17/18 ANNUAL REPORT

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

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AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY

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 $6.4 trillion in assets for Australian depositors, policyholders and superannuation fund members.

AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY
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WAYNE BYRES
Chairman

28 September 2018

The Hon Josh Frydenberg, 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 2018.

Yours sincerely,

CONTENTS

APRA MANDATE, VISION AND VALUES

Our mandate

Our mandate is to protect the Australian community by establishing and enforcing 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.

Our vision

Our vision is to deliver a sound and resilient financial system, founded on excellence in prudential supervision

Our values

Our values underpin the critical role we play in protecting the financial well-being of the Australian community. Our values were selected to help everyone at APRA to achieve the high standards necessary for us to protect the financial well-being of the Australian community. In our work and in our interactions with others, we seek to demonstrate:

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

Our supervisory approach

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.

KEY HIGHLIGHTS

19 JUL 2017

APRA released its assessment of the additional capital required for the Australian banking sector to have capital ratios that are considered 'unquestionably strong'.

11 AUG 2017

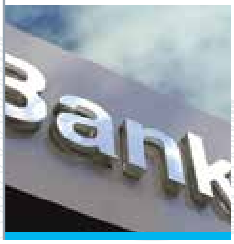
APRA proposed changes to the superannuation prudential framework to lift operational governance practices.

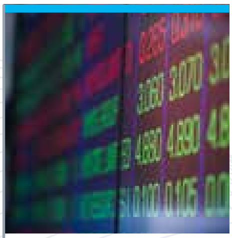
14 NOV 2017

APRA and ASIC published key industry data on life insurance claims.

30 NOV 2017

APRA released changes to the capital framework for mutual ADIs.



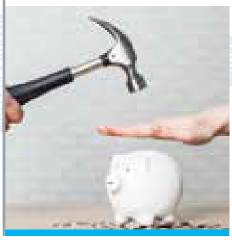


7 DEC 2017

APRA released the final standard establishing new requirements for securitisation.

13 DEC 2017

APRA released a consultation package on measures to strengthen superannuation member outcomes.



7 FEB 2018

APRA announced a package of measures designed to improve governance and decision-making in the private health insurance sector.

4 APR 2018

APRA released the results of its review of remuneration practices at large financial institutions.

4 MAY 2018

APRA finalised the new Restricted ADI licensing framework.

23 MAY 2018

APRA began a post-implementation review of the superannuation prudential framework introduced following the 2013 Stronger Super reforms.

7 MAR 2018

APRA proposed its first prudential standard on information security.

1 MAY 2018

APRA released the CBA Prudential Inquiry Final Report and accepted an Enforceable Undertaking from CBA.

17 MAY 2018

APRA released findings of its thematic review of superannuation board governance practices.

30 MAY 2018

APRA welcomed the reappointment of Helen Rowell as Deputy Chair and nomination of John Lonsdale as an additional Deputy Chair.

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
BEAR	Banking Executive Accountability Regime
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
LCR	Liquidity Coverage Ratio
MoU	Memorandum of Understanding
NSFR	Net Stable Funding Ratio
PHI	Private health insurers
PPF	Purchased payment facility
RBA	Reserve Bank of Australia
RSE	Registrable Superannuation Entity

CH/1
FROM THE CHAIRMAN

FROM THE CHAIRMAN

The Australian financial system maintained a healthy financial position in 2017/18 and the Australian community rightly remained confident in the stability and soundness of the system. Though domestic economic growth picked up through the year and global economic conditions remained broadly positive, 2017/18 was a testing year for many parts of the financial services industry as non-financial issues such as culture and governance rose significantly in prominence. The largest financial institutions faced particular scrutiny following a range of incidents over a number of years that eroded confidence that the financial system was operating in accord with the community's expectations.

Throughout the year, APRA continued to challenge regulated entities to examine and improve their risk cultures, emphasising the link between trust in financial institutions and sound prudential outcomes. A key message to all regulated industries in 2017/18 has been for institutions to go beyond the minimum prudential requirements and seek to implement better practice, both in the interests of their stakeholders and to enhance their prudential resilience.

Stability and accountability

Australia's authorised deposit-taking institution (ADI), insurance and superannuation sectors remain financially sound and well-capitalised relative to their minimum regulatory requirements.

Capital is the most important measure of financial resilience, allowing entities to absorb losses and remain solvent through periods of adversity. It is not, however, the only factor that influences an institution's resilience. Institutions must also be well-governed and prudently managed, with a culture that encourages informed risk-taking and decision-making from the boardroom to the front counter. The need to lift standards in these areas came into sharp focus in 2017/18.

Of note was APRA's decision to launch a prudential inquiry into the Commonwealth Bank of Australia (CBA) in August 2017, following a series of incidents that damaged the bank's reputation and public standing. The inquiry was carried out by an APRA-appointed panel, which examined the governance, culture and accountability frameworks and practices of the CBA group. APRA released the panel's final report in May 2018. Central to the report's findings was the conclusion that the CBA group's continued financial success had 'dulled the senses of the institution', particularly in relation to the management of non-financial risks. In response to the report, APRA accepted an Enforceable Undertaking from CBA covering its remediation plan, and applied a $1 billion capital addition to the bank's minimum capital requirements. As importantly, the report's findings and recommendations were closely examined by the entire financial services industry, providing a template against which they could assess the potential for similar issues to arise in their own institutions.

At the heart of much of the growing community distrust in the financial services industry has been a sense that boards and executives are generously rewarded, but face few consequences for poor outcomes. APRA moved to examine this in depth by conducting a review of executive remuneration practices at large financial institutions. The results were released in April 2018. The review found considerable room for improvement in the design and implementation of executive remuneration frameworks and practices, which often failed to consistently and effectively promote sound risk management and long-term financial soundness, and fell short of the better practices set out in APRA's guidance.

APRA's efforts in this area coincided with the development of the Banking Executive Accountability Regime (BEAR) by the Commonwealth Government, which came into force for the largest banks from 1 July 2018. Amongst other things, the BEAR emphasises the importance of these same issues of incentives and accountability, and provides APRA with greater powers to enforce its prudential standards in this area.

Following intense focus on issues of culture and accountability, the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Commission) was established in December 2017. The hearings of the Commission have, to date, highlighted many issues that have, at their heart, matters of incentives, conflicts and accountability. These issues will no doubt be important considerations as the Commission considers possible recommendations for change.

Prudential supervision and framework

The financial year began with APRA announcing the quantum and timing of the 'unquestionably strong' capital benchmarks for ADIs, in line with the recommendations of the 2014 Financial System Inquiry (FSI). Broadly speaking, these will require minimum capital requirements for banks using the internal ratings-based (IRB) approach to be increased by 150 basis points, while the minimum capital requirements for all other ADIs will be raised around 50 basis points. As most ADIs are already operating well above minimum requirements, APRA indicated that it expected all ADIs to be able to meet the new benchmarks by 1 January 2020 and indeed many already meet the new benchmarks. Though Australian ADIs are already strongly capitalised compared to their international peers, the application of the new unquestionably strong benchmarks will underpin this and further equip the Australian banking sector to better handle adversity in the future.

In February 2018, APRA commenced consultation on revisions to ADI capital requirements to complete the implementation of the Basel III reforms to risk-based capital. As part of the same package, and to meet the objectives of unquestionably strong capital, APRA proposed measures to address ADIs' structural concentration of exposures to residential mortgages by requiring higher capital requirements for mortgage lending than are required under the Basel framework.

At the same time, APRA also commenced consultation on the introduction of a leverage ratio as a complement to the risk-based capital framework.

Also high on APRA's list of priorities throughout 2017/18 was boosting the standard of residential mortgage lending policies and practices. After introducing a temporary benchmark on the share of new lending in the form of interest-only loans towards the end of 2016/17, APRA continued to monitor and reinforce sound lending practices in 2017/18, including gathering better quality data to track higher risk lending and collecting more information on ADIs' practices in this area.

Following observable improvements in ADIs' lending standards, APRA wrote to the industry in April 2018 announcing plans to remove the temporary 10 per cent investor loan growth benchmark imposed in 2014. In order to qualify for the removal of the benchmark, APRA required boards of ADIs to provide written assurance on the strength of their lending standards.

In May 2018, APRA formally established a new pathway for financial entities to become authorised as an ADI. Under the new framework, eligible entities can seek a Restricted ADI licence, allowing them to conduct a limited range of business activities for up to two years while they build their capabilities and resources. Through the new licensing route, APRA intends for consumers to benefit from greater competition and innovation, while ensuring the safety of deposits with all ADIs is adequately safeguarded. Also in May 2018, the first Restricted ADI licence was issued to volt bank Limited.

An important reform in the insurance sector was completed in June 2018, when APRA released a package of measures designed to clarify and strengthen the role of the Appointed Actuary within general, life and private health insurers. The prudential changes are intended to allow Appointed Actuaries to devote their attention to the most important and material matters that impact an insurer's financial standing, and make it easier for insurers to find and retain appropriately qualified professionals to fill this important role. The new standards come into force from 1 July 2019.

APRA's has had a long-running agenda to strengthen governance in the superannuation sector. This was further progressed in December 2017 with the release of a consultation package on measures aimed at assisting APRA-regulated superannuation licensees to deliver sound outcomes for their members. In addition to updating prudential standard *SPS 220 Risk Management* with regard to strategic and business planning and fund expenditure policies and processes, the package proposed a new prudential standard, *SPS 225 Outcomes Assessment*, which would require all RSE licensees to annually assess the outcomes provided to members using a broader range of metrics. APRA is currently considering feedback on the proposals, as well as liaising with the Government on its own legislative proposals in this area to ensure the respective reforms are aligned, and intends to respond to stakeholders with updated proposals in the near future.

> ***Releasing the findings of its thematic review into board governance practices, APRA urged superannuation licensees to assess whether their board had the optimum mix of skills, capabilities and experience needed to effectively carry out its responsibilities.***

In May 2018, APRA released the findings of two superannuation thematic reviews of board governance and related party arrangements. Releasing the findings of its thematic review into board governance practices, APRA urged superannuation licensees to assess whether their board had the optimum mix of skills, capabilities and experience needed to effectively carry out its responsibilities. Separately, APRA's thematic review of related party arrangements for superannuation licensees found room for improvement in licensees' management of commercial relationships with related parties. APRA will continue to work closely with superannuation licensees, particularly as this area has also been a focus of the Royal Commission.

Also in May, APRA began a post-implementation review of the 2013 Stronger Super reforms, starting with the release of an overarching discussion paper and two short topic papers on governance and risk management. The aim of the review is to ensure the prudential and reporting standards and related guidance that were introduced as a key component of the reforms have achieved their objectives and remain fit for purpose. A final report on the post-implementation review is due to be released in early 2019.

In March 2018, APRA responded to the growing threat of cyberattacks by proposing its first prudential standard on information security. The proposed new cross-industry standard, *CPS 234 Information Security*, builds on prudential guidance first released by APRA in 2010 and backs it with the force of law. The new standard is expected to be finalised around the end of 2018, following a review of industry feedback, and is due to be implemented from 1 July 2019.

> *In March, APRA responded to the growing threat of cyberattacks by proposing its first prudential standard on information security.*

Following many years of work involving APRA and the Treasury, the *Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Act 2018* was passed by Parliament in February 2018. APRA started work on this initiative almost a decade ago and consultation with industry first occurred in 2012. The Bill delivered a long-awaited and much needed strengthening of APRA's crisis management powers, better equipping APRA to deal with a financial crisis and thereby to protect the financial well-being of the Australian community. The 2014 FSI had endorsed the criticality of a robust crisis management framework for APRA.

The new powers provide APRA with enhanced tools to fulfil its key purpose in relation to banking and insurance: to protect bank depositors and insurance policyholders.

The task ahead for APRA is to invest in the necessary preparation and planning to make sure the tools within the legislation can be effectively used when needed.

Data-related initiatives

Throughout the year, APRA significantly advanced its data modernisation agenda, which includes the replacement of data collection tool, Direct to APRA (D2A). D2A has reached its end of life, and will be replaced by a new Data Collection Solution (DCS) that will be easier to use and maintain, and adaptable to future advances in data and technology. An extensive program of stakeholder engagement commenced in March 2018 involving webinars, industry and RegTech roundtables, as well as multiple cross-industry technical working sessions. This engagement provided crucial insights into industry needs in terms of desired solution features and the optimum approach to implementing the new system.

APRA expects to settle on the preferred system and implementation schedule by December 2018, with the new DCS on track to start being rolled out towards the end of 2019. In parallel with the DCS project, APRA is also replacing the infrastructure it uses to store, analyse and publish data, to ensure these capabilities keep pace with advances in technology and data analytics. This multi-year program of work advanced substantially in 2017/18, and will transform APRA into an organisation that uses modern analytic capabilities to deliver data and fact-based insights to a wide audience.

During 2017/18, significant progress was made on a pilot program involving both APRA and the Australian Securities and Investments Commission (ASIC) to collect and publish data on life insurance claims and claims-related disputes. The new data collection is designed to improve public reporting of life insurance claims performance across the industry in order to lift standards of transparency and accountability. The first release of industry aggregate data showed insurers finalised 103,100 claims during 2016, of which about 92 per cent were approved and about 8 per cent were declined. A second data release in May 2018, covering the first six months of 2017, was consistent with the initial findings. The results of the third round of data collection are expected to be published early in 2019.

Resourcing and new leadership

After implementing an executive restructure in 2016/17, APRA continued to refresh its leadership in 2017/18 with the arrival of three new Executive General Managers (EGMs). Sean Carmody took up the role of EGM Risk and Data Analytics Division, Mark Adams was appointed as EGM Specialised Institutions Division, and Therese McCarthy Hockey was appointed as EGM Strategy and Chief Risk Officer.

APRA's leadership was reinforced in May with the reappointment of Helen Rowell as Deputy Chair for another five-year term and the Government announcing its intention to appoint an additional Deputy Chair. The nomination of Treasury Deputy Secretary John Lonsdale to fill the new position will add further depth and breadth of financial and policy expertise at APRA.

APRA continues to focus on the efficiency of its operations. Despite an expanding range of activities and responsibilities, APRA's expenditure and staffing levels have changed little in recent years, with total permanent staffing on a full-time equivalent (FTE) basis of 630.6 at end-June 2018. 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 cost per $1,000 of assets supervised in 2017/18 of 2.2 cents, down from approximately 3.0 cents in 2010/11.

A major milestone

Finally, it is worth highlighting that 1 July 2018 marked APRA's 20th anniversary. Looking back on APRA's 20 year history, the organisation has consistently sought to respond to challenges and adversity by learning lessons and focusing on continually building a stronger, more effective prudential regulator.

Over the years, funding for APRA has grown and successive governments have entrusted it with greater responsibilities and enhanced powers. Perhaps the best indication of APRA's performance is that – at a time of community distrust and dissatisfaction in the conduct of the financial services industry – the community can nevertheless continue to have confidence in the financial strength of the institutions they deposit, insure and invest with.

Fundamentally, that result can be traced back to the quality and integrity of APRA's employees who are overwhelmingly committed to their responsibility to protect the financial well-being of the Australian community. The APRA Members – Helen Rowell, Geoff Summerhayes and I – are grateful for their unflagging commitment to the vision and values of the organisation, and we thank them for their efforts throughout the year.

Wayne Byres
APRA Chairman

APRA Members 2017/18 - (left to right) Helen Rowell, Wayne Byres, Geoff Summerhayes

CH/2
THE FINANCIAL ENVIRONMENT

THE FINANCIAL ENVIRONMENT

Over the past year, the forecast for global economic growth has improved. Growth rates have lifted, global stock market indices remain high and interest rates, while rising, remain low.

These supportive conditions nevertheless require careful monitoring. In response to stronger growth, a number of global economies have gradually tightened monetary policy over the past year. As markets adjust to higher interest rates, potential over-valuation of asset prices and the persistent build-up of debt have become greater concerns. International trade policy development, political risks in Europe and instability in some emerging markets have also come into greater focus over the past year. In this context, global equity markets have seen bouts of volatility as uncertainty has weighed on risk sentiment.

Despite rising interest rates in some economies and recent movements in funding markets, global financial conditions have remained expansionary and are expected to continue to support global growth in the year ahead.

The pace of change flowing from the international reform agenda appears to be slowing. For example, in late 2017, the Basel Committee on Banking Supervision (Basel Committee) finalised its Basel III reforms, the most significant of which related to revisions to the risk-weighted asset framework and the introduction of the leverage ratio framework. The Basel Committee's focus will now switch largely to implementation of agreed standards, rather than further regulatory reform. Likewise, the International Association of Insurance Supervisors (IAIS) continued to work towards finalising an international capital standard for insurers, revising the common framework for the supervision of internationally active insurance groups, enhancing a number of insurance core principles and, at a broader level, increasing its focus on emerging risks.

> ***Residential and commercial property markets remain areas of focus for APRA in an environment of low interest rates, restrained wage growth, high household debt and high asset prices.***

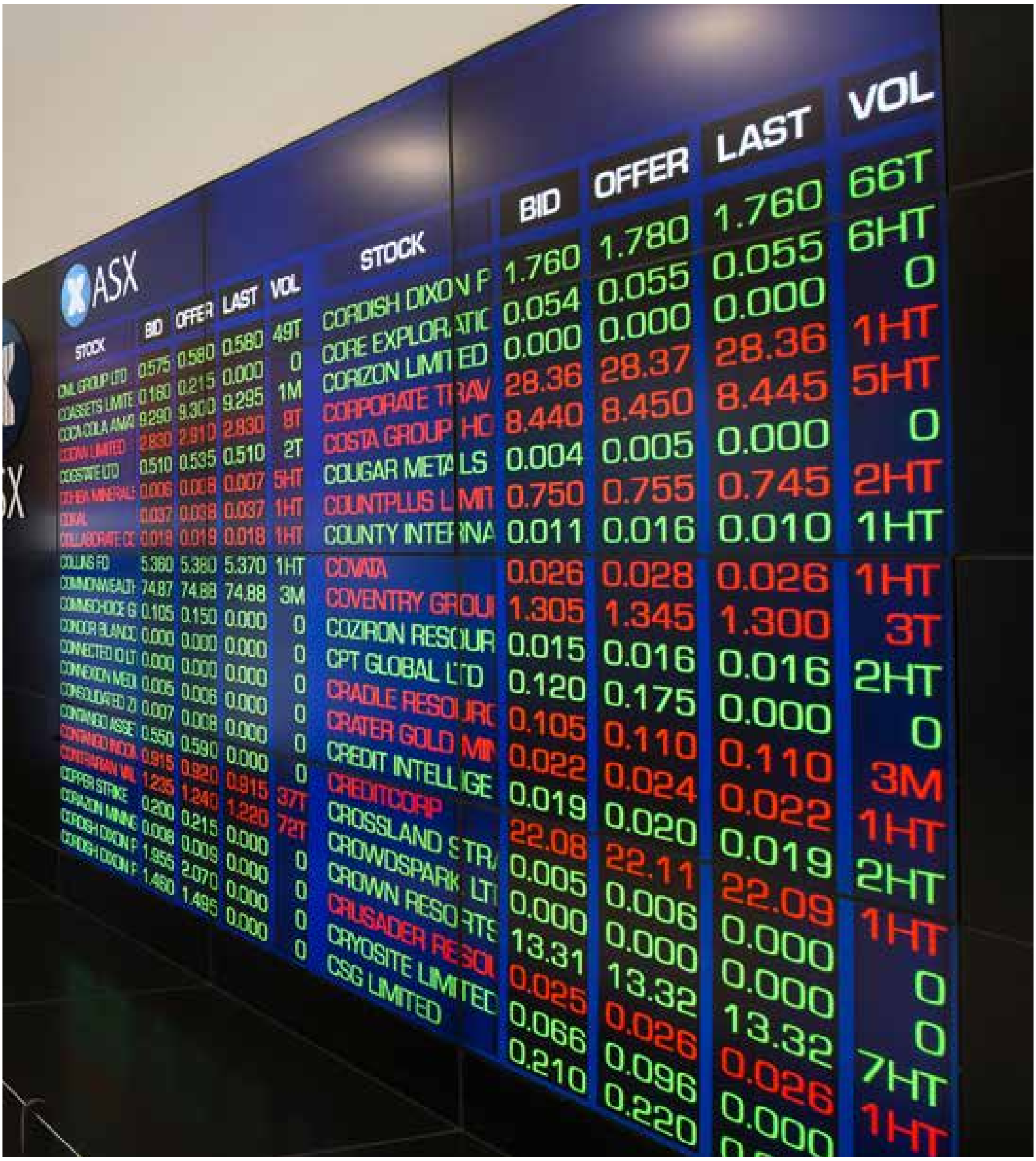
Domestic economic conditions have remained positive over the period, with steady growth in consumption, improved labour market conditions and continued growth in non-mining business investment. Dwelling investment continues to be high despite some softening of prices and rents in the established housing market. Residential and commercial property markets remain areas of focus for APRA in an environment of low interest rates, restrained wage growth, high household debt and high asset prices. However, riskier lending in these areas has been moderated, in part, by improvements to credit underwriting standards in recent years.

In insurance, sustained low inflation and wage growth have allowed for the continued release of claims reserves and therefore supported general insurers' underwriting profitability.

Despite low interest rates, life insurers have not sought to increase their exposure to riskier assets, whereas superannuation funds have continued to benefit from their diversified portfolios, delivering another year of strong growth in their investment returns.

In the broader environment, 2018 has seen intensified scrutiny on the financial services industry, particularly through the proceedings of the Royal Commission.

The findings and outcomes of the Royal Commission are expected to be a major influence on the operating environment for the financial services industry in the years ahead, challenging the robustness of some business models and putting downward pressure on revenue and margins.



AUTHORISED DEPOSIT-TAKING INSTITUTIONS (ADIs)

The ADI industry continued to consolidate over 2017/18, albeit at a slower pace than in recent years, with the number of ADIs falling from 149 to 145 *(Figure 1a)*. As in previous years, the reduction in the number of ADIs was primarily a product of the ongoing consolidation within the mutual sector. At 30 June 2018, there were 87 banks, 47 credit unions, three building societies, and seven other ADIs. In addition, APRA's new Restricted ADI (R-ADI) licensing framework was finalised in May 2018 and APRA granted its first R-ADI licence under the new regime to a digital bank. Over time, APRA expects that the framework will assist aspiring new entrants to the banking industry, particularly small firms with limited financial resources, to navigate the licensing process. This may serve to offset the continued trend for the exit of existing small ADIs.

At 30 June 2018, total ADI industry assets were $4.3 trillion. Industry concentration, as measured by share of industry assets, remained unchanged compared to both 12 months and five years earlier, with around 78 per cent of assets held by the five largest ADIs *(Figure 1b)*.

