Australian Prudential Regulation Authority

APRA

# Annual Report 2011

**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, life and general insurance companies and reinsurance companies, friendly societies and most of the superannuation industry. APRA is funded largely by the industries that it supervises. It was established on 1 July 1998.

APRA currently supervises institutions holding $4 trillion in assets for almost 23 million Australian depositors, policyholders and superannuation fund members.

# APRA vision, mission and values

**Our vision** is to be a world-class integrated prudential supervisor recognised for its leadership, professionalism and innovation.

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

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

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

- Integrity
- Collaboration
- Professionalism
- Foresight
- Accountability

**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.

**Australian Prudential Regulation Authority**

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**John F. Laker AO**
CHAIRMAN

12 October 2011

The Hon Wayne Swan, MP
Deputy Prime Minister and Treasurer
Parliament House
CANBERRA ACT 2600

Dear Deputy Prime Minister,

In accordance with Section 59 of the *Australian Prudential Regulation Authority Act 1998*, I am pleased to submit the Australian Prudential Regulation Authority Annual Report and Financial Statements for the year ended 30 June 2011.

Yours sincerely,

John Laker

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Chapter one

# From the Chairman

## The crisis continues

For much of 2010/11, the Australian financial system was able to put the earlier acute strains of the global financial crisis further behind it. The operating environment seemed set fair. The global economy continued to recover, with robust growth in economies critical to Australian exports; global funding markets were readily accessible; and, after early investor hesitation, global (and domestic) equity markets resumed their lift from crisis lows. The Australian economy benefitted from record terms of trade, boosting income and employment. However, the pattern of growth was uneven: the structural adjustment to high commodity prices, working in significant part through the exchange rate, has proved painful for some sectors. Despite the supportive environment, any financial institution anticipating a return to the headier days of strong balance sheet growth before the crisis would have been disappointed. Households and businesses (outside the resources sector) in Australia have taken a cautious approach to their finances since the crisis began, evident most in a strong increase in household savings and the slowest pace in credit growth for two decades.

Around the middle of 2010/11, the financial shocks that had characterised the crisis gave way to physical shocks, in the form of a spate of natural disasters in Australia in rapid succession. These disasters had a disruptive effect on economic activity that has been slow to unwind. Compounded by the Christchurch earthquake, the disasters also had a large and immediate impact on the general insurance industry in Australia, which coped with it well.

Overall, the industries regulated by APRA were in good shape at year-end. In the case of authorised deposit-taking institutions (ADIs, including banks, building societies and credit unions), asset quality was sound, with non-performing loan ratios declining a little in business lending but drifting upwards in housing lending. Further reductions in bad debt expenses bolstered ADI profitability while profit retention and dividend reinvestment schemes pushed Tier 1 capital ratios to record levels, leaving ADIs well placed to deal with future stresses and regulatory reforms.

Despite the adverse impact of the natural disasters, the general insurance industry remained profitable and well capitalised. A large amount of the claims arising from these disasters will be covered by reinsurance. The industry's resilience owes importantly to prudent risk management on the part of boards and management, particularly in maintaining and renewing comprehensive reinsurance programs to spread catastrophe risks; it also reflects the robust risk-based capital regime introduced some years previously by APRA.

The recovery in equity markets over much of 2010/11, though losing momentum in the final months, underpinned a further improvement in the profitability of the life insurance industry and enabled capital to stabilise around pre-crisis levels, reinforcing various initiatives by life companies to strengthen their capital management during the crisis. The recovery in equity markets and higher fixed-interest earnings ensured that most superannuation funds earned positive returns for the second year in a row, after two consecutive years in the red.

Unfortunately, the global financial crisis is not over. Events since year-end have shown, on the contrary, that its aftershocks remain powerful. Increasing concerns about public finances in Europe and the United States – which had been weakened by earlier large-scale intervention to support ailing banks – and the sovereign debt exposures of European banks have been reflected in renewed bouts of turbulence in global equity markets, greater risk aversion in global funding markets and increasing pessimism about growth prospects, particularly for advanced but highly indebted countries. The implications of these developments for the Australian economy are not yet clear but what is obvious is that the operating environment for the Australian financial system is, yet again, clouded with uncertainties.

