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Response to discussion paper:
Revisions to the related entities framework for ADIs

The Australian Financial Markets Association (AFMA) welcomes the opportunity to make this submission commenting on the Discussion Paper *Revisions to the related entities framework for ADIs*.

AFMA's comments express the views and concerns of our foreign ADI membership and subsidiaries of foreign banks.

AFMA notes a number of operational concerns with some of the proposals. It is important that sensible limits be put on the requirements for Australian ADIs to investigate risks from associated firms and individuals. There are very real practical limitations on the ability to source information in many circumstances and ensuring this information remains current.

More detailed responses to the questions posed in the consultation can be found in the attachment.

We trust this submission is of assistance and note that we would be pleased to assist APRA with further information or clarification if required.
Yours sincerely

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Responses to Consultation Questions and Additional Comments

1.1 Are there any other potential impacts from the proposals that should be considered in balancing APRA's objectives?

AFMA is of the view that competition impacts should be considered as some proposals may hinder an ADI's ability to expand its market operations

2.0 Additional Comment

At paragraph 19 of the draft standard it raises the issue as to whether an ADI should provide capital support to a related entity and then imposes additional requirements at Attachment B in relation to the provision of liquidity facilities. Paragraph 3 suggests the applicability of paragraph 19 (and thereby Attachment B) to Foreign ADIs.

The issue we seek clarification on is that Attachment B specifically talks about Funds Management as opposed to other relationships where an ADI might purchase or sell assets and securities or other liabilities. It appears to go further than the provision of liquidity facilities to a Fund, in particular it raises the issue of separation, and whether the ADI can have any interest at all in the Fund, from either a beneficial ownership perspective or from a management perspective.

We query whether paragraph 19, is only referencing paragraph 7 of Attachment B "Liquidity facilities", or is the intention of paragraph 19 of the standard to bring all of Attachment B into play for a foreign ADI? It is the only part of the standard that references Attachment B, which may contribute to the need for clarification.

2.1 What is the potential impact of the expanded related entities definition?

The expanded related entities definition will create significant operational challenges and may not in practical terms be fully implementable in all circumstances.

(i) Related individual of an ADI:

The requirements are broad and will cause significant operational challenges particularly for local subsidiaries of foreign banks which are highly likely to have exposures to offshore persons captured under this.

The consideration of aggregate exposures to "related individuals and their relatives" is likely to be immaterial relative to T1 capital. The costs to implement the requirement is disproportionate to any prudential benefits it may add, particularly if any lending to related individuals are done at arm's length, on commercial terms and secured against tangible assets.

Accordingly we believe it would be sensible to establish some limitations to restrict the requirement to local related individuals and to set a minimum value threshold for offshore-residing related individuals. APRA may also wish to consider limiting the requirement to related individuals with regard to unsecured lending only.

AFMA would also appreciate guidance on what would be included under "relatives" of related individuals. It would be preferable if this is limited to immediate relatives, specifically the spouse, children, and immediate parents.

We note that the draft standard wording "but is not limited to" suggests additional individuals to Board, senior managers and individuals with direct or indirect influence on those. This may be redundant as the wording already includes persons with direct and indirect control over the ADI, senior managers or the Board. In this regard we also note the need for more guidance on which type of individuals APRA would wish to include in those that may exert indirect control over ADI, the ADI senior managers and its Board members.

(ii) Exposure to Related ADIs, individually and aggregate level:

AFMA would like confirmation that exposure to single related ADI (or overseas equivalent) is meant to include the related ADI controlled (consolidated subsidiary ADIs) and associate ADIs, but excludes ADIs controlling the related ADI. We would also like to confirm that aggregate and single exposures to related ADIs is to exclude exposure to non-ADIs that are related to the related ADI?

(iii) Associate:

AFMA would seek limitations on establishing associate relationships if no public information is readily available particularly for non-listed customers. Assessment on association will have inherent limitations to information readily available and that volunteered by customer. We believe that ADIs should not be required to look beyond public and customer collated information.

We note that the expanded definition will require greater checks and controls over the purchase and sale of assets and securities to related entities to ensure that these activities do not constitute the provision of capital support to the related entity by the foreign branch.

Under provision of support ADIs are prohibited from providing a guarantee over the obligations of an unrelated entity to one or more related entities of the ADI. The intent of this restriction is not clear and it could have unintended consequences in a range of scenarios.

There are legitimate commercial applications where ADIs would provide counter-guarantees to support a client's business dealings with a related ADI particularly in instances where dealings are cross-border. There may be benefit of further dialogue on whether there are particular risk concerns with such practices and any particular circumstances such instances would not be acceptable.

2.2 What is the number and size of entities caught by the step-in risk criteria and what adjustments to the criteria could be made to ensure the requirements are balanced with the business need to ensure efficiency?

We expect this to directly impact a limited number of entities within our membership.