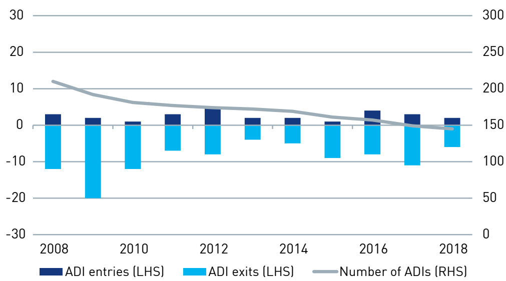
Profitability of the industry remains stable, supported by a number of factors, including very low levels of bad debts and broadly favourable funding conditions throughout the year. This resulted in stable net interest margins, and sustained overall return-on-equity (RoE) at an average of 12.1 per cent for the year to June 2018 *(Figure 1c)*. This represents a similar level to last year, and is only slightly below the average RoE of 13.0 per cent over the past decade. Largely due to slowing revenue growth, the industry-wide cost-to-income ratio was steady for the year at around 49 per cent *(Figure 1d)*, although there remains considerable variation by institution.

Asset quality continues to benefit from benign economic conditions, particularly low interest rates and low unemployment. Non-performing loans accounted for 0.8 per cent of gross loans and advances at 30 June 2018 *(Figure 1e)*, broadly the same level as for the past few years. This remains well below the post-GFC peak of 2.2 per cent at end-June 2010.

Risk-based capital ratios in the industry continued strengthening as ADIs position themselves to meet APRA's unquestionably strong benchmark. All ADIs are on track to meet the unquestionably strong target by 2020 and the general upward trend in capital ratios seen in recent years is expected to persist a little longer. At 30 June 2018, the weighted average CET1 ratio for the industry was 10.6 per cent, a rise of 36 basis points over the year, while the weighted average Tier 1 ratio rose 45 basis points over the year to 12.5 per cent *(Figure 1f)*.

As noted, in December 2017 the Basel Committee released the final set of reforms to complete Basel III. APRA is committed to ensuring that changes in capital resulting from implementation of the Basel reforms will be accommodated within APRA's unquestionably strong benchmark. Given the banking system has largely built the necessary capital, the finalised Basel reforms do not have significant implications for the aggregate capital needs of Australian banks.

Figure 1a - Number of ADI entries and exits



Representative offices of foreign banks excluded

Figure 1b - Assets of largest ADIs

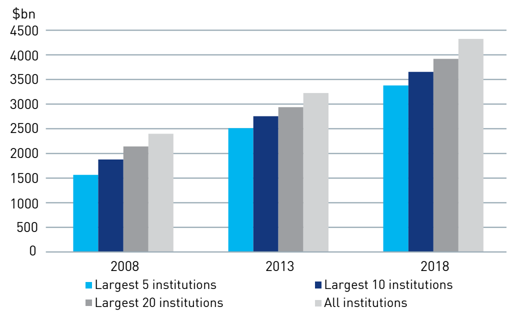


Figure 1c - ADI return on equity

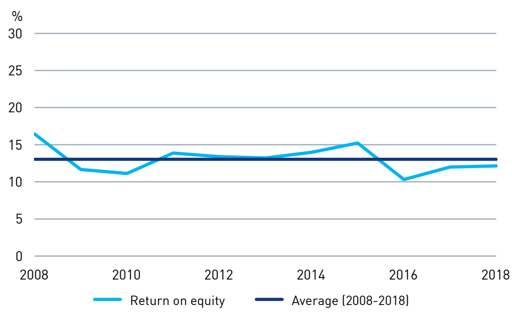


Figure 1d - ADI cost-to-income ratio

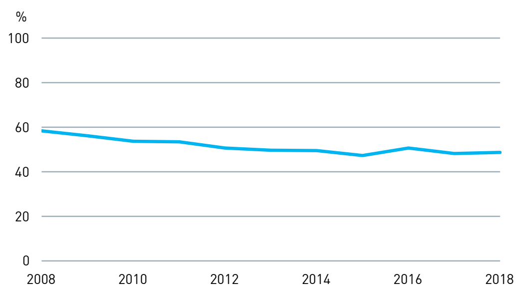


Figure 1e - Ratio of ADI non-performing loans to gross loans and advances

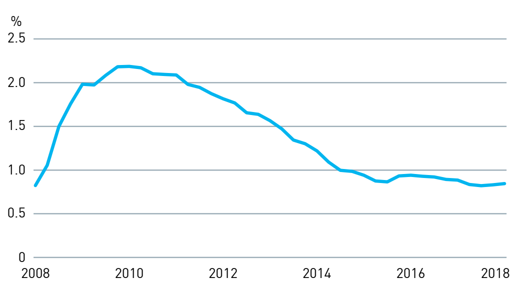
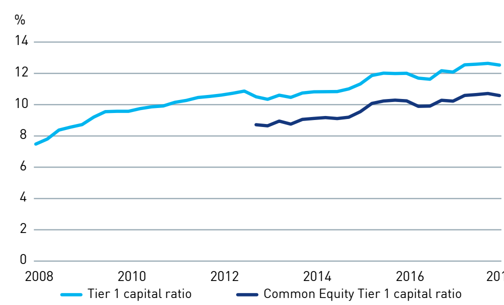


Figure 1f - ADI capital ratios



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

At 30 June 2018, 95 APRA-authorised general insurers operated in the Australian financial services industry, comprising 71 direct insurers, 10 reinsurers and 14 run-off insurers. Nine general insurance licences were revoked during the year *(Figure 2a)*. This was primarily due to insurance groups consolidating their licences, continuing a long-term trend in the industry.

This consolidation resulted in increasing levels of concentration, with the top five general insurers accounting for 64 per cent of industry gross written premiums, a significant increase from 41 per cent 10 years ago *(Figure 2b)*. The reinsurance segment is more concentrated than the direct insurance segment, with the three largest reinsurers representing 88 per cent of the reinsurance market by premium income.

The industry achieved a 14 per cent return on net assets in the year to June 2018, which was in line with its 10-year average *(Figure 2c)*. This was primarily due to lower claims costs from natural catastrophe events over the year to 30 June 2018 which led to lower net loss ratios for short-tail property classes of business, most notably in motor and household insurance *(Figure 2d)*. The net loss ratio for long-tail classes of business continues to be significantly lower than the 10-year average; this is attributable to reserve releases due to the ongoing low wage inflation present in the economy. The introduction of NSW Compulsory Third Party (CTP) reforms in December 2017 also led to a significant reduction in claims costs in the NSW CTP scheme.

Property catastrophe reinsurance plays an important role in the resilience of direct insurers by reducing the financial impact of natural catastrophe events on the short-tail property classes of business. This was evident following the flood and cyclone events in 2011 and Cyclone Debbie in 2017. The positive impact of reinsurance on direct insurers' results is illustrated in *Figure 2d* as the difference between gross and the net loss ratios for both long-tail and short-tail classes.

General insurers' asset portfolios remained heavily weighted to interest rate investments *(Figure 2e)*. Low interest rates are still eroding insurers' investment income and, in response, there was a small increase in insurers' investment allocation to lower graded interest rate investments in search of higher returns. However, low yields have not, at this stage, resulted in an increased investment allocation to riskier assets such as equities and property at an industry level.

The industry continued to report a stable capital position, with a coverage ratio of 1.8 times the minimum requirement at 30 June 2018 *(Figure 2f)*. The quality of capital held by insurers remained strong, with CET1 capital making up 91 per cent of non-branch insurer eligible capital.

Figure 2a - Number of general insurance entries and exits

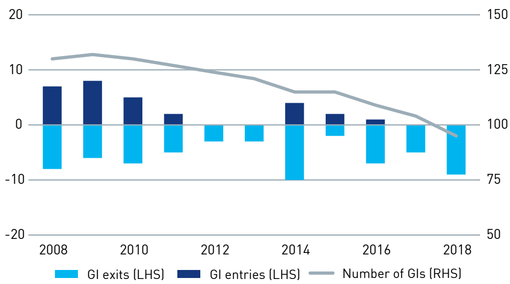


Figure 2b - Assets of largest general insurance institutions

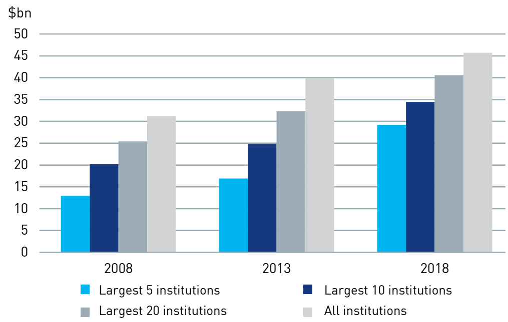
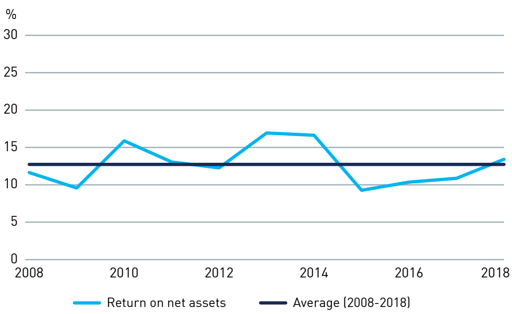
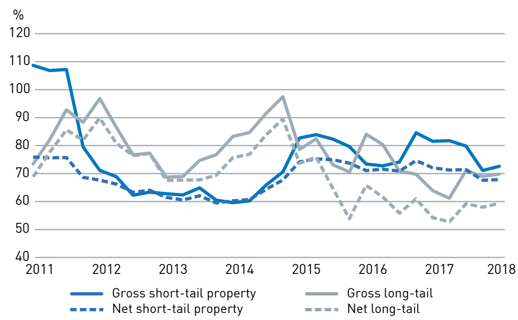


Figure 2c - General insurers' return on net assets



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

Figure 2d - General insurers' loss ratios



Equivalent loss ratio data not available prior to 1 July 2010 due to a change in reporting framework

Figure 2e - Investment performance

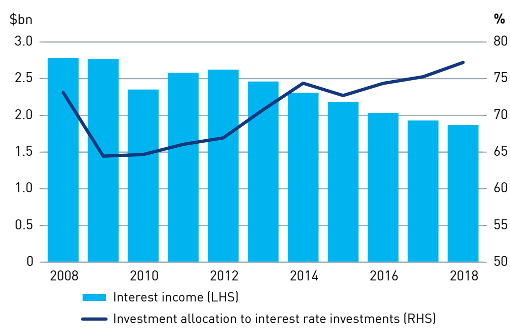
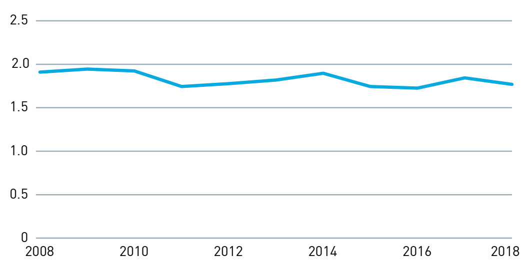


Figure 2f - General insurers' capital coverage ratio



LIFE INSURANCE

At 30 June 2018, 29 APRA-authorised life insurers and 12 friendly societies were operating in the Australian financial services industry, with no new life insurance licences granted and no licences revoked during the year. This industry picture has remained relatively stable in recent years *(Figure 3a)*, despite considerable change in the industry's ownership. The 29 life insurers comprise seven large diversified insurers, four insurance risk specialists, 11 small or niche market players and seven reinsurers that support the local risk market.

The life insurance industry remains highly concentrated, with the top five life insurers accounting for 81 per cent of total industry assets *(Figure 3b)*, largely unchanged from the previous the year. Significant changes in ownership of the industry continued to take place, and intensified over the year. Foreign – particularly Japanese – insurers have acquired, or are seeking approval to acquire, significant shareholdings in several large diversified insurers and niche market businesses.

The industry's 8 per cent return on net assets in 2017/18 was at a broadly similar level to the preceding year. This is significantly below the 10-year average of 12 per cent *(Figure 3c)* and continues a long-run declining trend. The main driver of the reduction in the return on net assets since 2015/16 has been a reduction in total profits across both investment-linked and non-investment-linked products.

Focusing on risk products, the net profit margin for 2017/18 was 5 per cent, below the longer-term average of around 9 per cent. This result was driven predominantly by the deterioration in profitability of individual lump sum and continued losses in individual disability income insurance *(Figure 3d)*. Premium rates for individual disability income insurance have increased in response to the substantial losses reported three years ago. However, the combined effects of persistent poor experience and the need to strengthen reserves have contributed to the overall losses recorded for this product in recent years. The profitability of individual lump sum business declined during 2017/18, continuing a deteriorating trend since 2015/16. In contrast, group lump sum profitability has been steady during 2017/18.

In the years since the global financial crisis, most insurers changed the asset mix in their investment portfolios by reducing the proportion invested in higher-risk asset classes such as equities and property *(Figure 3e)*. As a result, fixed-interest securities now provide a significant share of these portfolios. There has not been any significant reversal of this trend during 2017/18 despite the continued low interest rate environment, which has held yields on fixed-interest investments down. To date, most insurers have not sought to increase their exposure to higher-yielding fixed-interest securities to offset the low-yield environment.

The capital coverage ratio for the industry has been broadly stable over the past five years, remaining at sound levels. This is reflected in an aggregate capital coverage ratio at 30 June 2018 of 1.9 times the minimum requirement *(Figure 3f)*. The quality of capital held by insurers also remains strong, with CET1 capital being the predominant form of eligible capital.

Figure 3a - Number of life insurance entries and exits

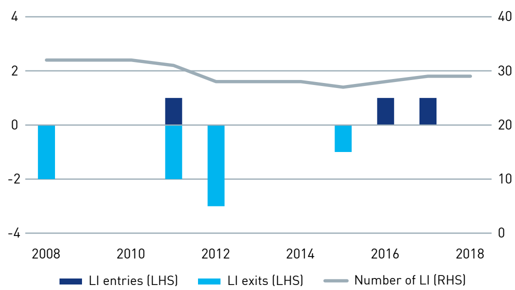


Figure 3b - Assets of largest life insurance institutions

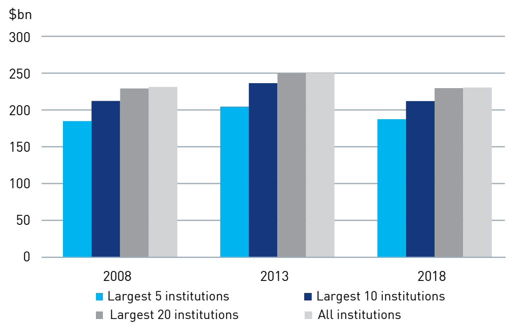


Figure 3c - Life insurers' return on net assets

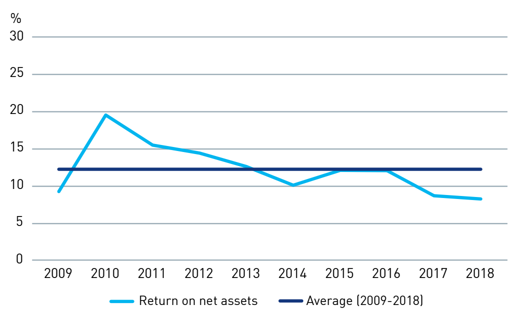


Figure 3d - Net profit after tax (risk products)

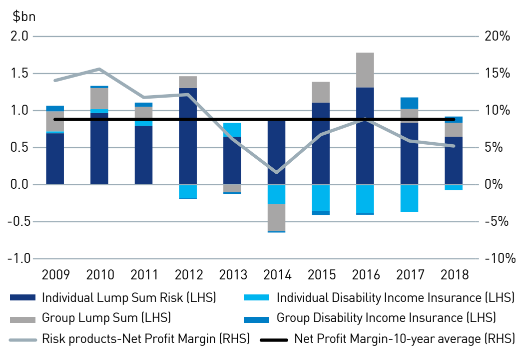


Figure 3e - Non-investment-linked assets

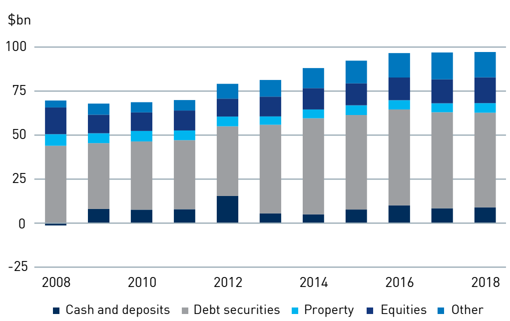
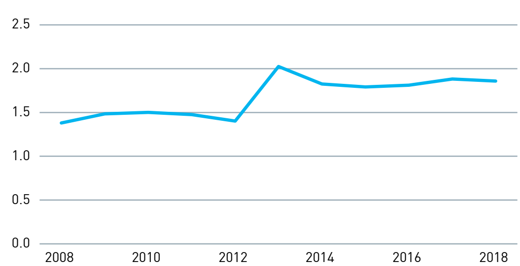


Figure 3f - Life insurers' capital coverage ratio



PRIVATE HEALTH INSURANCE

The composition of the private health insurance industry was stable at 37 licenced private health insurers, with no authorisations, departures or amalgamations over the 12 months to 30 June 2018 *(Figure 4a)*. Industry market share also remained stable, with the five largest private health insurers accounting for 5.3 million health insurance policies, or 80 per cent of total industry policies *(Figure 4b)*.

The industry has experienced an uncharacteristic stabilisation in profitability, with total profit in the year to June 2018 only marginally lower than for the prior year *(Figure 4c)*. This masked some underlying shifts, however: profit from investment and other revenue fell 16 per cent, but was offset by improved profits in health insurance business (up 5 per cent) and health-related business (up 9 per cent).

Looking specifically at health insurance business performance, the industry strengthened its gross margin to 14 per cent in 2017/18 *(Figure 4d)*, attributable to a 4 per cent growth in contribution income (in line with the rate of annual premium increases) and a favourable 3 per cent growth in benefit expenditure. Health insurance business management expenses remained relatively stable at 9 per cent, resulting in a slight strengthening of the net margin to just over 5 per cent in 2017/18.

While the total number of hospital treatment policies (5.5 million) and the number of insured persons (11.3 million) remained relatively stable over the year, the industry continued to face multiple challenges with its participation rates, fuelled by concerns regarding affordability and transparency. This was evidenced by the continued decline in the proportion of the Australian population with private hospital cover, falling to 45.1 per cent as at 30 June 2018 *(Figure 4e)*. The ageing population continues to impact private health insurance, with the proportion of membership over 65 years continuing to increase, in contrast to the shrinking younger membership cohort.

The industry maintained a strong capital position over 2017/18, ensuring that private health insurers were sufficiently capitalised to meet their prudential obligations to policyholders. Industry assets grew by $633 million in the year to $14.4 billion, with total assets in excess of the capital adequacy requirement *(Figure 4f)*. The coverage multiple was 1.9 times the regulatory requirement as at 30 June 2018, a marginal improvement in a multiple that has been static for the past four years.

Figure 4a - Number of PHI entries and exits

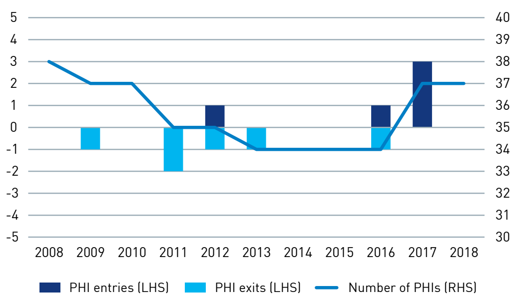


Figure 4b - Assets of largest private health insurance institutions

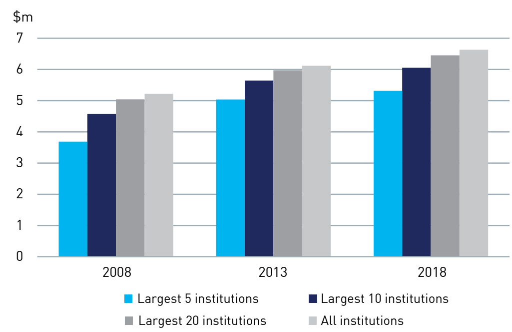


Figure 4c - Sources of industry profit

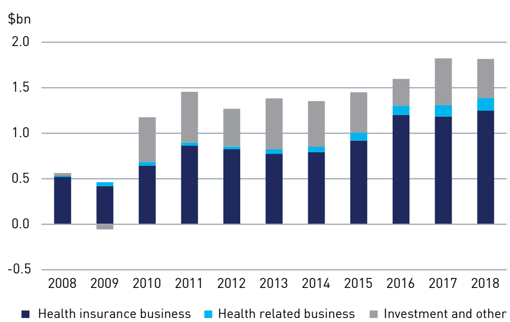


Figure 4d - PHI gross and net margin

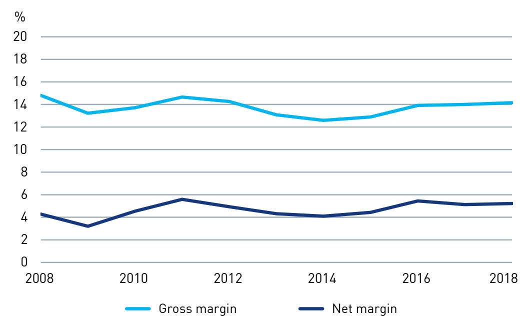


Figure 4e - Hospital treatment persons and population coverage

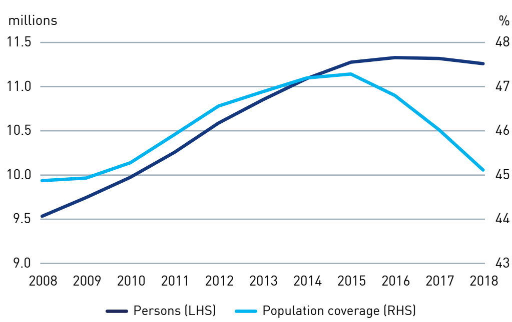
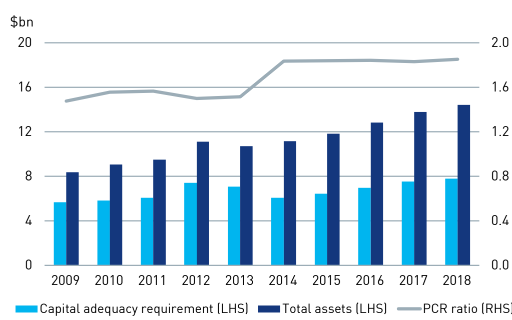


Figure 4f - PHI capital adequacy requirement and total assets



SUPERANNUATION

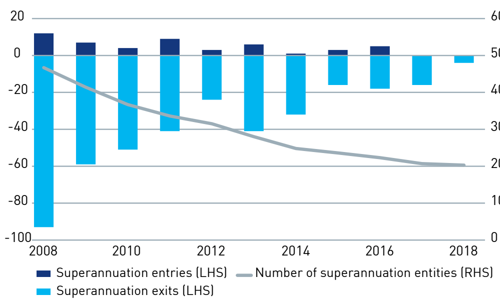
The superannuation industry further consolidated over the year to June 2018. At 30 June 2018, there were 129 licensed superannuation trustees responsible for 202 APRA-regulated superannuation funds with more than four members. APRA also supervised 1,983 small funds (funds with four or less members), 12 single-member approved deposit funds, 3 multi-member approved deposit funds, and 38 pooled superannuation trusts (PSTs) over the financial year. The consolidation of the superannuation sector slowed somewhat during the year *(Figure 5a)*. The five largest super funds accounted for 28 per cent of total industry assets at June 2018, up from 24 per cent 10 years ago *(Figure 5b)*.