The sharp decline in global and domestic equity markets since year-end has had an immediate impact on the life insurance industry, which APRA is monitoring closely, and has eroded returns for superannuation funds. The deteriorating environment also poses two particular challenges for the ADI industry. The first is the danger of a widespread dislocation in global funding markets, in a rerun of October 2008. Risk aversion has intensified in bank funding markets in the euro area, where credit spreads have widened considerably, and it appeared to be broadening. The larger ADIs in Australia that tap global funding markets have very little direct exposure to the European banks and sovereigns under pressure but they would not be immune if, as in October 2008, risk aversion tarred all internationally active banks whatever their underlying quality. That said, the larger ADIs are now much better positioned to cope with a loss of access to global funding for a period.

The second and more general challenge is coming to terms with 'life in the slow lane'. The cautious attitude of households and businesses in Australia, which will be reinforced by recent global developments, will very likely deny ADIs the strong volume growth that supported a sustained period of profit increases before the crisis. Unless shareholder expectations adjust to the prospect of lower returns on equity, boards and management may be tempted to chase unrealistic expectations by assuming more risk – through lowering credit standards or seeking new and unfamiliar markets where they may have little comparative advantage – or by aggressive cost-cutting that may weaken risk management capacities. Those temptations must be resisted in favour of more measured strategic ambitions.

In its 2010 *Report*, APRA said it was not ready to reduce the intensity of its supervision from crisis levels because of the uncertainties then prevailing. That stance may have seemed unduly cautious as 2010/11 unfolded, but APRA's continued close oversight of the strategies, risk management systems and capital positions of institutions has been vindicated by recent developments. The crisis is entering what the International Monetary Fund has described as a 'dangerous new phase' and APRA will need to maintain the intensity of its supervisory and policy activities in the current year, and possibly beyond the current year.

## Regulatory responses

The new phase of the crisis repeats the lessons of history that weaknesses in banking systems can have deep and enduring impacts on economic activity. Since the crisis first erupted in 2007, global policymakers have been pursuing an ambitious reform agenda aimed at promoting a more resilient global banking system. Recent developments will add impetus to global reform efforts, even if the implementation task may become harder in some countries.

The core elements of the global reform agenda were finalised by the G-20 Leaders at their Seoul Summit in November 2010. The reform agenda rests on four pillars – a strong regulatory framework, effective supervision, reducing the risks posed by systemically important financial institutions, and transparent international assessment and peer review. Each of these pillars is shaping, fundamentally in some cases, the prudential framework in Australia and APRA's supervisory approach.

Global reform measures to strengthen the regulatory framework (the first pillar) are centred on raising the quality, quantity and international consistency of bank capital and liquidity. A new global capital and liquidity framework ('Basel III') has been developed by the Basel Committee on Banking Supervision, the global standard-setting body for banking regulation, and was largely finalised in December 2010. This point was reached only after extensive deliberations within the Basel Committee (of which APRA and the Reserve Bank of Australia are members), industry consultation and a series of quantitative impact studies, in which a number of ADIs in Australia participated.

The rubber is now hitting the road on these particular reforms. Although the Australian banking system has to date weathered the global financial crisis much better than most peers, APRA sees no case to distance Australia from the reforms. The larger ADIs in particular trade actively in global financial markets, are reliant on global funding markets and raise equity from global investors. These ADIs are global citizens, and investors and market analysts judge them accordingly. It is entirely appropriate, in APRA's view, that they at least meet minimum global standards. To strengthen the resilience of the Australian banking system, APRA proposes to apply the new global capital and liquidity framework to all ADIs in Australia, with some exceptions for ADIs with simple, retail-based business models.

