

5 October 2018

Ms Heidi Richards  
General Manager, Policy Development  
Policy and Advice Division  
Australian Prudential Regulation Authority

via email: [ADIpolicy@apra.gov.au](mailto:ADIpolicy@apra.gov.au)

Dear Ms Richards

**Re: Revisions to the related entities framework for ADIs**

Thank you for the opportunity to provide comment on APRA's draft APS 222 related entities standard and discussion paper.

COBA is the industry association for Australia's customer owned banking institutions (mutual banks, credit unions and building societies). Collectively, our sector has \$113 billion in assets, 10 per cent of the household deposits market and 4 million customers. Customer owned banking institutions account for three-quarters of the total number of ADIs operating in Australia.

COBA recognises that APRA is updating its existing related entities framework to account for lessons from global financial crisis and to align with the revised large exposures framework<sup>1</sup>. While COBA supports the broad intent of APRA's proposals, COBA members have raised concerns about the adjustment timeline and seek further guidance around APRA's updated requirements and expectations.

**Additional adjustment time for smaller ADIs**

The discussion paper notes that APRA expects that the prudential and reporting requirements would commence from 1 January 2020.

COBA members have noted that, for the most part, the proposed requirements may not as a standalone be necessarily onerous but will be competing against other regulatory changes. In particular, there are expected to be a number of broader governance revisions coming from the Banking Executive Accountability Regime (BEAR) and the outcomes of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

COBA notes that given that the APS 222 is already 'out of sync' with the APS 221 standards in terms of timing, then additional time, say 6 months, for smaller ADIs (small and medium ADIs) to comply is unlikely to create significant risk.

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<sup>1</sup> which also deals with exposures to unrelated entities

### **Guidance on the expanded definition of related entities**

The discussion paper notes that APRA proposes to expand the definition of a related entity. COBA members have noted that this is a significant expansion of the current definition.

COBA and its members seek additional guidance on what/who APRA expects this definition to cover as the broadest interpretation of these criteria could lead to an excessive number of individuals and entities covered by this framework. COBA members have noted that this expanded requirement will create the need for a related individual register, which will take some time.

COBA notes that APRA has already provided some guidance with the discussion paper (page 13) clarifying the exclusion of most customer-owned bank members.

*APRA notes that members of ADIs such as credit unions, building societies and mutual banks that are owned by members rather than shareholders (mutually owned ADIs) are not intended to be captured by the proposed definition of a related individual and in most circumstances, will not be captured. However, where it is assessed that a member exercises control over an ADI, the member will be required to be treated as a related individual and the ADI's associations with the individual will be captured by APS 222's requirements*

The above is useful and COBA believes that further guidance on APRA's requirements and expectations will assist with the identification of related entities in a manner that is both efficient for ADIs and useful for APRA's purposes.

#### *Clarification on definition of 'relatives'*

COBA members have noted that further clarification is required for the definition of a related individual's 'relatives' (see draft APS 222 para 8(d)(vi)). Relatives can be a very broad concept and subjective noting that various definitions have it as a 'member of the family' or 'connected by blood or marriage'.

COBA notes that AASB 124<sup>2</sup> provides a definition (below) that is used for the related parties' disclosures within accounting statements. This has multiple criteria, i.e. 'family' and 'influence'. APRA could consider a similar definition (noting that to be consistent with its other definition it should refer to 'significant' influence).

*Close members of the family of a person are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity and include:*

- A. that person's children and spouse or domestic partner;*
- B. children of that person's spouse or domestic partner; and*
- C. dependants of that person or that person's spouse or domestic partner.*

### **Clarification on assessment of step-in risk**

The draft APS 222 outlines a requirement for the identification and management of step-in risk. Customer-owned banking institutions may have relationships with mutual sector-owned service providers and joint procurement operations that conceivably could pose this risk. Some of these entities may also be ADIs regulated by APRA.

These relationships could raise questions as to whether these institutions are potentially exposed to step-in risk. APRA's note that this risk exists where there are "incentives beyond contractual obligations or equity ties to step in to support other entities."

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<sup>2</sup>See AASB 124 [https://www.aasb.gov.au/admin/file/content105/c9/AASB124\\_12-09\\_COMPjun14\\_07-14.pdf](https://www.aasb.gov.au/admin/file/content105/c9/AASB124_12-09_COMPjun14_07-14.pdf)

COBA seeks clarification about APRA's expectations about whether these step-in risk requirements are intended to capture these entities. There is the potential that there would be some pressure to support particular entities in a downturn. This is due to the potential reputational damage and interruption of operations if these providers were to fail. This likely to create the situation outlined in the discussion paper where "an ADI would prefer to support an entity rather than allowing it to fail and expose the ADI to reputational contagion."

COBA notes that given that these providers are widely used across the mutual sector, this assessment may be further complicated by the fact that any support is likely to be as collective action rather than an individual action by a single mutual ADI.

#### **Clarification on the purpose of acknowledgement disclosures**

COBA seeks further information as to the intent of disclosure acknowledgement requirement (APS 222 para 23). Members have questioned whether this particular measure is targeted at wholesale or retail counterparties. If the application is to wholesale counterparties, then COBA questions what the point of this given that these clients are likely to be sophisticated enough to understand the relevant contracts and risks.

On the other hand, if it relates to retail counterparties, then while it is not likely to be onerous (as an addition to current disclosure requirements) is it likely to be meaningful and useful for the average consumer?

COBA also seeks clarification as to when APRA would expect these disclosures to be made for existing counterparties. For example, it is possible to get this disclosure acknowledged efficiently for an annually renewed product, however, if this is not a feature of the product then it may require a one-off process to seek acknowledgement.

#### **Consideration of supervisory discretion policy for smallest ADIs**

The draft APS 222 revises the prudential limits to be based on the 'more appropriate' Tier 1 regulatory capital base. This aligns APS 222 with the revised APS 221 large exposures framework. APRA's discussion paper notes that this primarily impacts ADIs that have a small capital base.

A smaller COBA member has noted that this change to the large exposures thresholds has seen their large exposures approaching or even violating limits despite their exposures remaining the same in terms of absolute size. COBA believes that APRA should consider its internal policy on exercising supervisory discretion in the case of APS 221 & APS 222 with respect to these limits for the smallest ADIs.

Please contact Mark Nguyen, Senior Policy Adviser, at [REDACTED] if you wish to discuss any aspect of this submission.

Yours sincerely

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**LUKE LAWLER**  
**Director - Policy**