Over the decade to June 2018, while net assets held in superannuation funds with more than four members grew by 145 per cent, the number of these funds fell by 55 per cent. This reflects a 440 per cent rise in average net assets per fund, increasing from $1.6 billion to $8.4 billion over this 10-year period. The median fund size increased from $0.1 billion to $1.3 billion over the period. Total administration and operating expenses continued to decrease as a percentage of net assets, down to 0.39 per cent over 2018, compared with 0.50 per cent a decade ago *(Figure 5c)*.

Ageing member demographics is the primary structural issue facing the industry over the longer term. While the industry as a whole may still have another 20 to 25 years before entering a phase in which aggregate assets are no longer growing, sustainability issues posed by ageing membership along with competitive pressures are already apparent for many RSE licensees. This impact of increasing draw-downs was reflected in the steady decline of net contribution flows as a percentage of average net assets, from 3.7 per cent as at June 2008 to 1.2 per cent as at June 2018 *(Figure 5d)*. This trend will continue to reduce one of the superannuation industry's two primary sources of growth: positive net contributions. This places increasing importance on RSE licensees positioning themselves to meet these strategic challenges and deliver quality, value-for-money member outcomes.

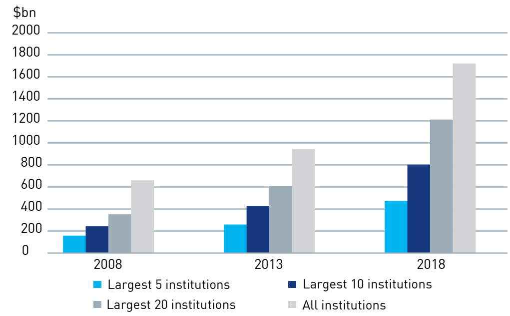
The superannuation industry's other primary source of growth is long-term investment returns. A high allocation to growth assets such as equity and property *(Figure 5e)* is enabling longer-term performance, despite returns facing volatility over shorter timeframes. The industry return was 5.7 per cent per annum over the past decade, and 7.9 per cent per annum over the past five years *(Figure 5f)*. The 2017/18 financial year saw a return of 7.6 per cent.

Figure 5a - Number of superannuation entries and exits



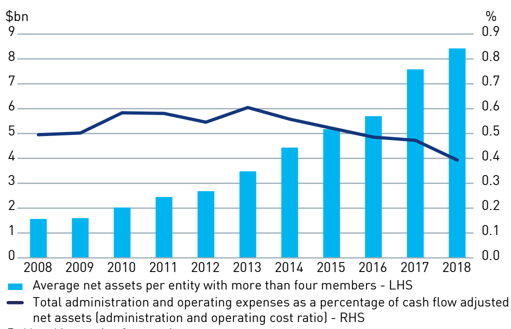
Only includes APRA regulated entities with more than four members.

Figure 5b - Assets of largest APRA-regulated superannuation funds



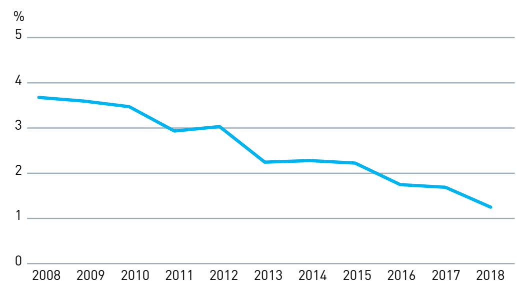
Only includes APRA-regulated entities with more than four members.

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



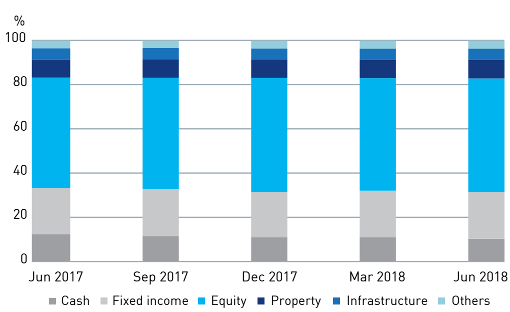
Entities with more than four members

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



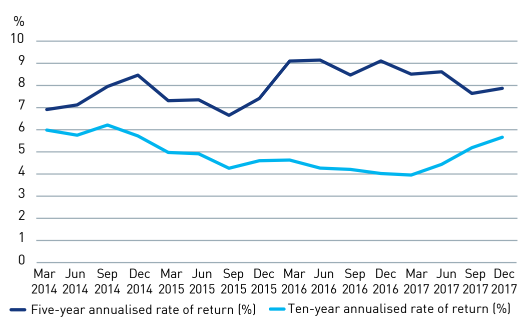
Entities with more than four members

Figure 5e - Asset allocation



Entities with more than four members

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



Entities with more than four members

APRA-REGULATED INSTITUTIONS

	Number of entities[1]			Assets ($ billion)[2]		
	30 Jun 17	30 Jun 18	% change	30 Jun 17	30 Jun 18	% change
ADIs[3]	149	145	-2.7	4,242.0	4,321.4	1.9
Banks	84	87	3.6	4,187.3	4,267.5	1.9
Building societies	4	3	-25.0	13.0	12.1	-6.9
Credit unions	54	47	-13.0	37.6	37.3	-0.8
Other ADIs	7	7	0.0	4.0	4.5	12.5
Restricted ADIs		1				
Representative offices of foreign banks	14	12	-14.3			
General insurers	104	95	-8.7	125.0	121.4	-2.9
Life insurers	29	29	0.0	229.5	232.5	1.3
Friendly societies	12	12	0.0	7.2	7.5	4.2
Licensed trustees	138	129	-6.5			
Superannuation entities[4]	2209	2235	1.2	1,616.7	1,764.1	9.1
Public offer funds	134	134	0.0	1,190.0	1,436.8	20.7
Non-public offer funds[5]	62	57	-8.1	420.2	321.0	-23.6
Small APRA funds	1,951	1,983	1.6	2.1	2.2	4.6
Approved deposit funds	15	15	0.0	0.0	0.1	7.1
Eligible rollover funds	8	8	0.0	4.4	4.0	-7.8
Pooled superannuation trusts[6]	39	38	-2.6	136.3	157.2	15.3
Private health insurers	37	37	0.0	13.8	14.4	4.3
Non operating holding companies	25	27	8.0			
Total	**2,717**	**2,721**	**0.1**	**6,234**	**6,461**	**3.6**

1. Number of entities for end-June 2017 has been revised where better source data has become available.
2. Asset figures for end-June 2018 are based on the most recently submitted returns. Asset figures for end-June 2017 have been revised slightly from APRA's 2017 Annual Report in line with the audited returns received during the year.
3. The ADI classification does not include representative offices of foreign banks. Restricted ADI assets are not included as they operate under a different framework to normal ADIs.
4. 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.
5. Revisions in this item reflect the adoption of AASB 1056 from the June 2017 annual reporting period.
6. Pooled superannuation trust assets are not included in totals as these assets are already recorded in other superannuation categories.

CH/3
THE YEAR IN REVIEW

THE YEAR IN REVIEW

SECTOR-WIDE ACTIVITIES

Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

The Royal Commission is inquiring into the conduct of financial service entities and seeking to identify instances of misconduct or conduct falling below community expectations. As well as identifying such conduct and making recommendations on how the system can be strengthened, the Commission is charged with examining the effectiveness of regulators in the areas into which it is inquiring. As the prudential regulator of the financial sector, many aspects of the Commission's enquiries are of interest and relevance to APRA.

> *APRA is also engaging with individual supervised institutions on the issues emerging from the Commission and examining ways to improve its own organisational effectiveness and to strengthen the prudential framework more broadly.*

APRA received a small amount of additional funding to address the increase in resources required to respond to the Commission. It has established a dedicated team to handle the Commission's requests for information, documents and background papers. APRA has also engaged external solicitors and counsel under arrangements agreed by the Attorney-General.

For most rounds of hearings, APRA's engagement with the Commission has been through the provision of information on APRA's mandate and how it carries it out and on examples of supervision activity relevant to the Commission's areas of interest. The first four rounds of hearings examined consumer lending, financial advice, and small and medium enterprise lending and remote and regional financial services, while the sixth round covered insurance. For these hearings, APRA's engagement also included assisting with background papers on APRA's regulatory capital framework for ADIs, providing input to Treasury background papers prepared for the Commission, responding to extensive ad-hoc information requests and making submissions on each round of proceedings.

In round 5, on superannuation, APRA's engagement was more extensive. Not only did APRA supply the Commission with large volumes of information, but two APRA senior executives provided witness statements and testimony in response to the Commission's requests. The Commission focused on how APRA pursued its prudential objectives when dealing with conduct-related matters, how it had responded to individual cases, its enforcement philosophy and approach and potential areas for regulatory reform.

Responding to the issues that have emerged at the Commission will be central to APRA's activities in the period ahead. This will involve not only pursuing relevant matters with individual institutions, but also examining the ways in which to improve APRA's own organisational effectiveness and strengthen the prudential framework more broadly.

In addition to legislative reforms and recommendations to improve the regulatory architecture, APRA will consider the means by which it can gain greater assurance that institutions' policies and procedures are being adhered to in practice; continuing to build APRA's capacity to make systematic assessments of organisational culture within regulated entities; and reviewing APRA's enforcement approach and decision frameworks.

Remuneration review

In July 2017, APRA began a review of remuneration policies and practices across a sample of large APRA-regulated entities. The sample included the largest institutions across the ADI, life insurance, general insurance and superannuation industries, which collectively account for a material proportion of the total assets of the Australian financial system. The purpose of the review was to gauge how well the requirements set out in the prudential standards and guidance were being implemented. The review focused particularly on how the stated remuneration frameworks and policies for senior executives were translating into outcomes.

APRA held bilateral feedback sessions in early 2018 with the institutions assessed in the review and also published an information paper in April 2018 setting out its broad findings. The review found that remuneration frameworks and practices across the sample did not consistently and effectively meet APRA's objective of encouraging behaviour that promotes appropriate risk-taking within robust risk management frameworks and supports institutions' long-term financial soundness. Although the institutions reviewed largely had frameworks, policies and processes that could provide the basis for a sound system of remuneration, their practical application often fell short of the practices set out in the relevant prudential guidance, and were therefore some way from best practice.

In response to the findings, APRA is considering ways to strengthen its prudential framework to support a more robust and credible implementation of the objectives of the prudential requirements and guidance on remuneration. APRA's review of the relevant prudential standards and guidance will also take account of the Banking Executive Accountability Regime, as well as international best practice and any recommendations in this area that may flow from the findings of the Royal Commission. APRA has, however, encouraged institutions to not wait for potential regulatory changes to address the scope for improvement that currently exists, nor regard the task as one of simply meeting minimum regulatory requirements.

Information security

Sound risk management is a cornerstone of prudential requirements across all APRA-regulated industries, including the management of risk in information security. Effective information security has become increasingly critical, as attacks on systems, networks and information worldwide accelerate in frequency, sophistication and impact. This was evident from the results of APRA's two recent cyber surveys of its regulated institutions, which indicated that cyber incidents varied widely in nature, sophistication and impact.

Consequently, APRA took further steps in 2017/18 to strengthen information security resilience across all APRA-regulated industries through consultation on a new cross-industry standard on the management of information security. The proposed new standard addresses the need to establish minimum requirements across all industries, including:

- clearly defined information security-related roles and responsibilities for the board, senior management, governing bodies and individuals;
- information security capability that is maintained and commensurate with the size and extent of threats to information assets, and enables the entity's ongoing sound operation;
- information security controls that protect the entity's information assets;
- undertaking systematic testing and assurance of the effectiveness of information security controls;
- robust mechanisms to detect and respond to information security incidents in a timely manner; and
- the need to notify APRA of material security incidents.

The new standard was issued for consultation in March 2018 and will be finalised along with updated industry guidance following APRA's consideration of industry feedback in the coming financial year.

Climate change risk

APRA continued building awareness of climate-related financial risks amongst its regulated entities and the broader financial services industry.

APRA's position on climate-related financial risk is evolving, in line with international regulatory best practice and developments such as the Financial Stability Board's Taskforce on Climate-Related Financial Disclosures. Regulated entities should be considering their exposure to climate-related financial risk in the context of their strategic and operational risk management frameworks.

In 2017, APRA promoted the establishment of the Council of Financial Regulators Working Group on Climate Risk to facilitate the sharing of knowledge and develop a coordinated approach to monitoring how the industry manages climate risk. APRA is the current chair of this group.

APRA also deepened its engagement and influence on the international stage with regards to monitoring climate risk. APRA Member Geoff Summerhayes was elected Chair of the United Nations Environment's Sustainable Insurance Forum and appointed Executive Committee Champion for Sustainability at the International Association of Insurance Supervisors.

Finally, APRA issued a cross-industry climate risk survey to 38 of its regulated entities to assess industry maturity in the area of climate risk governance, assessment and disclosure. Results from the survey are expected to be available in late 2018, and will help inform APRA's future supervisory approach.

Licensing

Entities that intend to carry out prudentially regulated activities in the banking, insurance and superannuation sectors must obtain a licence from APRA to operate. This ensures all APRA-regulated financial entities meet the relevant prudential requirements, reducing the likelihood of failure and providing the community with confidence these institutions will meet their financial commitments under all reasonable circumstances.

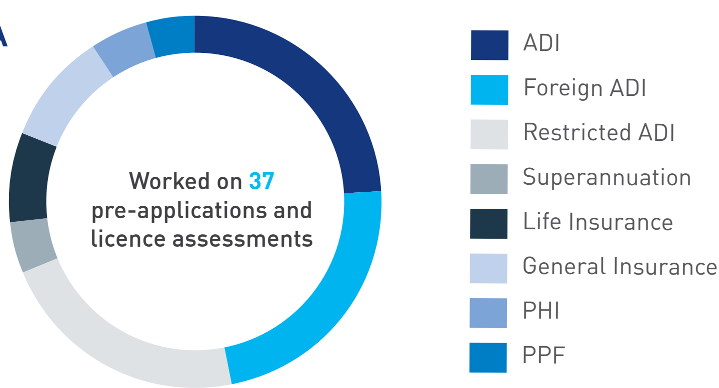
At the beginning of 2017/18, APRA established a new centralised licensing unit to provide more consistent and efficient engagement with entities wishing to be authorised by APRA, including those with innovative or non-traditional business models. The establishment of the licensing unit has been well received and there has been an increase in licensing

Licensing@APRA

This year we have:

Responded to 142 enquiries

Had 69 meetings with 60 potential applicants



enquiries from entities with both traditional and non-traditional business models, either aiming to enter or expand in the financial services industry. In 2017/18, APRA received 142 enquiries in relation to licencing, and issued seven new licences.

A new Restricted ADI Licencing Framework was also finalised in May 2018 – see page 33.

INDUSTRY SUPERVISION AND REGULATORY ACTIVITIES

ADIs

Residential mortgage lending

Continuing a theme from previous years, APRA maintained a strong focus on residential mortgage lending standards in its supervision of ADIs during 2017/18. This supervisory program encompassed three principal components: monitoring higher risk lending, reinforcing sound lending standards and enhancing APRA's prudential framework and data collection. During the past year, APRA:

- continued to closely monitor higher risk lending, with a particular focus on how ADIs tracked against the industry benchmarks APRA established for investor loan growth and lending on an interest-only basis;
- conducted a detailed review of lending practices at a range of ADIs, examining the effectiveness of controls around the collection of borrower financial information used to test affordability; and
- refreshed its data collection to gain a better insight into residential mortgage lending, with the release of the new industry reporting form *ARF 223 – Residential Mortgage Lending.*

In April 2018, APRA announced that the investor loan growth benchmark would be removed where the board of an ADI was able to provide assurance on the strength of its lending standards. This decision reflected the reduction in higher risk lending and improvements that ADIs have made to lending standards in recent years, as well as increases in capital resilience as ADIs progress towards APRA's 'unquestionably strong' capital ratio targets. While lending standards have improved, there is further work for the industry to do to ensure the improvements are fully embedded into ongoing practices.

Capital

In July 2017, APRA released the information paper *Strengthening banking system resilience – unquestionably strong capital ratios*, which set out its assessment of the amount of additional capital required for Australian ADI capital ratios to be considered 'unquestionably strong'[1].

For ADIs that use the internal ratings-based approach, APRA indicated that minimum capital requirements would need to be increased by approximately 150 basis points, while for ADIs that use the standardised approach, the increase would be approximately 50 basis points. APRA also indicated that, given the already strong capital position held by the industry, all ADIs would be expected to meet the new benchmarks by 2020.

APRA's supervision in action

Faced with significant implementation issues around a new banking technology platform, APRA was concerned with the ability of the Board and management of an ADI to effectively manage this increased level of risk. This concern was heightened by pressure on the entity's capital position and medium-term outlook. APRA took a number of steps to address deficiencies relating to the implementation of the new core banking system, including the appointment of an independent external advisor to advise management and the Board, and encouraging the acquisition of requisite banking skills onto the Board. As a result of these actions, a rectification plan was established to ensure the integrity of the new platform, which APRA continues to closely monitor.

1. The 2014 Financial System Inquiry (FSI) endorsed the benefits of a strong and well-capitalised banking system and recommended that APRA set capital standards such that capital ratios of authorised deposit-taking institutions (ADIs) are 'unquestionably strong'. The Australian Government subsequently endorsed this recommendation.

At that time, APRA also flagged its intention to release a discussion paper on proposed revisions to the capital framework designed to establish the detailed capital requirements that would underpin the new benchmarks. These amendments to the capital framework would also incorporate measures to address Australian ADIs' structural credit exposure concentration to residential mortgages, and APRA's implementation of the Basel Committee's on Basel III reforms.

The Basel III reforms were finalised in December 2017. The focus of these reforms was achieving a better balance between simplicity and risk sensitivity within the capital framework, as well as promoting greater comparability in the risk-based capital approaches by reducing variability in risk-weighted assets across banks and jurisdictions. The reforms include wide-ranging revisions to the credit, operational and market risk frameworks, as well as introducing a minimum capital 'floor' relative to the standardised approach for banks using internal models, and a non-risk-based leverage ratio requirement.

In February 2018, APRA began consulting on revisions to the ADI capital framework, releasing two discussion papers: *Revisions to the capital framework for authorised deposit-taking institutions*; and *Leverage ratio requirement for authorised deposit-taking institutions*. The first of these papers set out APRA's proposed revisions to the risk-based capital framework, including proposals to better align regulatory capital with the risk in ADIs' residential mortgage portfolios. This paper also included other proposed changes for credit, market and operational risk, and commenced consultation on a simpler framework for smaller ADIs.

The second discussion paper focused on the introduction of a leverage ratio as a complement to the risk-based capital framework. APRA also undertook a quantitative impact study to enable it to better understand the impact and overall calibration of the proposals.

CBA prudential inquiry

In August 2017, APRA announced it would establish a prudential inquiry into the Commonwealth Bank of Australia, following a number of incidents that damaged the bank's reputation and public standing. The inquiry was tasked with examining the bank's frameworks and practices in relation to governance, culture and accountability.

The inquiry differed significantly from APRA's usual method of prudential supervision in a number of ways:

- APRA appointed a panel of three highly experienced and credentialed financial services industry experts to lead the review. The panel was vital to the success of the inquiry, particularly in assessing the actions and decisions of, and environment surrounding, the decision-making of past and present board members and senior executives.
- The inquiry was undertaken in a more public manner than traditional supervision. The terms of reference for the inquiry were published in September 2017, followed by a progress report, published on 1 February 2018, and the final report which was published on 1 May 2018.
- The inquiry was a large undertaking with up to 25 people working full-time, and a number of others involved on a part-time basis. Resourcing to support the panel was provided by a core team of experienced APRA employees and an external consultant. The use of an external consultant enabled access

APRA's supervision in action

A lack of scale at a small mutual institution was increasing the reliance on oversight by the Board in respect to compliance and regulatory matters. Following investigation of concerns in respect to security of the entity's information technology environment and the financial impact of rectification, APRA took the view that the likelihood of future losses would inevitably erode member confidence and adversely impact the ongoing viability of the ADI. Consequently, APRA instructed the Board to undertake a merger to overcome these issues and protect the interests of the members.

to additional skills, as well as international perspectives and expertise, not normally available to APRA.

CBA publicly committed its support to the inquiry, and funded the cost of the work.

> *...the report holds insights for all financial institutions and is a useful guide to gauging whether similar issues are present in their own organisation.*

The review provided deep insights into governance, culture and accountability issues, culminating in 35 recommendations. As a result of the inquiry, CBA entered into an Enforceable Undertaking with APRA. The Enforceable Undertaking established a framework by which the bank will demonstrate it is addressing the panel's recommendations. In addition, APRA imposed an additional $1 billion capital requirement on CBA, which will remain in place until the bank can demonstrate satisfactory progress in responding to the recommendations.

The inquiry provided APRA with the opportunity to consider how its usual supervision practices could be further enhanced, particularly in assessing the quality of governance, the ability to judge the risk culture, and the degree to which accountability and remuneration frameworks have supported risk management. Similarly, the report holds insights for all financial institutions and is a useful guide to gauging whether similar issues are present in their own organisation. With this in mind, APRA has asked a number of organisations to prepare a self-assessment against the CBA report's findings.

Restricted ADI framework

In May 2018, APRA released the new Restricted ADI framework, designed to assist potential new entrants to the banking sector. Under the framework, eligible entities can apply for a Restricted ADI licence, which allows them to conduct a limited range of business activities for up to two years before meeting the requirements of the full ADI prudential framework.

This staged approach is designed to enable new and non-traditional entrants to the banking sector to build their capabilities and resources as they navigate the process towards a full (unrestricted) ADI licence.

In developing the new licensing pathway, APRA has sought to ensure the framework facilitates new entrants but does not create material competitive advantages for new entrants compared with incumbents, or compromise financial stability. Restricted ADIs are expected to seek investment, and build resources and capabilities, to meet APRA's full prudential framework and ultimately develop a full-scale banking business. If a licensee is unable to meet these standards within the two-year licence period, it must exit the industry.

The same month that APRA released the new Restricted ADI framework, it also granted the first Restricted ADI licence to a new digital bank start-up, volt bank Limited.

APRA's supervision in action

All regulated entities are looking to leverage technology to provide competitive and cost advantages, but there is an important balance that needs to be found between investing in new technology and ensuring sufficient spending on existing systems to ensure they are maintained in an appropriate state. To aid its understanding of industry practice, APRA undertook a thematic review of technology risks across a group of like entities. The review identified a range of weaknesses that were common, such as inadequate visibility at senior levels of the overall state of systems health, including end of life and end of support applications and associated infrastructure, and incomplete coverage of recovery testing. A lack of investment in the maintenance of systems raised concerns around the overall IT strategy and security. APRA responded by requiring the entities to provide a strategy for addressing the issues raised, with appropriate ongoing oversight at board level as well as regular reporting to APRA.

Banking Executive Accountability Regime

In February 2018, the *Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Bill 2018* was passed. The new accountability regime introduced specific accountability obligations for ADIs and individual accountable persons (senior executives and directors), who must be registered with APRA. The accountability regime seeks to drive improvement in governance by establishing clear obligations and providing additional enforcement powers to APRA to take action when those obligations are breached.