The new global framework will be implemented in Australia in three broad phrases. The first phase, involving enhancements to the three Pillars of the Basel II Framework, will come into effect from 1 January 2012. The enhancements, *inter alia*, improve the risk coverage of the Framework by ensuring that appropriate capital is held to support the risks arising in trading activities, securitisations and exposures to off-balance sheet vehicles. The new capital requirements will have only a limited impact on ADIs in Australia.

The second phase, involving a comprehensive package of capital reforms, will come into effect in stages from 1 January 2013. This package includes measures to raise the quality and minimum required levels of capital, promote the build-up of capital buffers and establish a back-up leverage ratio. It formalises two capital buffers – a conservation buffer above the regulatory minimum capital requirement that is intended to be drawn down in periods of stress, subject to restrictions on capital distribution, and a countercyclical buffer that will come into effect when excessive credit growth and other indicators point to a build-up in systemic risk.

APRA's proposals for implementing the Basel III capital reforms in Australia have now been released. APRA proposes to broadly adopt the minimum Basel III requirements for the definition and measurement of capital, which will require some 'give and take' on current policies in a number of areas. In other areas, however, APRA proposes to continue with its conservative policies and not apply the concessional treatment available. In sum, APRA's proposed approach, accompanied by clear disclosure of the points of departure from Basel III, will go a considerable way to improving the comparability of 'headline' capital measures for ADIs in Australia with overseas peers. International comparability, however, is not an end in itself. APRA's fundamental objective must be to ensure that capital held by ADIs in Australia is genuinely available to absorb losses. Two longstanding points of principle underpin APRA's conservatism: assets that rely on the future profitability of the ADI to be realised or that are highly uncertain in value cannot be included in the calculation of capital, and capital cannot be used more than once in the financial system to absorb losses. There is no evidence from the global financial crisis that APRA's conservatism, which produces lower 'headline' capital ratios compared to other jurisdictions, penalised ADIs in Australia in raising equity capital, accessing wholesale funds at competitive rates or maintaining their credit ratings. The opposite was more likely the case.

Furthermore, APRA's proposal to accelerate aspects of the Basel Committee's timetable has, quite rightly, been interpreted as a vote of confidence in the strength of the Australian banking system.

The third phase of global banking reforms, involving stronger liquidity regulation, will begin to come into effect from 1 January 2015. These reforms seek to promote stronger liquidity buffers and more stable sources of funding through two new global liquidity standards – a 30-day liquidity coverage ratio to address an acute stress scenario and a structural funding ratio to encourage longer-term resilience. Australia could not meet the liquidity coverage ratio as originally proposed because the volume of high-quality liquid assets (particularly government securities) is, for the best of reasons, in short supply in Australia. These circumstances have been recognised by the Basel Committee, and APRA and the Reserve Bank of Australia worked closely with fellow Committee members to agree an alternative treatment that meets the intent of the global reforms. APRA's proposals for implementing the Basel III liquidity reforms will be released shortly.

One aspect of the G-20's reform agenda has been finalised. That involves the implementation of 'tough' principles aligning remuneration in banking institutions with prudent risk management and the long-term financial soundness of these institutions. APRA implemented these principles in April 2010 through amendments to its governance standards and has since been assessing their practical impact.

APRA's substantial prudential policy workload in 2010/11 was not dictated entirely by global reform agendas and timetables, although some other initiatives have had their origins in lessons from the crisis. The severe contagion problems that required the public rescue of a major global insurance group highlighted the need for supervisors to be able to take a group-wide view of their regulated institutions and to understand the full range of risks that arise from group membership. Acknowledging this, APRA has been consulting on a proposed prudential framework for consolidated groups. APRA is also reviewing, and harmonising where it can, capital standards for the general and life insurance industries. This review has proven timely, given the recurring episodes of equity market volatility and, for general insurers, the recent natural disasters. APRA has also been preparing for the Government's Stronger Super reforms and it welcomes the Government's commitment to grant APRA the power to make prudential standards in superannuation. Prudential standards are more flexible than legislation, can recognise differences in the nature, size and complexity of institutions and can be kept up-to-date with industry developments. If approved by Parliament, a standards-making power in superannuation will be a major step in the harmonisation of the prudential framework in Australia, a key aspiration of APRA since its establishment.

