balances that include accrued interest, fees and charges unless an ADI already has systems in place to allow it to generate this data on a daily basis. Therefore, for testing purposes, APRA will allow for initial EOD balances to comprise only the principal amounts held in eligible FCS accounts, without adjusting for interest, fees and charges. If an ADI does run daily accruals then it would be expected to provide an EOD balance that includes accruals for interest, fees and charges. For those ADIs that only run a monthly accrual there will be no requirement to adjust their accrual processes for the purposes of providing FCS data to APRA.¹

In an actual payout situation, APRA would work with an ADI to achieve EOD balances that include accrued interest, fees and charges within the required timeframe for reporting. In the absence of sufficient lead-time, the month-end accrual would need to be run subsequent to production of the initial EOD balance so that a final payout figure can be arrived at for all account-holders who hold monies in eligible FCS accounts.

The legislation is clear that payout is to be on a gross basis and there is no allowance for netting of any type in reaching a payout figure for an account-holder for FCS purposes.

Time for submission of EOD data

In the Discussion Paper, APRA stated that ADIs would need to establish and maintain the capacity to submit the required aggregated account-holder information to APRA within a specified time period, being within 48 hours of any such request. This timeframe was proposed after taking into consideration the need to be able to make reasonably prompt payouts under the FCS.

Comments received

Submissions expressed general concerns about this proposal. The consensus was that it would be difficult to provide reliable data within the proposed timeframe and that a longer timeframe would be preferable. Most submissions argued that the timeframe should be extended to 72 hours, with one submission arguing that the time for submission should be five business days.

APRA's response

There are two aspects to data submission. ADIs will be required to submit data:

- (a) on a test basis each year, for the purpose of ensuring the process for data submission operates as intended within the required timeframes, and of verifying the quality of data; and
- (b) in the event of an actual failure.

¹ Should the FCS be invoked, APRA will require an ADI, to the extent practicable, to run an EOD accrual for the purposes of calculating interest, fees and charges.

APRA proposes to allow an extended time for submission of test data of 72 hours for all ADIs until 31 December 2013, after which it is proposed that the period for submission of EOD balances will move to 48 hours.

APRA remains of the view that, beyond a reasonable transition period, 48 hours is an appropriate period for submission of data, given the objective of paying out within seven days of the FCS being declared for a particular ADI. In the event of a failure, ADIs must reasonably be able to meet this timeframe.

Audit of FCS data

As part of the requirements relating to the external audit of FCS data, APRA proposed that the type of audit testing to be undertaken would be 'reasonable assurance' as opposed to 'limited assurance'.

Comments received

Submissions noted that *Prudential Standard APS 310 Audit and Related Matters* (APS 310) requires reasonable assurance of data sourced from the general ledger and argued that the proposed reasonable assurance review of data produced for FCS purposes was not aligned with APS 310 because that data is not sourced from the general ledger.

APRA's response

Given the nature of the data and their purpose, it is important that the data be subject to an appropriate level of independent review. As the deposit data to be collected form part of the general ledger, the level of audit assurance proposed by APRA is consistent with that for other data sourced from the general ledger (as required in APS 310).

APRA proposes to modify the original proposal such that an ADI would be required to engage its auditor to perform a reasonable assurance review for the first data transmission. If the initial audit gives APRA confidence that the data are of high quality in terms of accuracy and completeness, APRA proposes that a reasonable assurance review be conducted only every three years thereafter, with limited assurance reviews in intervening years.

If the limited assurance review is qualified, or the provision of data to APRA during tests of an ADI's FCS reporting capability is less than fully satisfactory, APRA would require the ADI to engage an auditor to undertake reasonable assurance reviews each year until such time as all identified issues are rectified.

CEO attestation

APRA proposed that the Chief Executive Officer (CEO) of an ADI be required to provide an attestation to the effect that the ADI has taken all necessary steps to ensure that it is compliant with FCS reporting requirements, including that the ADI is able to:

- identify each unique account-holder;
- aggregate protected accounts for each unique account-holder; and
- provide the data required by APRA within the timeframes set out in the reporting standard.

Comments received

The proposal requiring the CEO to provide an attestation with respect to certain matters was generally accepted. However, comments suggested that this should form part of the existing attestation requirements in APS 310 and not be a separate attestation. One submission suggested that the attestation should be provided by an officer other than the CEO.

APRA's response

The power to collect data, and associated matters, for FCS purposes is located in the *Financial Sector (Collection of Data) Act 2001*. Although it would be preferable to locate all attestation requirements in APS 310 alongside existing requirements, given FCS data is collected via a reporting standard, the attestation requirements cannot be dealt with by way of a prudential standard.

Therefore, the attestation requirement will form part of the reporting standard made for this purpose and will be separate from the existing attestation requirements set out in APS 310. Over the next two years, however, APRA intends to consider methods to streamline the applicable attestation requirements, so that attestations from one ADI officer for more than one purpose may be consolidated in a single format.

Payout process

In the Discussion Paper, APRA set out potential options for payout in the event of the FCS being declared in relation to an ADI. These included:

- (a) by way of cheque drawn on the Reserve Bank of Australia (RBA) or another provider;
- (b) transferring funds to new accounts at another ADI; and/or
- (c) payout using the failed ADI's own payment channels. This would involve temporarily re-opening the failed ADI's payment channels to make payment.