The regime commenced on 1 July 2018 for large ADIs and APRA worked closely with these institutions to establish an effective regime. Large ADIs identified and registered their accountable persons and submitted for each person an accountability statement setting out the aspects of the ADI's operations for which they hold senior executive responsibility. Each large ADI also prepared an accountability map outlining an organisational view of accountability and how accountability is allocated across the business in a manner appropriate to its risk and complexity.

APRA will refine and enhance the regime over time and will continue to engage with industry as medium and small ADIs approach their commencement date of 1 July 2019.

Other: large exposures, ADI disclosure, mutual capital, counterparty credit risk

During 2017/18, 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 large exposures. APRA's large exposure framework aims to limit the impact of losses when a large counterparty defaults, and to restrict the potential for problems in one entity from spreading across the financial system. These revisions reflect the Basel Committee's updated large exposures framework with appropriate Australian adjustments, as well as transitional arrangements for some of the more significant amendments. The reforms, which will take effect from 1 January 2019, incorporate revised definitions, limits and a revised measurement basis to better reflect the potential for concentration risk for ADIs.
- In November 2017, APRA finalised its framework for the issuance of common equity tier 1 (CET1) capital instruments by mutually owned ADIs. This framework provides mutually owned ADIs with an alternative means to raise CET1 capital beyond retained earnings. Mutually owned ADIs are now able to issue capital instruments, subject to some constraints, that are eligible for inclusion as CET1.
- In March 2018, APRA finalised revisions to the ADI public disclosure obligations. These revisions incorporated disclosures associated with the introduction of the Net Stable Funding Ratio (NSFR), a requirement for larger ADIs. The new disclosure requirements became effective on 1 July 2018.
- In April 2018, APRA finalised its revised regulatory framework for the measurement of counterparty credit risk for ADIs. The purpose of this reform is to improve risk sensitivity in the measurement of counterparty credit risk exposures while

APRA's supervision in action

A foreign-owned entity had ambitious growth plans in Australia and was competing aggressively in the local lending market. From APRA's forward-looking financial analysis, it was identified that the capital position and profitability of the entity could not sustain its medium-term growth ambitions. APRA engaged with local management, as well as the parent entity and the home regulator regarding its concerns. While the issue was resolved, APRA increased its supervisory intensity so that the entity significantly moderated its growth targets, in line with its profit generation, until such time as a capital injection was received from its parent.

retaining an appropriate degree of simplicity in the framework. The revisions reflect amendments to the Basel Committee's counterparty credit risk framework, while allowing ADIs with immaterial exposures to continue to use a simplified method. APRA's revised counterparty credit risk requirements will come into force on 1 July 2019.

General insurance

Appointed Actuary and actuarial advice

> *Appointed Actuaries should be able to maintain greater focus on the most material matters, thereby better protecting the interests of their insurer and its policyholders.*

In June 2018, APRA released a final package of measures to clarify and strengthen the role of the Appointed Actuary within general, life and private health insurers. As a result of the reforms, Appointed Actuaries should be able to maintain greater focus on the most material matters, thereby better protecting the interests of their insurer and its policyholders. The reforms included the creation of a new cross-industry prudential standard *(Prudential Standard CPS 320 Actuarial and Related Matters)* that harmonises the requirements and expectations for Appointed Actuaries across all three insurance sectors, while still accommodating industry-specific differences.

The effectiveness of the reforms relies on Appointed Actuaries, insurers and their boards reflecting on how the Appointed Actuary is utilised and supported within their organisations, and establishing the right frameworks to respond to these changes. Implementation will occur from 1 July 2019.

AASB leases and insurance contracts

APRA is increasing its engagement with industry on the impacts and prudential implications of new accounting standards: AASB 16 *Leases (AASB 16)* and AASB 17 *Insurance Contracts (AASB 17)*. In May 2018, APRA wrote to all insurers outlining its expectations regarding the application of the capital framework to the assets and liabilities arising under AASB 16. APRA also released the results of a 2017 survey of a panel of insurers on the potential impacts of both AASB 17 and AASB 16.

APRA continues to monitor developments with AASB 17 both in terms of implementation and implications for APRA's regulatory framework. Consistent with its mandate, APRA's focus here is primarily on prudential soundness and protecting the interests of policyholders. APRA intends to conduct another survey once insurers are more advanced with their implementation, to better understand the quantitative impacts of the changes.

Life insurance

Life claims data collection

APRA and ASIC made significant progress over 2017/18 towards their goal of publishing credible, reliable and comparable life insurance claims and disputes data. The

APRA's supervision in action

A small insurance company supervised by APRA was writing a limited range of insurance products and distributing these through third party networks. Following claims deterioration and a significant loss of revenue, the insurer's ongoing business model and financial viability came into question. After breaching its prescribed capital levels and with concern over its long-term viability, APRA took a range of steps, including insisting on an injection of capital from its shareholder, to protect policyholders' interests. Despite the capital injection restoring the immediate financial condition of the insurer, following a series of discussions with the Board around the longer-term viability of the business model, it was agreed with APRA that to protect the policyholders, the insurance book would be run off. The run-off was supported by an Enforceable Undertaking (EU) by the shareholder of the insurer to inject further capital if required to meet obligations to policyholders. APRA monitored the conditions of the EU during 2017/18 to ensure all obligations to policyholders were met.

objective of this work is to promote the transparency and accountability of life insurers and to inform public debate. Prior to ASIC and APRA's data collection, meaningful comparisons on life insurance claims were difficult to make because insurers used a variety of definitions and had a wide range of differing systems, products and processes.

The first round of results from the pilot data collection was published at an industry-aggregate level in November 2017. A second round of industry-aggregate results was published in May 2018. The third and final round of pilot data collection is being conducted in mid-2018 and the results will be analysed by APRA and ASIC.

In May 2018, APRA sought feedback from industry and other stakeholders on moving the collection of life insurance claims and disputes data from a pilot to ongoing formal data collection. Formal reporting on life insurance claims and disputes data under the *Financial Sector (Collection of Data) Act 2001* is scheduled to commence in late 2018 and publication of data at an entity level is anticipated to commence in 2019.

LPS 230 reinsurance consultation

In March 2018, APRA remade *LPS 230 Reinsurance Management* due to the sun-setting on the previous LPS 230 Standard (which expired April 2018).

The previous LPS 230 required reinsurance contracts that are potentially financial reinsurance arrangements, or that include non-standard features or clauses that may affect the extent of risk transfer, to be submitted to APRA for approval. Financial reinsurance arrangements are reinsurance arrangements that may not genuinely transfer, for the life of the book of business being reinsured, significant insurance risk from the life company to another life company or a reinsurer. Given the potential adverse prudential consequences of such arrangements, and the difficulty of precisely defining when a reinsurance arrangement would require APRA approval, the previous LPS 230 required a wide range of contracts to receive APRA approval, and was very narrow in defining which contracts are exempt.

The new LPS 230 included amendments that introduce a more principles-based approach to determining whether an arrangement is a financial reinsurance arrangement that requires approval by APRA. The amendments clarified that APRA's focus when considering financial reinsurance arrangements is on arrangements that, when viewed as a whole, may give rise to potentially adverse prudential or policyholder outcomes. The revised standard came into effect from 1 April 2018.

Asset concentration risk charge review

During 2017, APRA received a number of queries about the increased use by APRA-regulated life insurers of reinsurance arrangements with non-registered, offshore reinsurers.

Following consideration of issues raised, including potential risks that may arise from further involvement of non-registered reinsurers in the Australian life market, APRA decided to undertake a review of *Prudential Standard LPS 117 Capital Adequacy: Asset Concentration Risk Charge*. APRA released a letter to all life insurers in December 2017, informing them of the upcoming review and also commenced gathering information relevant to inform the review. APRA anticipates consulting further with insurers during 2018/19.

APRA's supervision in action

APRA undertook a review of an insurance entity with a strong focus on revenue growth and concerns around sales practices. The review sought to identify any drivers of poor sales behaviour, and the control environment in place to prevent such behaviours. From the review, it became apparent that the risk management and compliance controls had not kept pace with the growth of the organisation. The review and associated supervisory engagement saw an uplift of risk governance practices within the entity, adjusted sales staff remuneration arrangements and a clearer understanding by the Board of its risk culture.

Individual disability income insurance

Disability income insurance (DII) offered to individuals outside superannuation (individual DII) has been an area of heightened focus for APRA since early 2017 due to this product's ongoing poor performance and adverse experience. To better understand the situation, in mid-2017, APRA embarked on a thematic review of insurers involved with individual DII, which is being conducted in two phases.

Phase one of the thematic review focused on APRA-regulated life reinsurers, and comprised a roundtable discussion in August 2017, followed by on-site meetings with those reinsurers. After communicating the key insights back to the participants, APRA has now commenced the second phase of this thematic review.

The knowledge obtained from phase one, together with reinsurers' responses to APRA's feedback, will be used to inform phase two. The focus of this second phase will be on primary writers driving the positive changes needed to mitigate the risk of deterioration in the performance of DII, and enhancing its sustainability to ensure that insurers remain willing to offer this product. APRA will pursue close engagement with a select group of primary individual DII writers, and the core activity will be a targeted review of their individual DII portfolios in the second half of 2018. APRA will, however, also continue its engagement with reinsurers to monitor their progress in the areas APRA has raised for consideration.

Private health insurers

Building resilience within the industry

Since assuming responsibility for the prudential regulation of private health insurers in 2015, APRA has undertaken a progressive review of the prudential framework applying to private health insurers to ensure it remains fit for purpose, as well as to build resilience to current and emerging risks. The review consists of three phases: risk management, governance and capital. Significant progress was made on phases one and two during 2017/18; attention will turn to phase three, capital, during 2018/19.

APRA continues to consult extensively with the PHI industry and other relevant stakeholders as the review of the prudential framework progresses.

Risk management consultation

In July 2017, APRA released a response to submissions, and finalised amendments, to the cross-industry *Prudential Standard CPS 220 Risk Management* (CPS 220). The amended CPS 220 came into effect for PHIs from 1 April 2018, aligning these important requirements with those that apply to ADIs and other insurers. APRA engaged with industry on transitional matters in the lead-up to the implementation date, and will continue to monitor implementation by insurers.

PHI governance

In February 2018, APRA began consulting on the second phase of its review of the PHI prudential framework, with proposals to strengthen standards for governance, fit and proper and audit requirements. The proposed new standards are aligned with those in place for other APRA-regulated industries. The proposals will facilitate effective decision-making by ensuring appropriately strong governance arrangements supported by competent and proper responsible persons. APRA also consulted on revoking an existing standard, *HPS 350 Disclosure to APRA*, as it is now redundant.

APRA will assess the feedback received in response to the consultation paper. APRA expects to finalise the new requirements soon, for implementation from 1 July 2019. As with CPS 220, APRA will closely monitor the implementation of the new requirements, and will engage with insurers on transitional arrangements on a case-by-case basis where appropriate.

Superannuation

Supervisory activity of RSE licensees

In mid-2017 APRA assessed the outcomes being delivered by superannuation trustees (RSE Licensees) to the members of their funds, based on key measures of historical member outcomes (such as net investment returns and fees) and indicators of future sustainability (such as net cash flows and asset growth).

Using industry-wide analysis of APRA's superannuation data, and supervisory knowledge of each RSE Licensee's business operations, APRA identified 26 superannuation funds offered by 14 RSE licensees that were regarded as 'outliers' and not consistently delivering quality member outcomes or appropriately positioned for future effectiveness and sustainability.[2]

The objectives, methodology and broad findings from this review were outlined in a letter to industry dated 31 August 2017.

Over 2017/18, APRA met with all 14 RSE licensees identified as part of this review and required them to develop an agreed strategy to address the identified concerns and improve the outcomes being provided for their members within a reasonably short period.

As at mid-August 2018, 10 of the RSE licensees have implemented (or commenced implementing) strategies to address the identified issues. Follow-up by APRA is continuing with the remaining four RSE licensees to finalise an agreed approach.

The agreed actions have included the wind-up, merger or restructuring of 13 funds, and subsequent exit from the industry of four of the seven RSE licensees of these funds. Members of these funds have (or will be) transferred to another superannuation fund, either under the same RSE licensee or to another RSE licensee as part of a successor fund transfer or merger; outcomes for these members are expected to be improved as a result. Further, four RSE licensees have reduced fees for six funds, to improve the outcomes for members of those funds.

APRA is engaging regularly with all of the originally identified RSE licensees, but particularly those where an action plan has not yet been agreed for all of the relevant funds, to ensure that progress to address the areas of concern identified by APRA and/or implementation of the agreed strategy occurs within an appropriate timeframe.

APRA will continue to monitor the outcomes that are being delivered for members of all APRA-regulated superannuation funds as part of its ongoing supervision activities, based on regular updates of its analysis as further data is reported to APRA

Prudential policy developments

Complementing the supervisory work on RSE licensee performance, APRA is close to finalising a package of changes to the superannuation prudential framework focused on lifting practices in assessing outcomes for members as well as business planning and fund expenditure.

APRA's consultation on these proposals began in August last year with a letter outlining, at a conceptual level, the areas it was looking to amend to strengthen key requirements in strategic and operational areas, and drive a focus on the delivery of outcomes for superannuation members. Following this preliminary consultation, APRA released a discussion paper and accompanying draft prudential standards and guidance in December 2017.

APRA's supervision in action

APRA raised concerns with a trustee of a superannuation fund over a range of issues impacting outcomes for members. Of particular concern to APRA were fee structures and investment performance in the MySuper product. Following challenge by APRA, the trustee agreed to strengthen oversight and benchmarking over member outcomes. This has seen immediate benefit to members with a MySuper account, with the exit fee removed and the total administration and investment fee falling by approximately 40 per cent. APRA also raised concerns around the performance of the fund's cash investment option, particularly in regard to the fee structure, which resulted in the trustee reducing those fees by approximately 45 per cent. APRA continues to engage with the trustee on plans to review fees on other products offered.

2. Initially 28 RSEs were identified however two RSEs were removed from the initial list as they were closed defined benefit funds for which the employer fully bears the cost.

APRA's supervision in action

A small superannuation entity supervised by APRA experienced a steady reduction in members over a number of years and had a high proportion of inactive accounts. APRA challenged the trustees over the ongoing viability of the superannuation fund, and the detrimental impact its current structure could have on member outcomes. Following engagement with APRA, the trustees accepted the concerns and agreed to exit the industry via a merger with a larger party. When complete, this will deliver a sustainable offering to members with reduced fees and improved services.

Industry feedback supported the intent of the proposals but raised concerns about the level of prescription and the feasibility of meeting some of the requirements associated with the proposed member outcomes assessment. APRA has reflected on this feedback and is considering changes to the key requirements to ensure a principle-based approach that drives behavioural change, rather than a solely compliance-based exercise. APRA aims to ensure that the final changes will promote a member-focused and transparently managed industry, which delivers sound outcomes and is appropriately positioned for future effectiveness, resilience and viability in a competitive environment.

Thematic reviews

In May 2018 APRA released the findings of its thematic review into board governance practices in the industry. The review examined how well RSEs were meeting the requirements of *Prudential Standard SPS 510 Governance* (SPS 510), which was introduced on 1 July 2013. The review covered 29 licensees of various types, sizes, ownership models and board structures, and focused on board composition, board appointment and renewal, and approaches to board performance assessments. Based on the findings of the review, APRA issued a number of recommendations to ensure RSE boards have the optimum mix of skills, capabilities and experience needed to effectively carry out their responsibilities.

Also in May, APRA published a letter to industry calling for greater focus by superannuation licensees on administering outsourcing arrangements with related parties to effectively manage conflicts of interest. This recommendation drew on findings of a review of 14 licensees, comprising a cross-section of fund type, size and ownership structure. The review was prompted by concerns that some licensees' management of commercial relationships with related parties could detract from the outcomes delivered to their members, an area that has also more recently been a focus of the Royal Commission. Opportunities for improvement identified by APRA included embedding clear and measurable performance indicators in related party contracts, conducting rigorous market testing when entering into or renewing contracts, and proactively considering and documenting how decisions to use related party service providers are in the best interests of superannuation members.

RESOLUTION AND ENFORCEMENT

The purpose of APRA's resolution function is to plan and implement prompt and effective responses to the failure of a regulated institution or a crisis in the financial system. These responses could include early intervention with problem entities through to resolution of a failed institution, including administration of the Financial Claims Scheme (FCS). Work during the 2017/18 year continued to focus on APRA's strategic initiative to further build recovery and resolution capability, as well as supporting supervisors in formulating responses to problem entities. Key areas of activity over the period are outlined below.

Policy development

APRA worked with Treasury to progress crisis-related legislative reform as recommended by the Financial System Inquiry. This culminated in the enactment of the *Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Act 2018*.

The legislation strengthens APRA's crisis management powers which are critical to its ability to plan for, and act promptly to effectively deal with, failures and crises in a manner that protects beneficiaries and promotes financial system stability.

Recovery planning

Recovery plans generally comprise a menu of options, with supporting information, which can be implemented by a regulated institution to restore itself to a sound financial position following a severe stress. APRA's aim is to move its regulated industries to a point where institutions are better prepared to recover from severe stress by having credible and realistic recovery plans.

Over 2017/18, APRA conducted a further phase of its thematic review of recovery planning with larger ADIs. APRA will conduct a further benchmarking exercise of the revised recovery plans, which are due to be submitted by these ADIs in 2019. A similar thematic review has also begun with large general insurers and life companies, with recovery plans submitted for review in mid-2018. APRA is also conducting recovery planning with smaller ADIs and insurers where applicable, so their recovery plans are proportionate to their size and complexity.

Following the enactment of the *Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Act 2018,* APRA now intends to commence development of a formal prudential standard on recovery and resolution planning.

Financial Claims Scheme

The FCS is designed to protect Australian depositors and general insurance policyholders in a situation in which an ADI or general insurer fails. Administration of the FCS, once it is activated by the Australian Government, is one of APRA's primary responsibilities. In the 2017/18 financial year, APRA collected a large amount of information from ADIs relevant to the FCS, and completed work that gave APRA a view of the level of their FCS preparedness. Formal collection of FCS data and systems information will commence once the recently developed and released *Reporting Standard ARS 910 Financial Claims Scheme Data Collection* takes effect from the end of 2018.

APRA has continued to conduct FCS prudential reviews of ADIs, which help to identify entity-specific and industry-wide issues with FCS operational readiness. This year APRA also carried out benchmarking of all external auditors' FCS assurance reports and CEO attestations from the past 12 months. Key themes emerging from these activities will be relayed to industry and other bodies in order to clarify expectations and improve overall FCS readiness. FCS reviews and other initiatives to improve readiness will continue in 2018/19 given the important role that the FCS plays in supporting the stability of the Australian financial system.

Enforcement

APRA's supervisory approach is aimed at identifying and evaluating potential risks in regulated institutions at an early stage, and seeking to appropriately mitigate those risks before they pose a threat to the institution's viability. Should a regulated institution be unwilling or unable to take necessary corrective action, APRA can use its formal enforcement powers to protect the interests of depositors, policyholders and superannuation fund members. The powers APRA can use to achieve these outcomes include powers to issue formal directions, obtain information, remove and/or disqualify directors or senior managers, and commence investigations or proceedings against institutions.

> ***APRA can use its formal enforcement powers to protect the interests of depositors, policyholders and superannuation fund members.***

Throughout 2017/18, APRA's enforcement team continued to support frontline supervision in developing and executing appropriate responses to supervisory concerns in order to address prudential issues before more intrusive intervention measures were required. In cases where the use of a formal power was required to address prudential issues, APRA's enforcement and legal teams worked with frontline supervision to execute the relevant power. Examples of powers used in 2017/18 include issuing notices requiring information (ADI and superannuation), appointing a person to investigate and report on prudential matters (ADI) and issuing formal directions (general insurance).

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 restrictions on the use of certain words and phrases under relevant legislation.[3]

Additionally, APRA's enforcement function worked alongside other APRA teams to assist in a variety of projects including policy development, the prudential inquiry into the Commonwealth Bank of Australia, and APRA's responses to the Royal Commission. APRA continues to strengthen its processes for information-sharing and collaboration with other regulators and law enforcement agencies to ensure its supervisors have access to, and can assess the implications of, any relevant information about their regulated institutions.

DATA COLLECTION, ANALYTICS AND STATISTICAL ACTIVITIES

Data collections for APRA's primary activities

APRA collects, stores and analyses data to inform its core supervisory work, assist policy development, and support other government agencies. To effectively fulfil its role, APRA requires accurate data, received in a timely manner, through a secure channel. Advances in data, analytics and technology are increasing the capabilities of individuals, organisations and governments to use data, enabling them to deliver value in new ways.

To capitalise on these advances, APRA is undertaking a substantial data transformation program. This program will fundamentally change all aspects of APRA's data management by modernising how it collects, stores, analyses and innovates with data. Replacing the current data collection system, 'Direct to APRA' (D2A), with a more modern, efficient system is an integral part of APRA's data transformation program.

> *APRA will select and implement a new Data Collection Solution in 2019 and transition reporting entities to the new solution in 2020.*

In February 2018, APRA commenced engagement with stakeholders on replacing D2A and received feedback on desired solution features that would deliver benefits for reporting entities and reduce transition and ongoing costs. APRA will select and implement a new Data Collection Solution in 2019 and transition reporting entities to the new solution in 2020. APRA will maintain engagement with stakeholders throughout the implementation and transition period. To support this ongoing engagement, APRA has established a strategic reference group and two technical working groups with representatives from all regulated industries and service providers. These groups will meet regularly from 2018 to 2020.

Statistical publications

APRA introduced two new general insurance publications in November 2017.

The annual General Insurance Claims Development Statistics publication details trends in claims payments and reserves across the general insurance industry by class of business. With this publication, APRA aims to enable a better understanding of the performance of each class of business as it develops over time, which is particularly relevant for the long-tail classes of business.

3. In the 2017 Budget, the Treasurer announced a proposed change to the *Banking Act* to permit all ADIs to use the word 'bank' in their business or corporate name. That change took effect in May 2018.

The Quarterly General Insurance Institution-level Statistics publication contains individual insurer information relating to financial performance, financial position, capital adequacy and key ratios. It supplements the existing annual institution-level statistics publication.

Data collections for other agencies

APRA collects data from regulated and unregulated institutions to assist the Reserve Bank of Australia (RBA), Australian Bureau of Statistics (ABS), 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 is used by these agencies to support their policy making and statistical roles in relation to the Australian economy. In March 2018, following broad consultation with stakeholders, APRA finalised the data quality framework for data collected from ADIs and RFCs on behalf of the RBA and ABS. The data quality framework seeks to balance the cost to reporting entities against the requirements of the RBA and ABS for relevant, timely and accurate data to be used in analysis, for publication and for policy-making purposes. Reporting will commence in multiple phases over 2019 and 2020.

DOMESTIC LIAISON

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 Council of Financial Regulators (CFR). Beyond the members of the CFR, APRA also has active engagement with a range of other domestic bodies. These engagements are typically guided by a Memorandum of Understanding (MoU) which, although not legally binding, signifies a commitment to cooperate and share relevant information, and establishes the practical arrangements by which this will occur. Many of these MoUs are available on APRA's website.