## APRA's supervisory activities

The G-20's emphasis on effective supervision, as the second pillar of its reform agenda, is an important, albeit belated, recognition by global policymakers that a strong regulatory framework must be complemented with more intense and active prudential oversight and supervision. Differences in the ability and willingness of supervisors to act have come to be seen as a significant factor in the different performance of banking systems during the crisis, under the same broad set of global banking regulations. In support of this pillar, the International Monetary Fund (May 2010) and the Financial Stability Board (November 2010) have provided a series of recommendations for making the supervision of financial institutions more intense, effective and reliable. APRA has contributed to this work.

Some of the recommendations address broad governance issues, such as the mandate and independence of the supervisory agency, and some address supervisory powers. Australia's arrangements meet these recommendations. Importantly, APRA has been fully supported by successive governments in securing the broad range of powers needed to carry out its role. Other recommendations identify areas where improvements to supervisory techniques could be or are being made. These include the use of industry-wide ('thematic') reviews, analysis of business models and products, and stress-testing. The recommendations will be benchmarks for APRA as it seeks to enhance its supervisory approach in response to industry developments and its experience during the crisis.

One of these benchmarks relates to supervisory assessment of the role of boards, which have ultimate responsibility for the prudent management of a financial institution. APRA's engagement with boards is central to its supervisory approach. APRA has extensive formal requirements on boards that set out minimum foundations for good governance. APRA sees these requirements not as constraining but as empowering boards because they give a frame of reference for good practice and underpin the strong alignment of interests between the board and APRA. APRA has also increased its face-to-face contact with boards since the crisis began. Meetings with a board and its committees give APRA the opportunity to reinforce its expectations of board performance and to form first-hand impressions of whether these expectations are understood and accepted by directors. Discussions across the table enable directors to explore with APRA ways in which its prudential concerns could be addressed and how the institution is faring compared to its peers. The exchanges also enable APRA to take good soundings on the risk appetite of the board, its command of strategy, the transparency and candour with which the board approaches problems and, more generally, on how it sets the 'tone at the top' for the institution.

During 2010/11, APRA stepped up its engagement with boards in three particular areas. The first was risk appetite. A clearly articulated statement of the board's appetite for risk is at the heart of a good risk management framework and it needs to be actively and consistently applied in the business. APRA met with a number of boards to review practice in this area and found a wide range of approaches to risk appetite statements in terms of their length, their qualitative or quantitative nature, their scope and, indeed, their quality. APRA does not have a particular template in mind. Rather, as a principles-based supervisor, its interest is in how well the risk appetite statement fulfils its purpose, in conveying clearly and concisely the board's preferences and risk tolerances to the rest of the institution. Where needed, APRA will be seeking improvement in both the articulation of risk appetite and in its application.

The second area was executive remuneration. APRA met with the Board Remuneration Committees of the largest listed ADIs and insurers to assess the involvement of the board in establishing sound remuneration practices and to discuss any challenges facing boards in implementing APRA's remuneration requirements. Remuneration practices were generally sound but APRA saw scope to improve risk-adjusted performance measures, the differentiation of individual from organisation-wide performance, the use of scorecard approaches and oversight of the APRA-regulated subsidiaries in a group.

The third area was credit standards in ADI housing lending. Against the background of a continued upwards drift in loan arrears and intensifying competition in housing lending, APRA wrote to the boards of the largest ADI housing lenders reminding them of the need to be alert to any deterioration in housing lending standards. The letter was deliberately targeted at the largest lenders, which are the industry standard-setters. If these lenders choose to lower lending standards to win business, smaller competitors may feel they have little option but to follow. APRA received the assurances it sought. The decision to write such a letter to, and seek specific assurances from, boards rather than management was designed to have boards question the lending practices of their institution more deeply than they might have been doing.