The option or combination of options chosen would ultimately depend upon the circumstances surrounding the failed ADI. It is preferable to have a number of options so that APRA can respond to the specific circumstances of a failure when it occurs. This would allow payout to be achieved in the most expeditious and orderly manner, having regard to the circumstances of the failed ADI at the time.

Comments received

There was general support for APRA's intention to consider payout options on a case-by-case basis and to choose the most appropriate method in each case. In particular, submissions supported APRA's view that having a number of payout mechanisms available in order to appropriately respond to a failure is preferable to having a single payout mechanism. Submissions suggested that using cheques to effect payout should be a fallback position and only applied if a more suitable payout mechanism were not available. This position seemed to derive from the view that cheques will eventually be phased out and fully replaced by electronic payments.

Some submissions also noted the need for the ADI industry to be apprised of the details of the different payout options, particularly as regards possible implications under certain payout options where other ADIs' ATMs could be used as a means of payout or where payouts are made by cheques drawn on the RBA and these cheques are expected to be treated as cleared funds upon presentation.

APRA's response

APRA would select the most appropriate payout option or options on a case-by-case basis, taking into account the particular ADI, the nature of its deposit book, the operational soundness of its payments infrastructure, its size, location and the payments technology available at the time. At present, payout by cheques drawn on the RBA, supplemented as appropriate by the use of the failed ADI's own payment channels and branches, is the most practicable payout option consistent with prompt payout.² However, the payout mechanisms are not intended to be static and as new technologies emerge they will be assessed as to their suitability for effecting payout under the FCS.

Guidelines for aggregation and related matters

In the Discussion Paper, APRA provided guidance as to how certain accounts are to be treated for aggregation purposes. APRA also requested that submissions highlight any specific issues or matters that could be problematic or where further guidance for this purpose would be useful.

Comments received

Submissions indicated some misunderstanding of the nature and extent of coverage. Some ADIs interpreted the SCV requirement as applying to all products provided across a group of which an ADI is a part, rather than only in respect of eligible deposit products provided by the ADI itself.

² Certain types of accounts, namely prescribed accounts, will be transferred to like accounts at other ADIs regardless of the payout option used.

APRA's response

Initial high-level guidance on account aggregation set out in the Discussion Paper is attached to the draft reporting standard accompanying this paper. ADIs are encouraged to advise APRA of any aspects of aggregation on which further guidance would be useful. APRA will give such issues due consideration and incorporate relevant information into the final Instruction Guide where there is a need to do so.

With regard to the extent of coverage, it is important to note that the FCS only applies to ADIs incorporated in Australia. For the purposes of the FCS, it is only necessary for an ADI to have an SCV for customers of the ADI and only in respect of eligible deposit products. The FCS does not extend to other entities within a group that may have an association with an ADI. While the SCV only needs to capture eligible products for the purposes of paying out under the FCS, ADIs should ensure they have the functionality to add or remove deposit products should product coverage under the FCS change over time.

Data medium and APRA IT requirements

A critical aspect of the implementation of the FCS is the need for ADIs to make changes to their systems to enable an SCV and to transmit of FCS data to APRA in a timely and effective manner. The Discussion Paper indicated that the preferred data transmission mechanism would be via a comma-separated values (CSV) file.

APRA's response

There were no major concerns raised in submissions around the use of data transmission using CSV. APRA proposes to require the use of CSV files for transmission of deposit data but, as it works through the systems requirements for CSV purposes, APRA may modify its proposals in this area. Industry will be informed of any changes in this respect.

Chapter 3 – Reporting standard

This paper is accompanied by a draft reporting standard that sets out requirements for the data collection that APRA is proposing for FCS purposes. The account-holder and account data proposed to be collected are not significantly changed from the Discussion Paper. Additional issues, as set out in this paper, are included in the proposed reporting standard. The instructions to the standard reproduce the attachments to the Discussion Paper on calculation of EOD balances and provide additional guidance on the aggregation process.

Chapter 4 – Next steps

APRA will consider submissions in finalising the FCS data collection reporting standard. It is intended that the final reporting standard will be released late this year and commence in April 2011. However, as noted earlier, there will be a transition period of 12 months for ADIs to make the necessary systems and other changes, such that reporting obligations will take effect from early 2012. Individual ADIs requiring a longer transition period must contact APRA; such requests will be considered on a case-by-case basis.

Chapter 5 – Request for cost-benefit analysis information

To improve the quality of regulation, the Australian Government requires all proposals to undergo a preliminary assessment to establish whether it is likely that there will be business compliance costs associated with the proposal. In order to perform a cost-benefit analysis, APRA welcomes information from interested parties. As part of the consultation process, APRA requests respondents to provide an assessment of the impact of the proposed changes and, specifically, the marginal compliance costs ADIs are likely to face.

Given that APRA's proposed requirements will impose some compliance costs, respondents may also indicate whether there are any other regulations relating to the FCS implementation that should be improved or removed to reduce compliance costs. In doing so, please explain what they are and why they need to be improved or removed.

Respondents are requested to use the Business Cost Calculator (BCC) to estimate costs to ensure that the data supplied to APRA can be aggregated and used in an industry-wide assessment. APRA would appreciate being provided with the input to the BCC as well as the final result. The BCC can be accessed at www.finance.gov.au/obpr/bcc/index.html.



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