List of domestic MoUs

Agency
Australian Bureau of Statistics
Australian Capital Territory Compulsory Third-Party Insurance Regulator
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 Accidents Authority of NSW
Motor Accident Insurance Commission of Queensland
Office of Fair Trading
Reserve Bank of Australia
South Australia Compulsory Third-Party Insurance Regulator
WorkCover Tasmania

List of domestic agencies and organisations that APRA met during 2017/18

Public Sector	Private Sector
Australian Accounting Standards Board	Actuaries Institute
Australian Auditing and Assurance Standards Board of Australia	Association of Superannuation Funds
Australian Bureau of Statistics	Australian Bankers' Association
Australian Competition and Consumer Commission	Australian Financial Markets Association
Australian National Audit Office	Australian Institute of Superannuation Trustees
Australian Reinsurance Pool Corporation	Australian and New Zealand Institute of Insurance and Finance - Reinsurance Discussion Group
Australian Securities and Investments Commission	Banking and Finance Sector Group
Australian Taxation Office	Corporate Superannuation Association
Australian Transaction Reports and Analysis Centre	Customer Owned Banking Association
Commonwealth Treasury	Financial Services Council
Compulsory Third Party Insurance Regulator (SA)	FinTech Australia
Council of Financial Regulators	Friendly Societies of Australia
Department of Foreign Affairs and Trade	Industry Super Australia
Department of Health	Insurance Council of Australia
Motor Accident Insurance Commission of Queensland	Insurance in Super Working Group
Productivity Commission	InsureTech Australia
Reserve Bank of Australia	Members Health Fund Alliance
State Insurance Regulatory Authority	Regtech Association

STAKEHOLDER 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.

	2016/17	2017/18
Policy consultations conducted	12	15
Information letters issued to industry	40	30
Presentations at formal speaking engagements	73	93
Media releases issued	57	70
Parliamentary hearings attended	9	12
Submissions to formal inquiries	4	6

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 how international standards evolve.

APRA has formal bilateral information-sharing arrangements with 32 overseas regulatory agencies through MoUs and letters of exchange. APRA is one of 68 signatories to the International Association of Insurance Supervisors (IAIS) multilateral MoU arrangements that now cover agencies supervising insurers which write around 72 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 or participated in during 2017/18:

- 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
- 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
- OECD Working Party on Private Pensions

- 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 2017/18:

- Asian Development Bank
- Asia-Pacific Economic Cooperation – Financial Regulators Training Initiative
- Association of Financial Supervisors of Pacific Countries
- Financial Stability Institute
- International Monetary Fund
- 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 2017/18, APRA received visits from 37 international delegations from 17 countries, most commonly from South Korea and 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 addition to international engagements for core business purposes, APRA undertakes targeted technical assistance activities, primarily in the Asia-Pacific region. These activities support whole of Government initiatives that seek to improve governance in the region, and provide valuable interactions 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 and, to a lesser extent, the International Monetary Fund (IMF) and the World Bank.

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. All such activities are subject to postponement or cancellation in the case of core business priorities. Nevertheless, as well as strengthening the prudential frameworks and activities of the partner agencies involved, these activities offer APRA valuable staff development and retention benefits.

APRA engages with the Indonesian agencies – Otoritas Jasa Keuangan (OJK) and Bank Indonesia (BI) – under the Government Partnership Fund program. During 2017/18, this engagement primarily consisted of APRA hosting six secondments of staff from OJK, which focused on risk-based prudential supervision, and on- and off-site review techniques, including risk-rating procedures. APRA also hosted two visits by OJK staff to discuss APRA's supervision framework, risk-based approach to supervision and financial technology.

In the Pacific region, APRA supported five training programs under the multilateral Government Partnerships for Development program with Pacific prudential regulators. Outside of this program, APRA assisted the Financial Supervisory Commission of the Cook Islands on a bilateral basis by providing an APRA expert for an additional on-site training program. The on-site training programs over the year ranged across banking, superannuation and general insurance.

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 four regional conferences in Fiji, Laos, New Zealand and Singapore. Two APRA experts participated in the World Bank's and International Credit Union Regulators' Network's technical assistance missions in India and South Africa respectively.

CH/4 PERFORMANCE

PERFORMANCE

Through prudential supervision of ADIs, insurance and reinsurance companies and most superannuation funds, APRA aims to protect the financial interests of Australia's depositors, policyholders and superannuation fund members.

APRA's prudential powers are enabled primarily by the *Australian Prudential Regulation Authority Act 1998* (APRA Act) which grants APRA the ability to regulate financial services industry 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*.

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).

Under the PGPA Act, APRA must publish a Corporate Plan setting out information on its 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 APRA's website. (APRA has recently published its Corporate Plan for 2018-2022 - this is also available on APRA's website).

The PGPA Act also requires APRA to prepare an *Annual Performance Statement*, to be included in its *Annual Report* to Parliament, to report on performance against the Corporate Plan. In doing so, APRA draws on a range of indicators and qualitative information relevant to each of its core functions, capabilities and strategic initiatives.

These performance measures are disclosed in the Annual Performance Statement, included in this Annual Report.

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 with the Australian community and on the community as a whole.

Adherence to OBPR processes provides an important indicator of whether APRA has been able to achieve an appropriate balance in undertaking its mandate, and provides for open and transparent consideration of stakeholder views, including the publication of stakeholder submissions and APRA response papers.

During 2017/18, APRA continued to meet the OBPR requirements in its policy development activities.

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.

The RPF seeks to improve the way regulators operate, reduce the costs incurred by business, individuals and the community from the administration of regulation, and increase the public accountability and transparency of regulators. The Framework establishes six outcome-based Key Performance Indicators (KPIs) that apply to all regulators.

In accordance with the timetable required by the Government, APRA published its 2016/17 self-assessment against the six KPIs included in the RPF in December 2017, and will publish its self-assessment for 2017/18 in December 2018.

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 the 2017/18 reporting period, as required under paragraph 39(1)(a) of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act). In my opinion, this annual performance statement accurately presents the performance of APRA and complies with subsection 39(2) of the PGPA Act.

Purpose

APRA is an independent statutory authority established for the purpose of prudential supervision of financial institutions and for promoting financial stability in Australia.

APRA's role is to regulate relevant financial institutions through a robust prudential framework of legislation, prudential standards and guidance, which aims to ensure that risk-taking is conducted within reasonable bounds and that risks are clearly identified and well-managed.

In performing and exercising its functions and powers, APRA is required to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality, and in doing so to promote financial system stability in Australia [Outcome 1: Portfolio Budget Statement 2017/18].

This performance statement reports on the results of APRA's performance against its purpose and objectives as set out in its *2017-2021 Corporate Plan.*

Results

Given APRA's role is to protect the interests of depositors, policyholders and superannuation fund members (which APRA refers to collectively as its 'beneficiaries'), there are two important indicators used to measure APRA's performance – the Performing Entity Ratio (PER) and the Money Protection Ratio (MPR). These metrics have been calculated since APRA's establishment in 1998.

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

APRA endorses the view expressed in the *Government's Statement of Expectations*[1] that '...prudential regulation cannot and should not seek to guarantee a zero failure rate of prudentially regulated institutions or provide absolute protection for market participants. A regulatory approach with such intensity would remove the natural spectrum of risk that is fundamental to well-functioning markets, and ultimately reduce the efficiency and growth of the Australian economy' As such, APRA does not pursue a zero failure objective. APRA seeks to maintain a low incidence of failure of APRA-regulated institutions while not impeding continued improvement in efficiency or unduly hindering competition. APRA aims to identify likely failures early enough so that corrective action can be promptly initiated or orderly exit achieved.

1. Statement of Expectations (2018)

The following ratios indicate that APRA has broadly achieved this objective

Performance indicator	Description	2017/18 result (%)	10 year average (%)	20 year average (%)
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.	100.00	99.93	99.93
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.	100.00	99.99	99.97

Table 1 on the following page provides a summary of the number of failures, the dollar value of losses, the dollar value of protected accounts and the annual PER and MPR by financial year. While the incidence of loss has declined since APRA's formation, the value of protected accounts has considerably increased reflecting strong growth in the size of the Australian financial system.

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	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	706	3,319,391	100.00	100.00
2015	0	0	681	3,628,841	100.00	100.00
2016	0	0	660	3,870,659	100.00	100.00
2017	0	0	602	4,100,235	100.00	100.00
2018	0	0	573	4,451,132	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. From 1 July 2015, APRA became the prudential regulator for private health insurers. This has been reflected in the Table 1.
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 $4,451 billion at end-June 2018. From 1 July 2015, APRA became the prudential regulator for private health insurers. This has been reflected in Table 1.
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.

Table 2 – 10 year and 20 year PER and MPR averages by industry

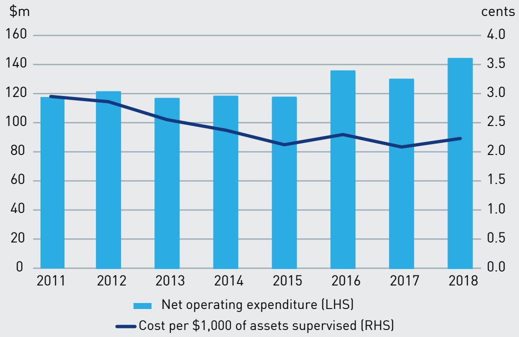
	ADI		GI		LI		Super		PHI*
Average (%)	10 year	20 year	10 year	20 year	10 year	20 year	10 year	20 year	3 year
PER	100.00	100.00	99.92	99.76	100.00	100.00	99.92	99.92	100.00
MPR	100.00	100.00	100.00	99.34	100.00	100.00	100.00	99.99	100.00

*APRA became the prudential regulator for private health insurers from 1 July 2015. Therefore only 3-year PER and MPR averages are reported.

As well as ensuring a low incidence of failure, APRA seeks to ensure it operates efficiently. APRA's total operating expenditure for the 12 months to 30 June 2018 was $144.0 million, against the original budget of $141.6 million. The over-expenditure primarily arose from unbudgeted costs associated with a Prudential Inquiry, partially offset by lower than budgeted staff numbers and delays in deploying new assets from projects.

Relative to the size of the industries that APRA supervises, the cost per $1,000 of assets supervised was 2.2 cents in 2017/18. This compared with approximately 3.0 cents per $1,000 of assets supervised at the start of the decade.

Figure 1: Costs per $1,000 of assets supervised by APRA



Analysis of performance against purpose

The strength of the annual PER and MPR for 2017/18 reflects an Australian financial system that is broadly in good health. This is primarily due 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, broader financial stability vulnerabilities and the global regulatory agenda.

In line with its *2017-2021 Corporate Plan*, APRA continued to strengthen its core supervision, policy and resolution functions and underlying capabilities (its people and culture, its risk intelligence and frameworks, and its organisational effectiveness and infrastructure) during the year. This strengthening was aided by the strategic initiatives outlined in APRA's *2017-2021 Corporate Plan*:

- enhancing leadership, culture and opportunities for its staff;
- honing internal governance and workplace effectiveness;
- sharpening risk-based supervision; and
- building recovery and resolution capability.

Core functions – supervision, policy and resolution

Supervision

In 2017/18, APRA maintained its proactive onsite and offsite supervision activities designed to identify and evaluate material risks in regulated institutions at an early stage and ensure that these risks were appropriately mitigated.

A key outcome from supervision activities in 2017/18 (and earlier) was improvements to housing lending standards and practices within ADIs. As a result of these improvements, in April 2018 APRA indicated its willingness to remove the temporary 10 per cent investor loan growth benchmark from 1 July 2018. APRA also commenced consultation on revised capital requirements for housing lending, designed to ensure that regulatory capital requirements for this important component of lending remained commensurate with underlying risks.

> ***APRA has maintained its focus on improving risk culture and governance practices in APRA-regulated industries.***

APRA also completed an extensive benchmarking review of remuneration practices at large financial institutions across regulated industries.[2] In response to the outcomes of the review, which identified considerable room for improvement in industry practices, APRA

2. Information Paper: *Remuneration practices at large financial institutions* (April 2018).

is engaging with individual institutions on the findings as part of ongoing supervisory work as well as examining ways to strengthen the prudential framework more broadly.

As acknowledged in APRA's *2017-2021 Corporate Plan*, there remains heightened public scrutiny on conduct across the financial sector (which has now culminated in the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry), and APRA has maintained its focus on improving risk culture and governance practices in APRA-regulated industries.

In the superannuation sector, this was evidenced by APRA's work to promote a strong focus amongst trustees on delivering quality, value outcomes for members. This work, while still relatively new, has generated a number of changes to trustees' business models and/or products designed to respond to measures of under-performance.

In August 2017, APRA established an independent prudential inquiry into the Commonwealth Bank of Australia (CBA) to examine the governance, culture and accountability frameworks and practices within the group. The final report released in May 2018 identified a number of findings and recommendations, and provided important insight for all financial institutions in these domains. As a result of the prudential inquiry, CBA provided an Enforceable Undertaking by which CBA's remedial action in response to the report will be monitored. APRA also applied a $1 billion add-on to CBA's minimum capital requirement.

APRA continued to integrate private health insurers (PHIs), which came under APRA's purview in July 2015, into its prudential and supervision frameworks. APRA's focus in 2017/18 has been on reviewing risk management, governance and decision-making.[3] APRA also sought information from private health insurers in February 2018 on the extent to which stress testing is utilised across the industry. Stress testing complements APRA's prudential requirements and risk-based supervision activities and is designed to improve the readiness of the financial system to withstand adversity, by enhancing capital management, informing recovery planning and reducing the likelihood for failure and resolution.

Policy

APRA continued to deliver reforms to the prudential framework across all regulated industries during the year through a thorough and consultative policy process consistent with the Office of Best Practice Regulation principles. APRA released or progressed a number of enhancements to the prudential framework including the calibration of benchmarks for 'unquestionably strong' capital ratios for ADIs; proposed revisions to capital, large exposure and counterparty credit risk frameworks for ADIs; updated reporting standard on residential mortgage lending; risk management for private health insurers; and industry consultation on strengthening the focus on member outcomes by superannuation entities.

For all changes to the prudential framework in 2017/18, APRA achieved 100 per cent compliance with OBPR requirements.

Throughout the year, APRA also provided input to the Australian Government across a range of other legislative initiatives designed to strengthen the prudential framework, including the new banking executive accountability regime (BEAR) and various reforms in superannuation.

In June 2018, APRA released a final package of measures to clarify and strengthen the role of the Appointed Actuary within general, life and private health insurers.[4] The revised prudential standards and guidance will come into effect on 1 July 2019 and are expected to improve prudential outcomes by focusing the Appointed Actuary on key decisions that impact the financial condition of the insurer. The extent of that impact will depend on the efforts of industry to engage with the opportunity afforded by these changes.

3. Consultation package: *Governance, Fit and Proper, and Audit Prudential Standards for the private health insurance industry* (September 2018).

4. Consultation package: *Role of the Appointed Actuary* (June 2018).

APRA's *2017-21 Corporate Plan* also highlighted the increasing prominence of technology-related matters in financial institutions' business plans and strategy. Technology can bring both benefits (for example, through fintech developments) and risks (for example, of cyber-crime). In response to an increase in innovation and technology-driven products and services that has seen the introduction and growth of non-traditional companies seeking to provide financial services, APRA refreshed its licensing framework in May 2018 by introducing a phased approach to licensing ADIs and in doing so established a new pathway for financial entities to become registered as an ADI in Australia. At the same time, in recognition of the growing threat posed by cyber-crime to financial institutions, APRA proposed to introduce a new prudential standard on information security management, *Prudential Standard CPS 234 Information Security*, to apply across all regulated industries. CPS 234 is expected to be finalised later this year with a view to implementation from July 2019.

In delivering policy reforms, APRA continued to play an active role in relevant domestic and 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.

Resolution

A major milestone during the year was the passing of the *Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Act 2018* in February 2018 to strengthen APRA's powers to plan for, and respond to, the failure of an ADI or insurer. This involved a considerable amount of effort and coordination across regulatory agencies and laid the foundation for the evolution of the prudential framework for crisis management.

In parallel, APRA progressed its internal readiness to resolve failures and near-failures and continued to assess and provide feedback to a selected group of regulated institutions on the credibility and proportionality of recovery plans. APRA continued its engagement with the Council of Financial Regulators (CFR) agencies to promote financial system stability in Australia and, with other key agencies such as through the Trans-Tasman Banking Council, conducted a crisis simulation exercise involving New Zealand authorities to test the preparedness of regulatory agencies to respond to a crisis.

Core capabilities – people and culture, risk intelligence and frameworks and organisational effectiveness and infrastructure

People and culture

In 2017/18, changes were made to APRA's organisational structure, leadership team and governance arrangements. A wholesale review of APRA's strategy was also undertaken to ensure APRA continues to deliver on its mandate and is able to respond to emerging trends and risks in a rapidly changing environment. APRA also refreshed its core 'Values' (Integrity, Collaboration, Accountability, Respect and Excellence) which underpin its organisational culture and made progress in refreshing its Inclusion & Diversity strategy to continue to promote diversity of thinking, inclusive leadership and a high performing culture.

Risk intelligence and frameworks

APRA commenced engagement across the Australian financial services sector on one of its largest programs in its 20-year history: the modernisation of APRA's data collection systems infrastructure. This is a significant stage in this multi-year program which, when complete, is intended to transform how APRA collects, stores and delivers data to its supervisors, industry and the public with the objective to have an easy-to-use system able to collect high-quality data and that is adaptable to future business needs. The goal is to have the new collections solution operational in 2020.

APRA also worked closely throughout 2017/18 with the Australian Securities and Investments

Commission (ASIC) to collect and publish comprehensive and reliable life insurance claims information.

Organisational effectiveness and infrastructure

Four significant external reviews impacting APRA began in 2017/18. Firstly, the International Monetary Fund (IMF) commenced its Financial Sector Assessment Program (FSAP) to provide an integrated and objective diagnostic analysis of stability and development issues in the Australian financial sector. The last FSAP for Australia was undertaken in 2012. The 2018 FSAP is due to be completed in December 2018 with the IMF expected to release its final report in early 2019. The FSAP involves extensive collaboration between APRA, ASIC, the Reserve Bank of Australia, and Treasury.

Secondly, the Royal Commission into Misconduct in Banking, Superannuation and Financial Services also commenced during the year. APRA is continuing to provide relevant information to assist the Commission with its inquiries. The Commission's final report is due to be released in February 2019.

Thirdly, APRA responded to the Productivity Commission's draft report on *Competition in the Australian Financial System* in March 2018. The submission responded to the findings and recommendations in the draft report that specifically relate to APRA and its role within the financial system, including APRA's actions with respect to the residential mortgage lending practices of banks. The Commission's final report was publicly released on 3 August 2018.

Fourthly, APRA has assisted the Productivity Commission with its draft report on Superannuation: Assessing Efficiency and Competitiveness. This assistance has included a formal submission, as well as the provision of industry data and background briefings.

The findings and recommendations from the FSAP, Royal Commission and the Productivity Commission reviews will be carefully considered by APRA with a view to improving organisational effectiveness where warranted.

Accountability

APRA is committed to appropriate transparency in the pursuit of its mandate, and does so through a number of methods, including publications, reporting, speeches and appearances before Parliament. To give greater visibility to these mechanisms, APRA recently set out an overview of its accountability requirements on its website.

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 to Parliament and the public on APRA's performance and how it continues to strengthen its ongoing ability to meet its purpose.

CH/5
GOVERNANCE AND RESOURCING

GOVERNANCE AND RESOURCING

THE APRA MEMBERS 2017/18

Under the *Australian Prudential Regulation Authority Act 1998* (APRA Act), the 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, FIAA – Deputy Chairman and Member

Helen Rowell was appointed as an APRA Member in July 2013, the Deputy Chairman of APRA in November 2015, and reappointed for a further five-year term from 1 July 2018. Mrs Rowell's responsibilities include oversight of the (APRA-regulated) superannuation industry.

Mrs Rowell joined APRA in 2002 as General Manager, Industry Technical Services. Other senior roles held by Mrs Rowell include General Manager, Policy Development, General Manager, Diversified Institutions Division and Executive General Manager, Supervisory Support Division. She was the Chair of APRA's (cross-divisional) general insurance industry group from 2006 to 2011. Mrs Rowell represented APRA at various sub-committees 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 also represents APRA at the OECD Working Party on Private Pensions and International Organisation of Pension Supervisors. Prior to joining APRA, Mrs Rowell was a partner at the international consulting firm Towers Perrin. She is also a Fellow and past President of the Institute of Actuaries of Australia.

Mr Geoff Summerhayes

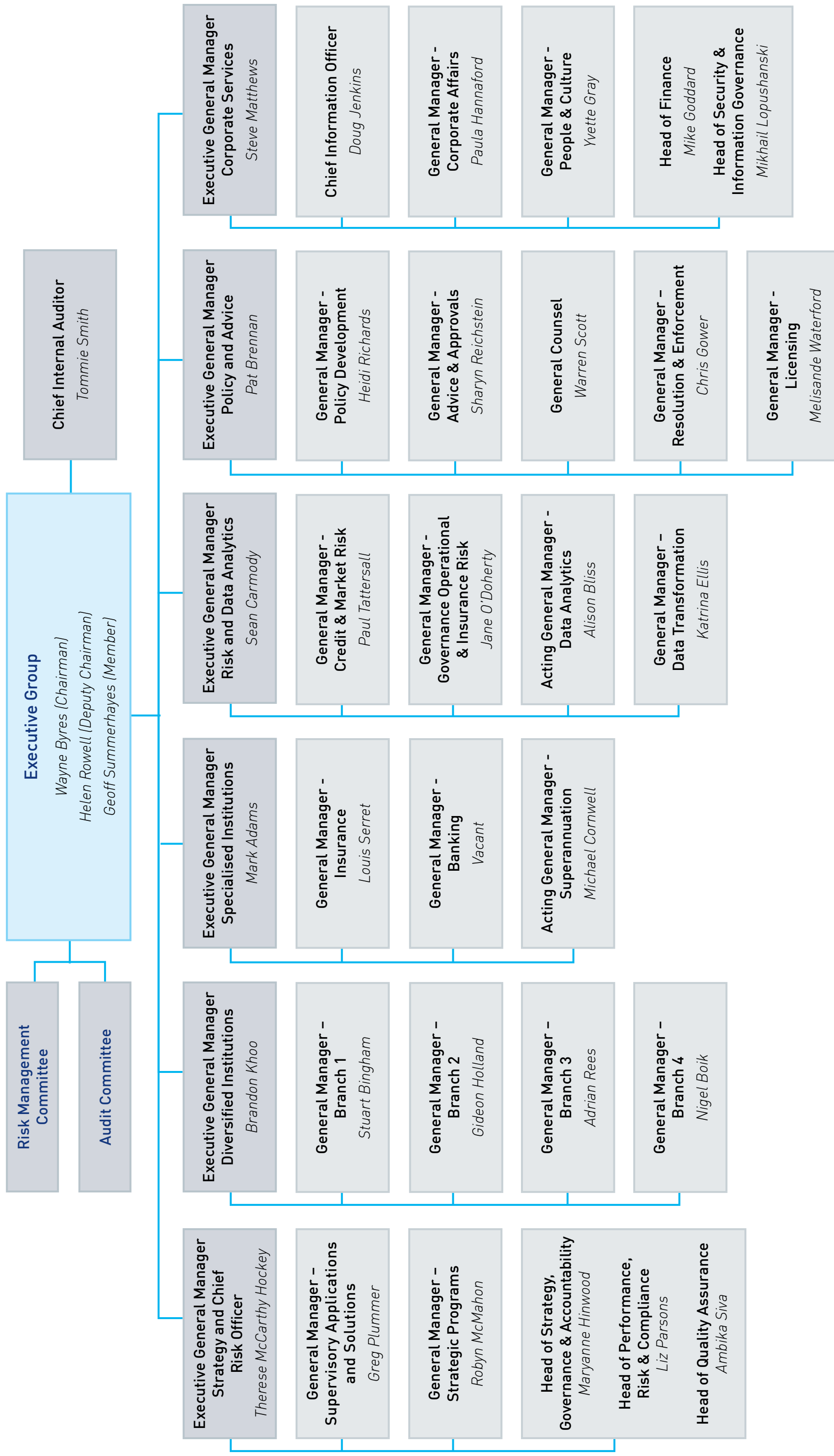
B Bus, GMQ (AGSM) – Member

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 Chair of the United Nations Environment's Sustainable Insurance Forum and a member of the Executive Committee Champion for Sustainability at the International Association of Insurance Supervisors.