2.3 How can the requirements to assess contagion risk be streamlined or enhanced?

3.1 What are the potential impacts of the proposed prudential limits and revisions to the measurement of exposures?

Further guidance and clarity is sought on the interaction between paragraph 31 of the draft APS 222 which references the revised APS 221 and paragraph 29. APS 221 states "Prudential limits and other requirements for an ADI's exposures to other related entities

are contained in Prudential Standard APS 222 Associations with Related Entities". These limits appear to be covered in APS 222 under paragraph 29.

We would seek to confirm this requirement is consistent with requirement under paragraph 29(a)(i) except for the inclusion of non-ADI entities owned by the Foreign parent ADI and operating in Australia and the exclusion of foreign parent Associates and related individuals.

We note also that paragraph 31 does not explicitly mention "related" entities to foreign parent but instead requires inclusions of its overseas based subsidiaries and directly owned Non-ADI entities to be within scope. We seek clarity on whether the intent is for the exposure scope to be those entities related to the immediate and operating Foreign ADI parent only, its consolidated overseas ADI subsidiaries, and owned non-ADI entities operating in Australia, and to exclude related entities in instances where the foreign parent is controlled by another foreign parent (the ultimate foreign parent).

We would also seek to confirm whether foreign branches of the parent ADI including branches operating in Australia as a foreign ADI are within scope under paragraph 31.

In relation to the application date of this requirement given its connectivity to both standards would it be the APS 221 application date of January 2019 or the APS 222 application date of January 2020.

To remove any ambiguity we would recommend APRA consider the deletion of paragraph 31 from APS 222 and increase limits to individual ADIs to 50% of Tier 1 capital. The proposed reduction of limit to individual ADIs to 25% is perhaps more than is needed and could risk undermining some of the critical banking services performed by foreign ADIs such as trade financing as well as facilitating cross border corporate lending.

4.1 What is the potential commercial impact to removing the ELE-eligibility of overseas subsidiaries which are established to hold or invest in assets?
4.2 What transition period would be required to mitigate the impacts of the proposals in this paper?
4.3 What additional or alternative measures could be taken to mitigate the risks and concerns expressed regarding offshore ELE subsidiaries?

5.1 How effective are current requirements relating to group badging and disclosures on mitigating the potential for reputational contagion to flow to the ADI?

AFMA is supportive of the existing requirements around Group badging and disclosures which are viewed as effective and not requiring extension.

If changes are made then for a Foreign ADI, the requirement to provide a disclosure should be limited to ADI group entities operating in Australia, and we are strongly of the view that the disclosure requirement itself should (i) only be applicable to retail consumers and not wholesale counterparties; and (ii) only be applicable when the ADI group entity is acting as principal, rather than agent.

5.2 Are acknowledgements of disclosures effective in ensuring information is understood? Can these be implemented via electronic means?

AFMA strongly opposes the proposals around acknowledgement of disclosures under 23(b) that counterparties have read and understood the disclosure due to the very onerous operational challenges associated with implementation.

The main issues arise around tracking and recording of such acknowledgement: a) enhanced monitoring and resources; b) regular testing; c) maintenance of records; and d) likely delays in the execution of a transaction. The acknowledgement of disclosures requirements are onerous on ADIs including foreign ADIs, and will be difficult to implement.

5.3 What alternative measures could be taken to enhance requirements on group badging and disclosures to mitigate reputational impacts to the ADI?

We believe current practice of disclosure is working well and see it as sufficient however, we do acknowledge there may be merit in ensuring such disclosure is prominent and this should be sufficient to inform and alleviate APRA's concerns.

6.1 Are there any operational issues to implementing the prior notification, notification and approval requirements and, if so, how can these be addressed?

The proposed prior notification requirements on commitments to any proposed exposure to a related entity that is greater than or equal to 10% of Tier 1 Capital go beyond the prior notification requirements under APS 221 which limits prior notifications to Non-ADIs and Non-government counterparties only.

Imposing a stricter pre-notification requirement on commitments to related ADIs will add onerous compliance requirements which may require constant notification due to the typically temporary nature and shorter tenor of related party dealings. We would suggest that APRA consider revising pre-notification requirements to be restricted those to Non-ADI related counterparties only so as to have consistency with APS 221.

7.1 How often do ADIs provide underwriting facilities to funds management entities and are there any reasons why an ADI cannot reduce its holdings in a fund to below 20 per cent within two months of an underwriting facility being exercised?

8.1 Are there any operational difficulties to reporting substantial shareholders and changes in substantial holdings, and the twenty largest exposures to related entities, under proposed changes to ARS 222.0?
No issues raised.

9.1 What proposals will require a transition period beyond the proposed commencement date of 1 January 2020?

AFMA recommends delaying implementation of stricter prudential limits until the full implementation of the revised capital framework.

AFMA members are supportive of a transition period beyond the commencement date. The period of transition that will be appropriate will depend on the refinements made to limit application to foreign ADIs and related individuals.

Other

We would recommend that paragraph 28 of the draft read 'Board/SOOA' to account for organisations in which there is no local Board.