ORGANISATION CHART



RISK MANAGEMENT AND AUDIT

APRA's risk management and audit matters are subject to oversight by the Risk Management Committee and 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, compliance with applicable laws and regulation, and internal performance reporting.*

This includes assisting the APRA Chairman assess 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 reporting, external performance reporting responsibilities, and APRA's systems of internal control.

The Risk Management Committee met five times during the year. The Committee reviewed and assessed the Enterprise Risk Management Framework, Compliance Framework and Performance Reporting Framework, including their application and use across APRA. It 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 the year. 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 with regards to APRA's annual financial statements and annual performance statement.

In addition to its members, the Australian National Audit Office (ANAO), Chief Internal Auditor, Executive General Manager Enterprise Performance, and APRA management representatives are regular attendees at meetings of both committees.

The members of the Risk Management Committee and Audit Committee in 2017/18 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 was reappointed for a further two-year term on 1 January 2018. She 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 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 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 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 Limited (since February 2015), acting as Chair of the Audit, Governance and Risk Management Committee and as a non-executive director of Orora Limited (since March 2014), where she is Chair of the Audit and Compliance Committee and non-executive director of Nine Entertainment Co. Holding Limited (since March 2017), where she is Chair of the Audit and Risk Committee.

Mrs Helen Rowell

APRA Deputy Chairman and Member

For bio please see page 59.

Further information on attendance at Risk Management Committee and Audit Committee meetings is provided in Chapter 7 – Statutory Reports and Appendices.

FINANCIAL RESOURCES

APRA's expenditure

APRA's total operating expenditure for the 12 months to 30 June 2018 was $144 million against a budget of $141.6 million. The over-expenditure related to unbudgeted costs associated with the CBA Prudential Inquiry, partially offset by lower than budgeted employee numbers and delays in acquiring new assets.

APRA's income

APRA's total income in 2017/18 was $147.5 million against a budget of $143.5 million. The income surplus was primarily driven by a small under-collection in industry levies, lower licencing and other fees offset by unbudgeted cost recoveries associated with the CBA prudential inquiry.

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 relevant 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.

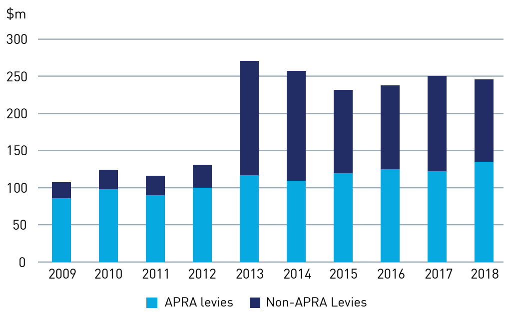
Levies are also collected to cover the costs of the National Claims and Policies Database (NCPD); in this case a rate is applied to the gross earned premiums of general insurers that contribute to this database. The amount raised for NCPD purposes in 2017/18 was $0.9 million.

The total levies collected by APRA also cover certain costs attributable to ASIC, the ATO, the Department of Human Services, the ACCC and for the final year, the Government's SuperStream initiative[4]. Total levies collected by APRA, including on behalf of these agencies, in 2017/18 were $246 million.

On an annual basis, APRA releases a Cost Recovery Implementation Statement to provide further transparency on the APRA component

4. The SuperStream collection completed in 2017/18.

Figure 2 - Financial industry levies



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 2017/18 were $428.4 million.

Reserves

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

- APRA's retained surpluses increased by $2.5 million to $20.4 million, attributable to an operating surplus from ordinary activities of $3.5 million, offset by a transfer of $1.0 million to the Contingency Enforcement Fund; and
- The Contingency Enforcement Fund was increased by $1.0 million from retained surpluses to $7.0 million, attributable to a planned growth in the size of the fund arising from the BEAR. This increase provides APRA with greater powers to enforce the BEAR legislation. APRA will continue to grow this fund by $1.0 million per year to further grow this capability in the coming years.

With these items, total reserves increased to $51.3 million. This included contributed equity of $16.7 million and an Asset Revaluation Reserve of 7.2 million, both of which were unchanged over the year.

TALENT AND DEVELOPMENT

People resources

At 30 June 2018, APRA's total permanent employee headcount was 630.6 on a full-time equivalent (FTE) basis, which was an increase from 600 at 30 June 2017 *(see Figure 3)*. APRA's turnover increased from 7.3 per cent in 2016/17 to 8.3 per cent during 2017/18 *(see Figure 4)*.

Figure 3 – APRA staffing (as at end June)

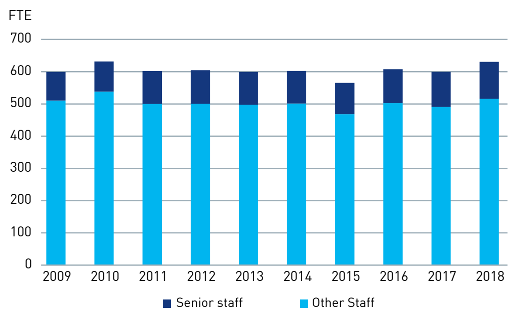
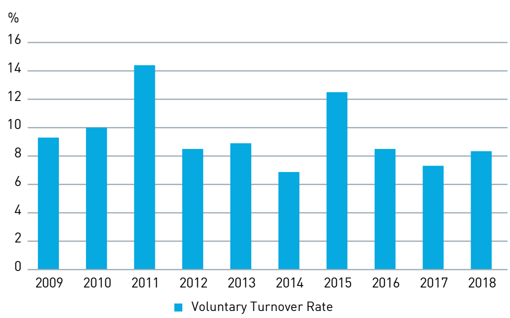


Figure 4 – Voluntary turnover rate



APRA is focused on maintaining a highly skilled workforce that comprises a strong blend of supervisory and industry expertise. This is essential for a supervision-led regulator such as APRA, which relies heavily on the judgement and experience of its employees to achieve sound prudential outcomes. While APRA has been reasonably successful in building and retaining supervisory experience within its employee base, maintaining the level of industry experience remains a challenge (*see Figure 5*).

Figure 5 – Employee supervisory experience levels

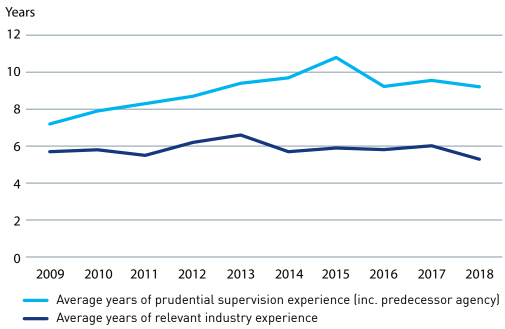
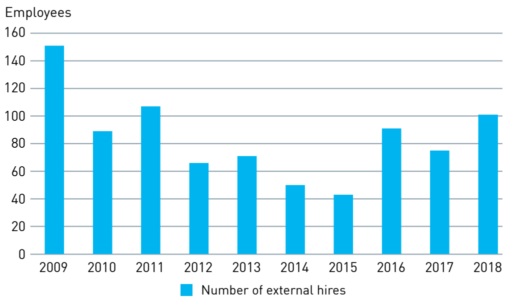


Figure 6 – External recruitment



Building organisational and individual capabilities remained a priority for APRA during 2017/18. Learning initiatives across APRA focused on enhancing technical capability, further developing behavioural skills to enhance effective application of our core technical skill set as well as continuing to focus on building leadership capability.

APRA continues to review learning methodologies and integrating technology into learning design to increase the efficiency of development initiatives while maintaining provision of a broad range of development options for employees.

Learning and development expenditure per employee rose slightly during 2017/18 as core in-house technical and behavioural skill development was supplemented with external specialist development.

Support for employees undertaking postgraduate study continued in 2017/18, with 43 employees participating in the studies support program. APRA also maintained its well-regarded graduate program, employing 13 graduates in 2017/18 as a supplement to general recruitment. The 2018 graduate cadre undertook two 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 – Learning and development activities

Training by type (%)	2016	2017	2018
Internal technical training and seminars	55	79	53
External training	41	3	37
Leadership Development programs	4	18	10

Key training metrics	2016	2017	2018
Training spend per employee	$4088	$2982	$3225
Percentage of employees provided with training[1]	100	100	100
Training sessions per employee	11.8	14.0	12.5
Training days per employee	5.5	4.1	3.0
Number of internal classroom courses offered	440	393	275
Employees undertaking formal post-graduate studies	43	44	43

1. This figure is for all training, including mandatory annual compliance training such as online Fraud and Security Awareness training for all employees

APRA AND DIVERSITY

APRA believes that to successfully fulfil its mandate, every employee should have the opportunity to reach their true potential. In practice, this means creating and cultivating an environment where every employee, regardless of background or personal circumstances, feels valued, included and able to contribute fully to the work and social life of the organisation. The result of this philosophy is a dedication to promoting inclusion and diversity within APRA.

To embed a culture of inclusion and diversity, APRA created a strategy in 2016 with seven 'streams', each focused on a different segment of the employee population, under the guidance of a governing Inclusion and Diversity (I&D) Council.

APRA's I&D vision is: We embrace differences and work together to achieve great outcomes for APRA and the Australian community.

Table 2 – Diversity and Inclusion characteristic across APRA employees

Level	Female	Male	ATSI[1]	CALD[2]	PWD[3]
Level 1	12	10	-	9	-
Level 2	55	35	1	35	1
Level 3	73	80	-	71	-
Level 4	93	160	1	101	3
Senior Manager	23	61	-	20	2
General Manager	10	11	-	2	-
Executive	2	7	-	1	-
Total	**268**	**362**	**2**	**239**	**6**

1. Aboriginal and Torres Strait Islander
2. Culturally and linguistically diverse
3. People with disability

2017/18 progress

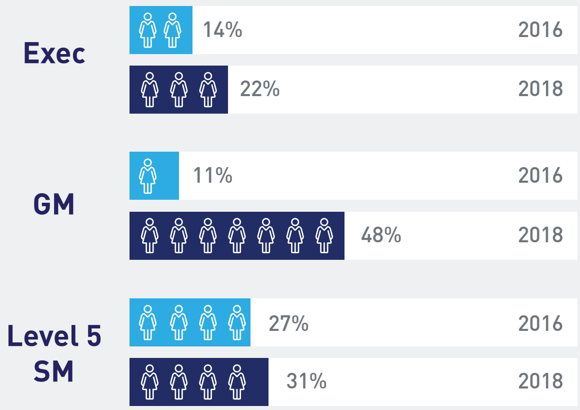
In 2017/18, APRA's I&D Council worked with APRA employees to deliver on the 12 commitments set out in its initial Inclusion and Diversity Strategy, which included building employee networks for each stream, and embedding diverse thinking across APRA.

In February 2018, APRA launched its first Reconciliation Action Plan. The plan sets out specific actions APRA will take to increase opportunities for Aboriginal and Torres Strait Islander people to join APRA, to raise understanding of Aboriginal and Torres Strait Islander experience and to contribute to programs that will improve outcomes for Aboriginal and Torres Strait Islander communities.

Gender diversity in senior roles

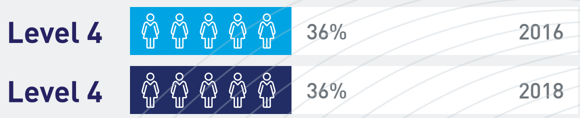
Female appointments to senior roles (Level 4 and above) increased from 28 per cent in 2017 to 31 per cent in 2018. At the General Manager level, women now occupy 48 per cent of positions.

Females in senior roles



Target

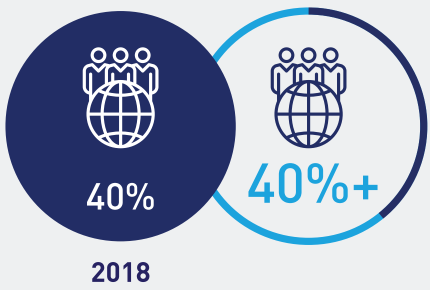
Females in Level 4 roles



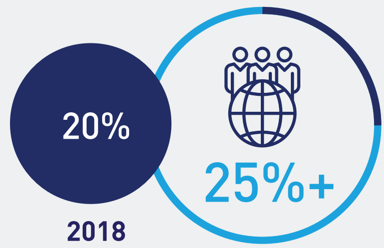
Culturally and linguistically diverse (CALD) employees

APRA has put in place targets for CALD employees at Level 4 and above. Overall, 38 per cent of APRA employees in 2017/18 came from culturally and linguistically diverse backgrounds, including 20 per cent of senior employees.

Level 4 roles — Target



Senior employees — Target

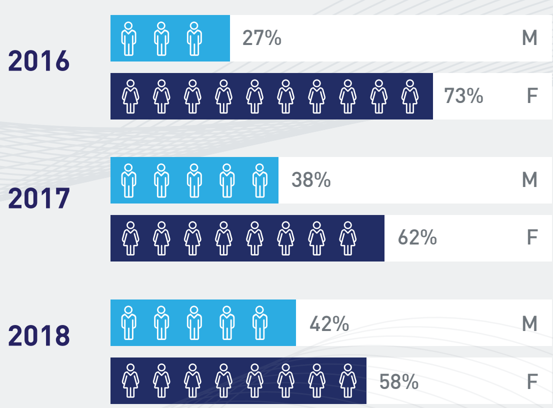


Flexibility – if not why not?

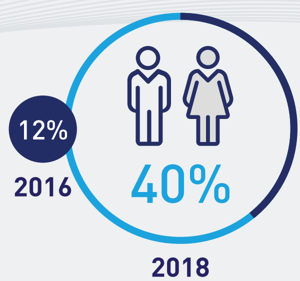
In July 2016, APRA introduced a new practice of 'Flexibility for all – if not, why not?' which has been promoted over the last two years through events and panel discussions where employees shared their stories. Over that period, APRA has seen significant growth in the number of employees taking up flexible working arrangements at all levels, including a significant increase in men taking up flexible working arrangements.

The figure below shows that in 2016, 12 per cent of the total employee population had a flexible working arrangement. This has increased to 40 per cent (of the total employee population) in 2018.

Flexible working arrangement



Percentage of total employee population on a flexible working arrangement



CH/6
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 2018 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
21 August 2018

Mrs Helen Rowell
Deputy Chairman
21 August 2018

Geoff Summerhayes
Member
21 August 2018

Mr Steve Matthews
Executive General Manager - Corporate Services
21 August 2018

STATEMENT OF COMPREHENSIVE INCOME

for the year ended 30 June 2018

	Notes	2018 $'000	2017 $'000
Expenses			
Employee benefits	1.1A	100,903	99,109
Suppliers	1.1B	34,283	22,188
Depreciation and amortisation	2.2	8,666	8,285
Grants and scholarships		129	135
Finance costs	1.1C	22	13
Losses from asset disposals		9	14
Total expenses		144,012	129,744
Own-source revenue			
Other revenue	1.2A	7,863	849
Rendering of services		3,837	3,756
Rental income		49	41
Total own-source revenue		11,749	4,646
Gains			
Other gains	1.2B	-	148
Total own-source revenue		11,749	4,794
Net cost of services		132,263	124,950
Revenue from Government	1.2C	135,792	123,860
Operating surplus/ (deficit)		3,529	(1,090)
Other comprehensive income			
Items not subject to subsequent reclassification to net cost of services			
Changes in asset revaluation reserve		-	(196)
Total comprehensive income/ (loss)		3,529	(1,286)

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

STATEMENT OF FINANCIAL POSITION

as at 30 June 2018

	Notes	2018 $'000	2017 $'000
Assets			
Financial assets			
Cash and cash equivalents	2.1A	83,343	71,635
Trade and other receivables	2.1B	4,758	4,277
Total financial assets		88,101	75,912
Non-financial assets			
Property, plant and equipment	2.2	20,157	22,398
Intangibles	2.2	15,829	15,706
Prepayments		2,830	1,863
Total non-financial assets		38,816	39,967
Total assets		126,917	115,879
Liabilities			
Payables			
Suppliers	2.3A	3,668	1,538
Other payables	2.3B	28,653	25,851
Total payables		32,321	27,389
Provisions			
Employee provisions	4.1	40,127	37,514
Other provisions	2.4	3,183	3,219
Total provisions		43,310	40,733
Total liabilities		75,631	68,122
Net assets		51,286	47,757
Equity			
Contributed equity		16,657	16,657
Reserves		14,216	13,216
Retained surpluses		20,413	17,884
Total equity		51,286	47,757

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

STATEMENT OF CHANGES IN EQUITY

for the year ended 30 June 2018

	2018 $'000	2017 $'000
Contributed equity		
Opening balance	16,657	16,657
Closing balance as at 30 June	**16,657**	16,657
Retained surpluses		
Opening balance	17,884	18,974
Transfer to Contingency Enforcement Fund	(1,000)	-
Surplus / (deficit) for the period	3,529	(1,090)
Closing balance as at 30 June	**20,413**	17,884
Asset revaluation reserve		
Opening balance	7,216	7,412
Decrease in revaluation reserve	-	(196)
Closing balance as at 30 June	**7,216**	7,216
Contingency Enforcement Fund		
Opening balance	6,000	6,000
Transfer from retained surpluses	1,000	-
Closing balance as at 30 June	**7,000**	6,000
Total equity		
Opening balance	47,757	49,043
Decrease in revaluation reserve	-	(196)
Surplus / (deficit) for the period	3,529	(1,090)
Closing balance as at 30 June	**51,286**	47,757

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

CASH FLOW STATEMENT

for the year ended 30 June 2018

	Notes	2018 $'000	2017 $'000
Operating activities			
Cash received			
Appropriations		149,949	144,069
Rendering of services		4,604	4,287
Net GST received		2,073	-
Other		7,078	658
Total cash received		**163,704**	149,014
Cash used			
Employees		(98,253)	(100,416)
Suppliers		(33,183)	(21,128)
Net GST paid		-	(203)
Section 74 receipts transferred to Official Public Account (OPA)		(14,002)	(21,902)
Total cash used		**(145,438)**	(143,649)
Net cash from operating activities		**18,266**	5,365
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		(1,106)	(3,712)
Purchase / development of software intangibles		(5,452)	(2,885)
Total cash used		**(6,558)**	(6,597)
Net cash used by investing activities		**(6,558)**	(6,561)
Financing activities			
Cash received			
Lease incentive receipt		-	13,599
Net cash from financing activities		-	13,599
Net increase in cash held		**11,708**	12,403
Cash and cash equivalents at the beginning of the reporting period		71,635	59,232
Cash and cash equivalents at the end of the reporting period	2.1A	**83,343**	71,635

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

ADMINISTERED SCHEDULE OF COMPREHENSIVE INCOME

for the year ended 30 June 2018

	Notes	2018 $'000	2017 $'000
Net cost of services			
Expenses			
Risk equalisation payments		428,385	458,343
Lloyd's Security Trust Deposit interest expense	7.4	55	55
Total expenses administered on behalf of Government	7.1	**428,440**	458,398
Income			
Levy revenue			
Risk equalisation levy collections	7.2	428,385	458,343
Financial Institutions Supervisory Levies	7.2	256,875	250,156
Supervisory levy waivers [1]	7.2	(10,825)	-
Total levy revenue		**674,435**	708,499
Other revenue			
Lloyd's Security Trust Deposit interest income	7.4	55	55
Total other revenue		**55**	55
Surplus		**246,050**	250,156

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

1. The impact of *AASB 1056 'Superannuation Entities'* resulted in employer-sponsor receivables being included in the asset base upon which levies were calculated in 2017-18. This significantly increased the levy burden on public sector superannuation funds. A Treasury review of this impact resulted in such receivables being excluded from the 2018-19 levy base, pending a wider review and consultation with industry. For consistency, waivers were granted in 2017-18 to exclude the impact of AASB 1056 on affected funds.

ADMINISTERED SCHEDULE OF ASSETS AND LIABILITIES

as at 30 June 2018

	Notes	2018 $'000	2017 $'000
Assets			
Financial assets			
Receivables	7.3	2,203	2,348
Cash and cash equivalents	7.3	835	835
Total assets administered on behalf of Government		**3,038**	3,183
Liabilities			
Lloyd's 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		**1,038**	1,183

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

ADMINISTERED RECONCILIATION SCHEDULE

	Notes	2018 $'000	2017 $'000
Opening assets less liabilities as at 1 July		1,183	1,153
Income		674,490	708,554
Expenses	7.1	(428,440)	(458,398)
Transfers (to) / from the Australian Government:			
Appropriation transfers from Official Public Account (OPA)		428,385	458,349
Transfers to OPA		(674,580)	(708,475)
Closing assets less liabilities as at 30 June		**1,038**	1,183

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

ADMINISTERED CASH FLOW STATEMENT

for the year ended 30 June 2018

	Notes	2018 $'000	2017 $'000
Operating activities			
Cash received			
Financial Institutions Supervisory Levies		246,195	250,126
Risk equalisation levy collections		428,385	458,343
Total cash received		**674,580**	708,469
Cash used			
Risk equalisation levy payments		(428,385)	(458,343)
Total cash used		**(428,385)**	(458,343)
Net cash from operating activities		**246,195**	250,126
Cash from Official Public Account for:			
APRA Special Account: Supervisory Levies		757	4
Risk equalisation collections		428,385	458,343
Total cash from Official Public Account		**429,142**	458,347
Cash to Official Public Account for:			
Financial Institutions Supervisory Levies		(246,952)	(250,130)
Risk equalisation payments		(428,385)	(458,343)
Total cash to Official Public Account		**(675,337)**	(708,473)
Net increase / (decrease) in cash held		**-**	-
Cash at the beginning of the reporting period		835	835
Cash at the end of the reporting period	7.3	**835**	835

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

OVERVIEW

Objectives of the Australian Prudential Regulation Authority (APRA)

APRA's mandate is to protect the Australian community by establishing and enforcing 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. 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 balances the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and, in balancing these objectives, promotes 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.

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. The financial statements are presented in Australian dollars.

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

Departmental

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.

Administered

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

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

for the year ended 30 June 2018

1. DEPARTMENTAL FINANCIAL PERFORMANCE

This section analyses the financial performance of the Australian Prudential Regulation Authority for the year ended June 2018.

1.1 Expenses

	2018 $'000	2017 $'000
1.1A: Employee benefits		
Salaries and wages	80,092	79,575
Superannuation		
Defined benefit plans	1,359	1,679
Defined contribution plans	7,533	6,884
Leave and other entitlements[1]	10,987	9,268
Separation and redundancies	587	1,532
Other employee benefits	345	171
Total employee benefits	100,903	99,109

1. Long service leave paid out during the year has been reclassified from Leave and other entitlements to Salaries and wages for the current and prior period.

Accounting policy

Employee benefits

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

	2018 $'000	2017 $'000
1.1B: Suppliers		
Services supplied or rendered		
Professional services and consultants	12,551	3,075
Information, communication and technology	5,030	3,875
Administrative	2,700	2,106
Travel-related	2,402	2,355
Property	2,175	1,655
Contractors	2,065	1,303
Training and conferences	1,652	1,414
Other	5	25
Total services supplied or rendered	28,580	15,808
Other suppliers		
Operating lease rentals	5,477	5,958
Workers compensation expenses	226	422
Total other suppliers	5,703	6,380
Total suppliers	34,283	22,188

1. DEPARTMENTAL FINANCIAL PERFORMANCE (continued)

1.1 Expenses (continued)

	2018 $'000	2017 $'000

Leasing commitments

APRA in its capacity as lessee has leasing commitments for all its offices. Office leases, with expiry dates shown in brackets and subsequent lease extension options are:

- Sydney (2026) - Two 5 years options;
- Melbourne (2024) - One 5 years option;
- Brisbane (2020) - One 2 years option;
- Adelaide (2024) - One 4 years option; and
- Canberra (2020) - Two 2 years options.

Commitments for minimum lease payments in relation to non-cancellable operating leases are payable as follows[1]

	2018 $'000	2017 $'000
Within 1 year	8,325	2,322
Between 1 to 5 years	35,235	33,740
More than 5 years	31,070	40,315
Total operating lease commitments	**74,630**	76,377

1. Commitments are stated inclusive of GST where relevant.

Accounting policy

Leases

Payments under an operating lease (minimum lease payments) are expensed on a straight-line basis which is representative of the pattern of benefits received.

	2018 $'000	2017 $'000
1.1C: Finance costs		
Adjustment to discount on restoration provisions	9	-
Banking fees	13	13
Total finance costs	**22**	13

1. DEPARTMENTAL FINANCIAL PERFORMANCE (continued)

1.2 Own-source revenue and gains

	2018 $'000	2017 $'000
1.2A: Other revenue		
Licence fees from finance sector entities	779	240
Resources received free of charge	197	196
Fees from foreign bank representative offices	47	211
Superannuation trustee application fees	28	61
Other[1]	6,812	141
Total other revenue	7,863	849

1. 2018 includes revenue received to recover expenses incurred during a prudential inquiry.

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 relates 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 Australian National Audit Office (ANAO) of $197,000 (2017: $196,000).

1. DEPARTMENTAL FINANCIAL PERFORMANCE (continued)

1.2 Own-source revenue and gains (continued)

	Notes	2018 $'000	2017 $'000
1.2B: Other gains			
Adjustment to discount on restoration provisions		-	148
Total other gains		-	148
1.2C: Revenue from Government			
Appropriations:			
Special appropriation	6.1	135,076	122,317
Departmental appropriation		716	1,543
Total revenue from Government		135,792	123,860

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

This section analyses the Australian Prudential Regulation Authority's assets used to conduct its operations and the operating liabilities incurred as a result.

Employee-related information is disclosed in the People and Relationship section (section 4).

2.1 Financial assets

	2018 $'000	2017 $'000
2.1A: Cash and cash equivalents		
Cash in special account	80,882	69,282
Cash on hand	2,461	2,353
Total cash and cash equivalents	83,343	71,635
2.1B: Trade and other receivables		
Goods and services receivables		
Goods and services	2,570	2,337
Total goods and services receivables	2,570	2,337
Appropriations receivables		
Other appropriations	1,544	1,684
Special appropriations	6	37
Total appropriations receivables	1,550	1,721
Other receivables		
GST receivable from the Australian Taxation Office	405	192
Other	233	27
Total other receivables	638	219
Total trade and other receivables	4,758	4,277

Credit terms for goods and services were within 30 days (2017: 30 days).

Accounting policies

Receivables

Trade receivables, and other receivables that have fixed or determinable payments that are not quoted in an active market, are classified as 'receivables'. Receivables are measured at amortised cost using the effective interest method less impairment.

Impairment of financial assets

Financial assets are individually assessed for impairment at each balance date.

2. DEPARTMENTAL FINANCIAL POSITION (continued)

2.2 Non-financial assets

2.2: Reconciliation of the opening and closing balances of property, plant and equipment and intangibles - 2018

	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 2017							
Gross book value	21,166	3,855	25,022	44,233	8,181	52,413	**77,435**
Accumulated depreciation, amortisation and impairment	(2,611)	(13)	(2,624)	(29,666)	(7,041)	(36,707)	**(39,331)**
Net book value 1 July 2017	**18,556**	**3,842**	**22,398**	**14,567**	**1,140**	**15,706**	**38,103**
Additions:							
By purchase	55	1,149	1,204	-	828	828	**2,032**
Internally developed	-	-	-	4,624	-	4,624	**4,624**
Adjustment to restoration provision asset	(98)	-	(98)	-	-	-	**(98)**
Depreciation:							
Depreciation and amortisation expense	(2,078)	(1,348)	(3,426)	(4,154)	(1,175)	(5,329)	**(8,755)**
Adjustment to restoration provision asset	89	-	89			-	**89**
Disposals:							
Write-off (at cost)	-	(26)	(26)	(14)	(664)	(678)	**(704)**
Write-off (accumulated depreciation)	-	17	17	14	664	678	**695**
Net book value 30 June 2018	**16,523**	**3,634**	**20,157**	**15,036**	**793**	**15,829**	**35,986**
Net book value as at 30 June 2018 represented by:							
Gross book value	21,123	4,977	26,100	48,883	8,305	57,188	**83,288**
Accumulated depreciation, amortisation and impairment	(4,600)	(1,343)	(5,943)	(33,847)	(7,512)	(41,359)	**(47,302)**
Net book value 30 June 2018	**16,523**	**3,634**	**20,157**	**15,036**	**793**	**15,829**	**35,986**

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. Management has assessed there is no material change to that valuation as at 30 June 2018.

No significant non-financial assets are expected to be sold, disposed of or retired within the next 12 months.

No material contractual commitments for the purchase of property, plant equipment and intangible assets currently exist.

2. DEPARTMENTAL FINANCIAL POSITION (continued)

2.2 Non-financial assets (continued)

Accounting policies

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.

Revaluations

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 amounts of assets did not differ materially from the assets' fair values at the reporting date. The regularity of independent valuations depend on the volatility of movements in market values for the relevant assets. APRA conducts such valuations every three years as at 30 June (last valuation occurred in 2017). For 2018 a desktop valuation was undertaken.

Revaluation adjustments are made on a class basis. Any revaluation increment is credited to equity under the heading of asset revaluation reserve except to the extent that it reversed a previous revaluation decrement of the same asset class that was previously recognised in the surplus/deficit. Revaluation decrements for a class of assets are recognised directly in the surplus/deficit except to the extent that they reversed a previous revaluation increment for that asset class.

Any accumulated depreciation as at the revaluation date is eliminated against the gross carrying amount of the asset and the asset restated to the revalued amount.

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.

2. DEPARTMENTAL FINANCIAL POSITION (continued)

2.2 Non-financial assets (continued)

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.

Depreciation rates applying to each class of depreciable asset are based on the following useful lives:

	2018	2017
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 2018. 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.

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 (2017: 3 to 5 years).

All software assets were assessed for indications of impairment as at 30 June 2018.

Significant accounting judgements and estimates

In the process of applying the accounting policies listed in this note, APRA has made assumptions or estimates in the following areas that have the most significant impact on the amounts recorded in the financial statements:

The fair value of leasehold improvements reinstatement assets is based on independent expert assessments and reconsidered by management each financial year.

2. DEPARTMENTAL FINANCIAL POSITION (continued)

2.3 Payables

	2018 $'000	2017 $'000
2.3A: Suppliers		
Trade creditors and accruals	3,668	1,538
Total suppliers	3,668	1,538
Suppliers are expected to be settled in less than 12 months.		
2.3B: Other payables		
Minimum lease liabilities	14,458	9,647
Lease incentives	12,680	14,179
Salaries and wages	758	723
Unearned revenue	404	951
GST payable to the Australian Taxation Office	299	286
Other	54	65
Total other payables	28,653	25,851
Total payables	32,321	27,389

Accounting policy

Financial liabilities

APRA classifies its financial liabilities as 'payables'. 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. DEPARTMENTAL FINANCIAL POSITION (continued)

2.4 Other provisions

	2018 $'000	2017 $'000
2.4: Provision for restoration		
Carrying amount 1 July	3,219	4,855
Additional provisions made	66	130
Adjustment for lease extensions	(111)	-
Payments	-	(1,618)
Adjustment to discount on restoration provisions	9	(148)
Closing balance 30 June	**3,183**	3,219

At 30 June 2018, APRA leased premises in Sydney, Melbourne, Brisbane, Canberra and Adelaide.

In the lease conditions of the Sydney and Melbourne locations there is a requirement for APRA, upon expiration of the lease, to restore the premises to their original condition they were in at the conclusion of the lease. For the other locations the requirement is to leave the premises in a clean and tidy condition at the end of the lease. APRA has made the required provisions to reflect the present value of these obligations.

Accounting judgements and estimates

Estimated cost per square metre ($ sqm) to restore the leased properties to the required condition are:
Sydney - $350 sqm; Melbourne - $250 sqm; Canberra and Adelaide - $80 sqm and Brisbane - $50 sqm.

3. FUNDING

This section identifies the Australian Prudential Regulation Authority's funding structure.

3.1 Appropriations

3.1A: Annual appropriations ('recoverable GST exclusive')

Annual appropriations for 2018

	Annual appropriation $'000	Section 74 receipts $'000	Total appropriation $'000	Appropriation applied in 2018 (current and prior years) $'000	Variance[1] $'000
Departmental					
Ordinary annual services	716	14,002	14,718	13,174	1,544
Total departmental	**716**	**14,002**	**14,718**	**13,174**	**1,544**
Administered					
Other services					
New administered outcomes	-	-	-	-	-
Total administered	**-**	**-**	**-**	**-**	**-**

Annual appropriations for 2017

	Annual appropriation $'000	Section 74 receipts $'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	**-**	**-**	**-**	**-**	**-**

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.

3. FUNDING (continued)

3.1 Appropriations (continued)

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

	2018 $'000	2017 $'000
Departmental		
Appropriation Act (No. 1) 2017-18	1,544	-
Appropriation Act (No. 1) 2016-17	-	1,684
Total	**1,544**	1,684

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

Authority	Type	Purpose	Appropriation applied 2018 $'000	Appropriation applied 2017 $'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*.	135,076	122,312
Total			**135,076**	122,312

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]	
	2018 $'000	2017 $'000	2018 $'000	2017 $'000	2018 $'000	2017 $'000
Balance brought forward from previous period	71,635	59,232	835	835	-	-
Increases:						
Departmental						
Total departmental increases	163,704	162,649	-	-	-	-
Administered						
Special appropriation for reporting period	-	-	-	-	428,385	458,343
Total administered increases	-	-	-	-	428,385	458,343
Available for payments	235,339	221,881	835	835	428,385	458,343
Decreases:						
Total departmental decreases	(151,996)	(150,246)	-	-	-	-
Administered						
Repayments made from the Special Account	-	-	-	-	(428,385)	(458,343)
Total administered decreases	-	-	-	-	(428,385)	(458,343)
Balance represented by						
Cash in APRA official bank accounts	2,461	2,353	-	-	-	-
Cash with the Official Public Account (OPA)	80,882	69,282	835	835	-	-
Total balance carried to the next period	83,343	71,635	835	835	-	-

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 147 (2017: 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 2015* (refer to section 318-10 of the *Private Health Insurance Act 2007*).

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, which keeps 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 insurer 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

	2018 $'000	2017 $'000
Amounts applied		
Departmental		
Special appropriations (including special accounts)	135,076	122,317
Own source revenue	11,417	4,325
Administered		
Special appropriations (including special accounts)	246,050	250,156
Total amounts applied	392,543	376,798
Expenses		
Departmental	142,964	128,201
Administered	-	-
Total expenses	142,964	128,201
External revenue		
Departmental	146,493	125,099
Administered	-	-
Total revenue	146,493	125,099

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 activities, excluding charges to the RBA and ABS as these are intra-governmental, are available at: https://www.apra.gov.au/adis-fees-and-levies

4. PEOPLE AND RELATIONSHIPS

This section describes a range of employment and post-employment benefits provided to our people and our relationships with other key people.

4.1 Employee provisions

	2018 $'000	2017 $'000
4.1: Employee provisions		
Leave	32,853	31,153
Other employee provisions	7,088	6,027
Separations and redundancies	186	334
Total employee provisions	40,127	37,514

Accounting policies

Liabilities for 'short-term employee benefits' and termination benefits expected within 12 months of the balance date are measured at their nominal amounts.

All other long-term employee benefits are measured as the net total of the present value of the defined benefit obligation at the end of the reporting period minus the fair value at the end of the reporting period of plan assets (if any) out of which the obligations are to be settled directly.

Leave

The liability for employee benefits includes provision for annual leave and long service leave.

The annual and long service leave liabilities are calculated on the basis of employees' remuneration at the estimated salary and superannuation rates that will be applied at the time the leave is taken during service rather than paid out on termination. The estimate of the present value of the liability takes into account attrition rates and pay increases through promotion and inflation.

Separation and redundancy

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.

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. 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 is recognised in the financial statements of the relevant fund.

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

Significant accounting judgements and estimates

The employee leave provision has been determined by reference to standard parameters provided by the Department of Finance as well as an estimate of the proportion of leave likely to be taken in-service as compared to taken on termination.

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 Portfolio Ministers, the APRA Members and the APRA Executive General Managers (EGMs)[1].

Key management personnel remuneration is reported in the table below:

	2018 $'000	2017 $'000
Short-term employee benefits	3,949	4,017
Other long-term benefits	571	448
Post-employment benefits	344	413
Total key management personnel remuneration expenses[2]	**4,864**	4,878

The total number of key management personnel that are included in the above table are: 13 (2017: 10). These figures include the headcount of staff holding these positions in an acting capacity but will exclude temporary absences (leave, overseas travel etc.).

1. The role of Chief Risk Officer was restructured to include strategy and classified as an EGM during the year.
2. The above key management personnel remuneration excludes the remuneration and other benefits of the Portfolio Ministers. Their remuneration and other benefits are set by the Remuneration Tribunal and are not paid by APRA.

4. PEOPLE AND RELATIONSHIPS (continued)

4.3 Related party disclosures

Related party relationships

APRA is an Australian Government controlled entity.

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 (PSSap).

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. These are not considered individually significant to warrant separate disclosure as related party transactions.

5 MANAGING UNCERTAINTIES

This section analyses how the Australian Prudential Regulation Authority manages financial risks within its operating environment.

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 (2017: Nil).

Quantifiable contingencies (APRA departmental)

APRA has no quantifiable contingencies as at the balance date (2017: Nil).

Unquantifiable contingencies (APRA departmental)

APRA has no unquantifiable contingencies as at the balance date (2017: 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 this note. 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	2018 $'000	2017 $'000
Categories of financial instruments			
Financial assets			
Cash and cash equivalents	2.1A	83,343	71,635
Trade receivables	2.1B	4,758	4,277
Total financial assets		**88,101**	75,912
Financial liabilities			
At amortised cost:			
Trade creditors and accruals	2.3A	3,668	1,538
Total financial liabilities		**3,668**	1,538

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

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' which are recognised at amortised cost. Liabilities are recognised at amortised cost and they are recognised to the extent that the goods or services have been received (and irrespective of having been invoiced). See Note 2.3 for further details.

5. MANAGING UNCERTAINTIES (continued)

5.3 Fair value measurements

Accounting policy

Fair value measurement

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

	Notes	Fair value measurements at the end of the reporting period 2018 $'000	2017 $'000
Non-financial assets[1]			
Leasehold improvements	2.2	16,523	18,556
Computer hardware and office equipment	2.2	3,634	3,842
Total non-financial assets		20,157	22,398

1. No non-financial assets were measured at fair value on a non-recurring basis as at 30 June 2018 (2017: nil).

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*.

	2018 $'000	2017 $'000
Table 1: Summary of APRA levy funding		
Current year levies and penalties (see Note 7.2, Table 1)	256,875	250,156
Risk equalisation receipts	428,385	458,343
Less: Waivers and doubtful debts (see Note 7.2)	(10,825)	-
Net current year levies and penalties (see Table 2 below)	674,435	708,499
Less: Amount retained in the Consolidated Revenue Fund (see Table 3 below)	(110,974)	(127,839)
Less: Risk equalisation payments to private health insurers	(428,385)	(458,343)
Total APRA levy funding (see Table 4 below)	135,076	122,317
Table 2: Net current year levies and penalties by levy type		
Superannuation funds	102,804	110,340
Authorised deposit-taking institutions	84,447	79,167
General insurers	31,952	34,471
Life insurers and friendly societies	20,132	22,042
Private health insurers	6,715	4,136
Risk equalisation receipts from private health insurers	428,385	458,343
Total	674,435	708,499
Table 3: Amounts retained in the Consolidated Revenue Fund by levy type[1] or returned to industry		
Superannuation funds	(72,768)	(81,939)
Authorised deposit-taking institutions	(22,050)	(22,200)
Life insurers and friendly societies	(6,955)	(10,500)
General insurers	(9,201)	(13,200)
Total	(110,974)	(127,839)
Table 4: Amounts of levy payable to APRA under the APRA Special Appropriation by levy type[2]		
Superannuation funds	30,036	28,401
Authorised deposit-taking institutions	62,397	56,967
Life insurers and friendly societies	13,177	11,542
General insurers	22,751	21,271
Private health insurers	6,715	4,136
Total	135,076	122,317
This is represented by:		
Special Appropriation	135,076	122,317
Total	135,076	122,317

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 upon receipt. The revenues from the Financial Assistance Levy are also not available to APRA for its own purposes. All administered collections are remitted to the Official Public Account with APRA's portion being transferred to its special account in accordance with annual determinations made by the Minister. 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 Budgetary reports and explanations of major variances (continued)

The following tables provide a comparison of the original budget as presented in the 2017/18 Portfolio Budget Statements (PBS) to the 2017/18 final outcome as presented in accordance with Australian Accounting Standards. The Budget is not audited.

6.2 Departmental budgetary reports

Summary of key variances to budget

Expenses

- Employee benefits are lower than budget predominately due to fewer staff (21 full-time equivalent employees);
- Supplier costs are higher than budget due to an unbudgeted Prudential Inquiry, which was fully cost recovered; and
- Depreciation and amortisation is lower than budget due to delays in acquiring new assets.

Own-source income

- Rendering of services is lower than budget due to lower licensing and other fees received; and
- Other revenue is higher than budget due to unbudgeted recoveries relating to the unbudgeted Prudential Inquiry noted above.

Revenue from Government is lower than budget due to industry consolidation and the impacts of the implementation of a new accounting standard (AASB1056 : Superannuation Entities), whereby increased levy amounts arising from the impact of this accounting standard were waived.

Statement of comprehensive income

for the year ended 30 June 2018

	Actual	Budget estimate	
		Original	Variance
	2018	2018	2018
	$'000	$'000	$'000
Expenses			
Employee benefits	100,903	103,843	2,940
Suppliers	34,443	27,634	(6,809)
Depreciation and amortisation	8,666	10,147	1,481
Total expenses	144,012	141,624	(2,388)
Less:			
Own-source revenue			
Other revenue	7,863	1,056	6,807
Rendering of services	3,837	4,639	(802)
Rental income	49	-	49
Total own-source revenue	11,749	5,695	6,054
Net cost of services	132,263	135,929	3,666
Revenue from Government	135,792	137,789	(1,997)
Operating surplus	3,529	1,860	1,669
Total comprehensive income	3,529	1,860	1,669

6. OTHER INFORMATION (continued)

6.2 Budgetary reports and explanations of major variances (continued)

6.2 Departmental budgetary reports (continued)

Summary of key variances to budget

Assets

- Cash and cash equivalents and Trade and other receivables respective variances are primarily due to the restatement of the APRA special account to cash and cash equivalents. When viewed at the total financial asset position, the actual is higher than budget driven by the variance in operating surplus;
- Property, plant and equipment (PP&E) and intangible assets are lower than budget due to timing differences in acquiring depreciable assets; and
- Prepayments are higher than budget due to earlier payments for IT and property management renewals.

Liabilities

- Suppliers and other payables and provisions contain a large variance due to reclassification of certain liability accounts. When viewed at the total payables and provisions level, actuals were lower than budget due to changes to the presentation of APRA's relocation of its Melbourne office; and
- Employee provisions were lower than budget due to prior year bond rate movement, lower provisions required for fewer staff (21 full-time equivalent) and staff who had accrued large leave balances leaving the organisation.

6. OTHER INFORMATION (continued)

6.2 Budgetary reports and explanations of major variances (continued)

6.2 Departmental budgetary reports (continued)

Statement of financial position as at 30 June 2018	Actual	Budget estimate	
		Original	Variance
	2018	2018	2018
	$'000	$'000	$'000
Assets			
Financial assets			
Cash and cash equivalents	83,343	1,904	81,439
Trade and other receivables	4,758	84,112	(79,354)
Total financial assets	88,101	86,016	2,085
Non-financial assets			
Property, plant and equipment	20,157	26,536	(6,379)
Intangibles	15,829	17,747	(1,918)
Prepayments	2,830	1,858	972
Total non-financial assets	38,816	46,141	(7,325)
Total assets	126,917	132,157	(5,240)
Liabilities			
Payables			
Suppliers	3,668	31,251	27,583
Other payables and provisions	31,836	7,606	(24,230)
Total payables and provisions	35,504	38,857	3,353
Employee provisions			
Employee provisions	40,127	45,253	5,126
Total employee provisions	40,127	45,253	5,126
Total liabilities	75,631	84,110	8,479
Net assets	51,286	48,047	3,239
Equity			
Contributed equity	16,657	16,657	-
Reserves	14,216	14,412	(196)
Retained surpluses	20,413	16,978	3,435
Total equity	51,286	48,047	3,239

6. OTHER INFORMATION (continued)

6.2 Budgetary reports and explanations of major variances (continued)

6.2 Departmental budgetary reports (continued)

Summary of key variances to budget

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

Statement of changes in equity for the year ended 30 June 2018	Actual 2018 $'000	Budget estimate Original 2018 $'000	 Variance 2018 $'000
Contributed equity			
Opening balance	16,657	16,657	-
Closing balance as at 30 June	**16,657**	**16,657**	-
Retained surpluses			
Opening balance	17,884	16,118	1,766
Transfer to Contingency Enforcement Fund[1]	(1,000)	(1,000)	-
Surplus for the period	3,529	1,860	1,669
Closing balance as at 30 June	**20,413**	**16,978**	3,435
Asset revaluation reserve			
Opening balance	7,216	7,412	(196)
Closing balance as at 30 June	**7,216**	**7,412**	(196)
Contingency Enforcement Fund			
Opening balance	6,000	6,000	-
Transfer from retained surpluses[1]	1,000	1,000	-
Closing balance as at 30 June	**7,000**	**7,000**	-
Total equity			
Opening balance	47,757	46,187	1,570
Surplus for the period	3,529	1,860	1,669
Closing balance as at 30 June	**51,286**	**48,047**	3,239

1. During the 2017-18 Federal budget APRA was provided additional funds to assist with the introduction and administration of legislation to make Authorised Deposit taking Institutions (ADIs) and their executives more accountable. This included requiring banking executives to be registered with the APRA, strengthening APRA's powers to remove and disqualify senior executives, new penalty provisions and deferral of remuneration for senior executives.

   Levies were increased by a $1.0 million a year, should APRA require additional resourcing to enforce breaches of the new requirements, to increase the Contingency Enforcement Fund.

6. OTHER INFORMATION (continued)

6.2 Budgetary reports and explanations of major variances (continued)

6.2 Departmental budgetary reports (continued)

Summary of key variances to budget

The restatement in the prior year of the APRA special account from receivables to cash and cash equivalents post the finalisation of the budget altered the basis upon which the cash flow is constructed.

Restatement of the budget cash flow on a similar basis produces a net increase to cash held by $5.2 million, which results in a variance of $6.5 million. The primary driver of this variance is the timing differences in the acquisition of depreciable assets and the operating surplus for the year.

Cash flow statement

for the year ended 30 June 2018

	Actual	Budget estimate	
		Original	Variance
	2018	2018	2018
	$'000	$'000	$'000
Operating Activities			
Cash received			
Appropriations	149,949	132,561	17,388
Rendering of services	4,604	4,639	(35)
Net GST received	2,073	-	2,073
Receipts from Government	-	5,499	(5,499)
Other	7,078	1,056	6,022
Total cash received	163,704	143,755	19,949
Cash used			
Employees	(98,253)	(100,913)	2,660
Suppliers	(33,183)	(24,387)	(8,796)
Section 74 receipts transferred to Official Public Account (OPA)	(14,002)	(5,499)	(8,503)
Total cash used	(145,438)	(130,799)	(14,639)
Net cash from operating activities	18,266	12,956	5,310
Investing activities			
Cash used			
Purchase of property, plant and equipment and intangibles	(6,558)	(12,956)	6,398
Net cash used by investing activities	(6,558)	(12,956)	6,398
Net increase in cash held	11,708	-	11,708
Cash and cash equivalents at the beginning of the reporting period	71,635	1,904	69,731
Cash and cash equivalents at the end of the reporting period	83,343	1,904	81,439

7. ADMINISTERED NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

for the year ended 30 June 2018

7.1 Administered expenses

	Notes	2018 $'000	2017 $'000
Expenses			
Risk equalisation levy payments	6.1	428,385	458,343
Lloyd's security deposit interest expense	7.4	55	55
Total administered expenses		428,440	458,398

Accounting policy

Expenses

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

	2018 $'000	2017 $'000
Income		
Levy revenue		
Risk equalisation levy receipts	428,385	458,343
Financial Institutions Supervisory Levies and penalties (see Table 1)[1]	256,875	250,156
Supervisory levy waivers (see Table 2)	(10,825)	-
Total levy revenue	674,435	708,499

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)

	2018 $'000	2017 $'000
Income (continued)		
Table 1: Financial Institutions Supervisory Levies revenue by type		
Levy:		
Superannuation funds	113,038	110,326
Authorised deposit-taking institutions	84,447	79,167
General insurers	31,953	34,471
Life insurers and friendly societies	20,137	22,042
Private health insurers	6,715	4,136
Total Financial Industry Supervisory Levies	256,290	250,142
Late payment penalties:		
Superannuation funds	585	14
Total late payment penalties	585	14
Total current year financial industry levies and penalties	256,875	250,156
Table 2: Levies and late payment penalties waived by type		
Waiver:		
Superannuation funds	(10,819)	-
General insurers	(1)	-
Life insurers	(5)	-
Total waivers	(10,825)	-

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.

Waivers of levy debts are recognised as an offset to invoiced revenue 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 or, as occurred in 2017-18, following a change in an accounting standard.

	2018 $'000	2017 $'000
Other revenue		
Lloyd's security deposit interest income	55	55
Total other revenue	55	55

7. ADMINISTERED NOTES (continued)

7.3 Administered financial assets

	2018 $'000	2017 $'000
Cash and cash equivalents		
Financial Claims Scheme	835	835
Total cash and cash equivalents	**835**	835
Receivables		
Lloyd's security held in trust	2,000	2,000
Financial Assistance Levy	197	311
Financial Institutions Supervisory Levies	6	37
Total receivables	**2,203**	2,348
Receivables were aged as follows:		
Not overdue	2,197	2,037
Overdue by:		
more than 90 days	6	311
Total receivables	**2,203**	2,348

There is no impairment allowance in 2018 (2017: 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.

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*.

	2018 $'000	2017 $'000
Lloyd's Deposit Trust Security		
Total amount held at the beginning of the reporting period	2,000	2,000
Receipts	(55)	(55)
Payments	55	55
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 2018 for the Lloyd's Security Deposit Trust was $2,030,231 (2017: $2,052,124).

Non-monetary assets

APRA has no non-monetary assets held in trust.

7.5 Administered liabilities

	2018 $'000	2017 $'000
Other payables		
Lloyd's Security Trust Deposit	2,000	2,000
Total other payables	2,000	2,000

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 2017, deposits eligible for coverage under the Scheme were estimated to be $890 billion, compared to $850 billion as at 31 December 2016, 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.

7. ADMINISTERED NOTES (continued)

7.7 Administered budgetary reports and explanations of major variances

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 2018. This difference drives the overall magnitude of the risk equalisation levy collections and payments across the industry.

The Financial Institutions Supervisory Levies over-collection against budget is due to the implementation of AASB1056:'Superannuation Entities' not captured in the original budget. This increased the levies charged significantly, however this increase was subsequently waived.

Administered schedule of comprehensive income	Actual	Budget estimate	
for the year ended 30 June 2018		Original	Variance
	2018	2018	2018
	$'000	$'000	$'000
Expenses			
Risk equalisation levy payments	428,385	572,162	143,777
Lloyd's security interest expense	55	55	-
Total expenses administered on behalf of Government	428,440	572,217	143,777
Less:			
Income			
Risk equalisation levy collections	428,385	572,162	(143,777)
Financial Institutions Supervisory Levies	256,875	245,462	11,413
Waivers and doubtful debts	(10,825)	-	(10,825)
Lloyd's security interest income	55	55	-
Total income	674,490	817,679	(143,189)
Surplus	246,050	245,462	588

7. ADMINISTERED NOTES (continued)

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

Summary of key variances to budget

The original budgeted assets did not include the Lloyd's Security Trust Deposit and Financial Claim Scheme assets which were included in the results for the first time in 2017.

Administered schedule of assets and liabilities	Actual	Budget estimate	
as at 30 June 2018		Original	Variance
	2018	2018	2018
	$'000	$'000	$'000
Assets			
Financial assets			
Receivables	2,203	317	1,886
Cash and cash equivalents	835	-	835
Total assets administered on behalf of Government	3,038	317	2,721
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	1,038	317	721

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 2018:

(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 2018 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 2018 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* (the Code) to the extent that they are not in conflict with the *Auditor-General Act 1997*. 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.

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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, as applicable, matters related to going concern and using the going concern basis of accounting unless the assessment indicates that it is not appropriate.

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

Bola Oyetunji

Senior Executive Director

Delegate of the Auditor-General

Canberra

22 August 2018

CH/7
STATUTORY REPORTS AND APPENDICES

STATUTORY REPORTING REQUIREMENTS

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 persons conducting investigations under Division 2 of Part II and section 61 of that Act the *Banking Act 1959*;
- the activities of Banking Act statutory managers (within the meaning of the *Banking Act 1959*);
- the activities of Insurance Act statutory managers (within the meaning of the *Insurance Act 1973*);
- the activities of Life Insurance Act statutory managers (within the meaning of the *Life Insurance Act 1995*);
- 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 persons to conduct an investigation under Division 2 of Part II of the *Banking Act 1959* during 2017/18. An investigation into the IT infrastructure of a small ADI was completed under section 61 of that Act. There were no appointments continuing from the previous year.

APRA did not appoint statutory managers under the *Banking Act 1959*, *Insurance Act 1973* or *Life Insurance Act 1995*. There were no appointments continuing from the previous 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[5]. No payments were made from the Financial Claims Scheme Special Account in 2017/18 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 2017/18 that were not legislative instruments.

APRA did not exercise its powers under Part 15 of the RSA Act in 2017/18.

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
A7 of 2017	5/07/2017	s.93(4)
A8 of 2017	4/08/2017	s.93(3)
A9 of 2017	10/10/2017	r.7.04(1)
A10 of 2017	27/10/2017	s.93(3)(a)(ii)
A11 of 2017	19/10/2017	r.13.17A
A12 of 2017	29/11/2017	s.93(3)(a)(ii)
A13 of 2017	18/12/2017	r.6.17(2)
A14 of 2017	18/12/2017	r.1.06(8)(d)
A1 of 2018	5/03/2018	s.92(4)
A2 of 2018	4/04/2018	s.93(3)(a)(ii)
A3 of 2018	23/03/2018	r.9.04D(2)
A4 of 2018	4/05/2018	r.9.04I

Modification number	Date	Provision of SIS Act / regulations modified
A3 of 2017	27/09/2017	s.82(2)(a) to (d)
A4 of 2017	27/09/2017	Revocation of A3 of 2013 (s.89(2))
A5 of 2017	8/11/2017	r.6.7
A6 of 2017	27/10/2017	Revocation of A6 of 2013 (s.93(4))
A7 of 2017	29/11/2017	Revocation of A9 of 2013 (s.93(3)(a)(ii))
A8 of 2017	21/12/2017	Revocation of A21 of 2006 (s.93(4))
A1 of 2018	21/02/2018	r.1.06(8)(d)(viii)

5. Australian Family Assurance limited (in liquidation).

Environment Protection and Biodiversity Conservation Act 1999 (EPBC Act)

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 employee awareness of environmental issues including considering the need to print documents.

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

Inclusion and diversity at APRA

APRA is dedicated to ensuring it continues to create an environment that fosters inclusivity and respect for all its employees. Diverse and inclusive teams are critical for APRA's success as they broaden the range of thinking that supports strong judgments, which are the foundation of supervisory authorities.

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 2017/18, APRA dealt with 28 applications for access to documents under the FOI Act, which included four applications that were on hand from the preceding year. One application for access to documents remained on hand as at 30 June 2018. One complaint made to the Information Commissioner was resolved in APRA's favour in 2017/18. In addition, one review by the Information Commissioner was ongoing as at 30 June 2018.

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

FOI application	Number
Grant in full	3
Grant in part	1
Access refused	21
Withdrawn	1
Transferred to another agency in full	0
Transferred to another agency in part	2
Ongoing at 30 June 2018	1
Total	**29**

No charges were collected for FOI requests in 2017/18. The estimated cost of handling initial FOI requests along with internal and Information Commissioner reviews was $35,000.

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;
- no investigations 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 work health and safety (WHS) measures during 2017/18 to safeguard the health and safety of its employees and visitors. These measures included:

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

A key project in 2017/18 was a review of the Rehabilitation Management System to support APRA's long term commitment to improving and supporting the physical and mental health of employees. This involves providing high quality and timely rehabilitation assistance and support to employees with injury or illness.

In addition, the Mental Health Ambassadors were replaced by 'Wellbeing Ambassadors' who have undertaken comprehensive mental health training as well as internal training relating to APRA policies and procedures to assist with their role.

WHS policies including establishing employee committees and selecting health and safety representatives

APRA conducts consultations on all WHS issues, including maintaining the WHS Committee with four employees and four management representatives. The WHS Committee satisfies legislative requirements, including meeting at least every three months and providing all employees with access to minutes of its meetings.

Health and safety outcomes

Two new workers compensation claims were submitted in 2017/18. APRA's Wellbeing Strategy, supported by health and wellbeing initiatives and increased workplace flexibility, has helped to ensure that personal sick leave is not taken beyond a reasonable level. In the 2017 calendar year, APRA employees were absent on personal sick leave for an average of 6.5 days per person, a slight increase from 5.9 days in 2016. On metrics for employee absences, APRA compares favourably to the overall public sector average and 'all-industry' averages.

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 relating to electoral expenditure.

In 2017/18, APRA has not incurred any electoral expenditure in relation to an election.

Auditor-general activities

The Australian National Audit Office (ANAO) undertook the required statutory financial audit of APRA for 2017/18.

Collective agreements and common law contracts

As at 30 June 2018, 515 employees were covered by the terms of the APRA Employment Agreement, 2015. In addition, 104 senior employees were covered by common-law agreements.

All employees 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 ranges for non-executive employees as at 30 June 2018 are:

Level	Range
Level 4	$127,239 - $212,136
Level 3	$89,566 - $149,206
Level 2	$61,762 - $102,937
Level 1	$40,962 - $68,342

The APRA Employment Agreement 2015 commenced on 8 December 2015 for a three-year term, with a nominal expiry date of 8 December 2018.

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 2017/18.

Commonwealth procurement rules

The *APRA Chairman's Finance Instructions and Finance Policies* (CFIs) 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 2017/18, APRA had one AusTender-exempt contract. 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 (SME) 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

APRA's CFIs, 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 in 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 2017/18, APRA entered into a total of six new consultancy contracts involving a total expenditure of $539,110.

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 finalising prudential policies, including new or amended prudential standards and reporting standards, as well as formal prudential guidance.

APRA complies with the Government's policy on best practice regulation. During 2017/18, APRA finalised one Regulation Impact Statement, and undertook three Independent Reviews in which APRA certified that its policy development involved a process and analysis equivalent to a Regulation Impact Statement. In addition, APRA completed 16 preliminary assessments; of these, the Office of Best Practice Regulation (OBPR) advised that further regulatory impact analysis was required for three.

Courts and tribunals

Over 2017/18, 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 usually 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 2017 to 30 June 2018:

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

The Executive Board has established a number of supporting committees and working groups.

These groups are set out below.

Risk Management Committee

APRA's risk management, compliance and performance reporting is overseen by the Risk Management Committee.

Attendance at Risk Management Committee meetings from 1 July 2017 to 30 June 2018

Member	Meetings	Attended
Fiona Bennett (Chair; external)	5	5
Sam Lewis (external)	5	5
Helen Rowell	5	4
Geoff Summerhayes (Alternate for Helen Rowell)	1	1

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 2017 to 30 June 2018

Member	Meetings	Attended
Sam Lewis (Chair; external)	5	5
Fiona Bennett (external)	5	5
Helen Rowell	5	4
Geoff Summerhayes (Alternate for Helen Rowell)	1	1

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 and 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, this 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 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: authorised deposit-taking institutions, 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 employees 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 concerning the health, safety and wellbeing of employees, and ensures these are integrated into broader management systems and practices.

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.

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 websites for at least two financial years. Grant programs, including discretionary grant programs, that APRA either jointly administered or participated in during 2017/18, including previous recipients of the Brian Gray Scholarship and the University of New South Wales Cooperative Actuarial Scholarship, are available on APRA's website: https://www.apra.gov.au/brian-gray-scholarship-program

Information on grants awarded by APRA during 2017/18 is available at: https://www.apra.gov.au/grants-and-scholarships

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 2017/18, APRA's total expenditure on external legal advice and litigation services was $1,277,788 (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 2017/18, APRA Members and executives made themselves available for public hearings before the:

- House of Representatives Standing Committee on Economics reference on APRA's Annual Report (13 September 2017 and 28 March 2018)
- Senate Economics Legislation Committee (sitting as Senate Estimates) (26 October 2017, 1 March 2018 and 30 May 2018)
- Senate Select Committee on Lending to Primary Production Customers (17 August 2017)

- Senate inquiry into the Treasury Laws Amendment *(Improving Accountability and Member Outcomes in Superannuation Measures No. 2) Bill 2017* (10 October 2017)
- Senate Community Affairs References Committee Private Health Insurance Inquiry Public Hearing (31 October 2017)
- Senate Economics Legislation Committee – Treasury Laws Amendment *(Banking Executive Accountability and Related Measures) Bill 2017* (17 November 2017)
- Economics Legislation Committee – Inquiry into the Financial Sector Legislation Amendment *(Crisis Resolution Powers and Other Measures) Bill 2017* (18 December 2017)
- Senate Economics Legislation Committee – Inquiry into Treasury Laws Amendment (*Enhancing Whistleblower Protections) Bill 2017* (March 2018)
- Parliamentary Joint Committee – Inquiry into options for greater involvement by private sector life insurers in worker rehabilitation (19 June 2018)
- House Standing Committee on Agriculture and Water Resources (21 June 2018)

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 employees and management, covering all eligible employees. For 2017/18, the aggregate bonus pool was $6.75 million. Under deferred bonus arrangements introduced in the APRA Employment Agreement, 2017/18 bonuses are only paid to eligible employees still in APRA's employ at the payment date.

Privacy Commission

There were no investigations by the Privacy Commissioner under section 40 of the *Privacy Act 1988* during 2017/18. 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

During the financial year 2017/18, the Hon. Scott Morrison MP, had portfolio responsibility for APRA as Treasurer of the Commonwealth of Australia. He was assisted by the Hon. Kelly O'Dwyer MP, Minister for Revenue and Financial Services.

EMPLOYEE STATISTICS

Additional statistics on APRA's employees are presented in Chapter 5 – Governance and Resourcing.

Table 1 - Type of employee agreements

Employee agreements	Total agreements (FTE)
Collective agreement	**515.6**
Common law contract	**104**
Fixed term < 12 months	**4**
Fixed term > 12 months	**4**
Statutory office holder	**3**
Total	**630.6**

Table 2 - Full-time and part-time employees across locations

Capital city	Full-time	Part-time	Total
Adelaide	7.0	1.5	**8.5**
Brisbane	14.0	0.6	**14.6**
Canberra	3.0	-	**3.0**
Melbourne	54.0	4.6	**58.6**
Sydney	508.0	37.9	**545.9**
Total	**586.0**	**44.6**	**630.6**

Table 3 - Full-time and part-time employees across divisions

Divisions	Full-time	Part-time	Total
Corporate Services	109.0	7.1	**116.1**
Diversified Institutions	88.0	7.7	**95.7**
Governance	46.0	2.3	**48.3**
Policy & Advice	109.0	11.0	**120.0**
Risk & Data Analytics	130.0	6.1	**136.1**
Specialised Institutions	104.0	10.4	**114.4**
Total	**586.0**	**44.6**	**630.6**

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 2017/18 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		14,718	13,174	1,544
Total		14,718	13,174	1,544
Total available annual appropriations and payments	**A**	**14,718**	**13,174**	**1,544**
Special accounts				
Opening balance		71,635		
Appropriation receipts		155		
Special appropriation receipts		135,076		
Payments made			123,523	
Total special account	**B**	**206,866**	**123,523**	**83,343**
Total resources and payments				
A+B		221,584	136,697	84,887
Less appropriation drawn from annual or special appropriations above and credited to special accounts		(14,718)	(13,174)	(1,544)
Total net resourcing and payments for APRA		**206,866**	**123,523**	**83,343**

AGENCY RESOURCES AND EXPENSES BY OUTCOME (continued)

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 and, in balancing these objectives, promotes financial system stability in Australia.	Budget	Actual expenses	Variance
Program 1.1: Australian Prudential Regulation Authority	$'000	$'000	$'000
	(a)	(b)	(a)-(b)
Departmental expenses			
Departmental appropriation[1]	6,426	14,718	(8,292)
Special accounts	135,198	129,294	5,904
Other services (Appropriation Bill No. 2)		-	-
Total expenses for outcome[1]	**141,624**	**144,012**	(2,388)

	Actual 2017/18	Actual 2016/17	Variance
Average staffing level (number)	607	606	1

1. Departmental appropriation combines '*Ordinary annual services (Appropriation Bill 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 2
	Index	Page 134-135
	Glossary	Page 6
	Contact officer(s)	Page 136
	Internet home page address and internet address for report	Page 136
Review by Chairman		Chapter 1
	Overview	Chapter 4
	Role and functions	Chapter 3 and 4
Overview of authority		
	Organisation structure	Page 60
	Outcome and program structure	Chapter 3 and 4
Report on performance		
	Review of performance in relation to programs and contribution to outcomes	Chapter 4
	Actual performance in relation to deliverables and KPIs	Chapter 4
	Narrative discussion and analysis of performance	Chapters 3-5
	Trend information	Chapters 3-5
	Discussion and analysis of the Authority's financial performance	Chapter 5 and 6
	Authority's resource statement and summary resource tables by outcomes	Pages 130-131
Corporate governance		
	Compliance with the Commonwealth Fraud Control Guidelines	Page 124
	Statement of the main corporate governance practices in place	Chapter 5
External scrutiny		
	Significant developments in external scrutiny	Chapter 3
	Judicial decisions and decisions of administrative tribunals	Chapter 7
	Reports by the Auditor-General, a Parliamentary Committee or the Commonwealth Ombudsman	Chapter 7

Part of Report	Description	Location or applicability
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 7
	Statistics on employees who identify as Indigenous	Chapter 5
	Enterprise or collective agreements, determinations and common law contracts	Chapter 7
	Performance pay	Chapter 7
Assets management		
	Assessment of effectiveness of assets management	Chapter 7
Purchasing		
	Assessment of purchasing against core policies and principles	Chapter 7
Consultants		
	Summary statement detailing consultancy arrangements and confirming that information on contracts and consultancies is available through the AusTender website.	Chapter 7
Australian National Audit Office access clauses		
	Absence of provisions in contracts allowing access by the Auditor-General	Chapter 7
Exempt contracts		
	Contracts exempt from the AusTender process	Chapter 7
Financial Statements		Chapter 6
Other information		
	Schedule 2 Part 4 of the *Work Health and Safety Act 2011*	Chapter 7
	Advertising and market research (Section 311A of the *Commonwealth Electoral Act 1918*) and statement on advertising campaigns	Chapter 7
	Ecologically sustainable development and environmental performance (Section 516A of the *Environment Protection and Biodiversity Conservation Act 1999*)	Chapter 7
	Grant programs	Chapter 7
	Disability reporting	Chapter 7
	Information Publication Scheme statement	Chapter 7

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