One key element of effective supervision that global policymakers are now emphasising is the adequacy of staffing resources and skills in a supervisory agency. Although resourcing has always been tight, APRA has over recent years been able to build up sufficient capacity to absorb a substantial supervisory and policy workload. Even so, the resources APRA dedicates to the supervision of large and complex financial institutions is at the lower end of the scale compared to many other supervisory agencies. APRA's current staffing levels are supported by the special four-year funding from Government to deal with the global financial crisis, which comes to an end after 2011/12. In the face of the continuing aftershocks from the crisis, APRA believes it is essential that it maintains its supervisory and policy capacity over the coming period.

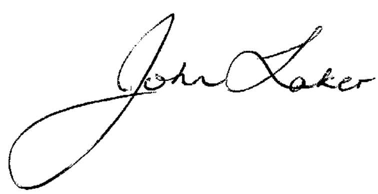
The remaining two pillars of the G-20's reform agenda are now beginning to shape APRA's supervisory approach and workload as well. Global reform efforts under the third pillar – reducing the risks posed by systemically important financial institutions (SIFIs) – have to date focussed on a policy framework for dealing with global systemically important banks (G-SIBs). That framework envisages a scorecard methodology developed by the Basel Committee for identifying G-SIBs, which would be subject to higher capital requirements, strengthened supervisory oversight and robust recovery and resolution regimes. No Australian-owned bank is included in the initial list of G-SIBs. The G-20 has indicated its intention that, in due course, a policy framework be put in place for domestic SIFIs but to date there has been little discussion about such a framework in the global standard-setting bodies. The intensity of APRA's supervisory activities, its supervisory response system and its setting of prudential capital requirements already have regard to the systemic importance of regulated institutions within Australia, measured broadly in terms of balance sheet size. As part of its enhancement to crisis management arrangements in Australia, APRA has begun work with the larger ADIs on their 'living wills', starting with their recovery plans for circumstances in which they suffer major depletion of their capital.

The final pillar, transparent international assessment and peer review, will see APRA subject to greater external scrutiny on its adherence to global standards and the rigour of its supervisory approach. APRA welcomes such scrutiny. During 2010/11, APRA contributed to three reviews conducted by the Financial Stability Board – a peer review of the Australian financial system, a thematic review of Australia's compliance with global principles for deposit insurance and a peer review of implementation of the Board's remuneration principles in member jurisdictions. APRA also undertook a self-assessment of its compliance with those aspects of the Basel Committee's *Core Principles for Effective Banking Supervision* most relevant to the Board's work on supervisory intensity for SIFIs. APRA is also preparing to participate in the second review of Australia under the International Monetary Fund's Financial Sector Assessment Program (FSAP), which evaluates the strength of a country's financial system and regulatory architecture. The first FSAP review of Australia was conducted in 2005/06.

APRA Members in 2010/11 – (left to right) **Dr John Laker, Mr Ross Jones** and **Mr Ian Laughlin**.

## Our people

The adequacy of staff resourcing and skills in a supervisory agency is more than a story about headcount and training budgets, important though these are. There is a less tangible dimension that cannot be overlooked, namely, having staff with the right supervisory 'mindset'. APRA has worked hard to inculcate in each of its staff an inquiring mind, a certain level of feistiness and doggedness, a willingness to challenge and intervene, the ability to see the broader industry or policy context and, of course, a strong professional ethos. That mindset, though always under development, has stiffened APRA's resolve for periods of crisis. It has also been broadly acknowledged in the positive results of APRA's second stakeholder survey, which gave two of its three top scores to APRA's staff's demonstration of integrity and professionalism. The coming period will be another test of skills and stamina but the APRA Members are fully confident that APRA staff, as they have since the crisis erupted, will meet that test. Their commitment to the financial security of the Australian community has been outstanding.



Dr John F Laker
Chairman

Chapter two

# APRA's supervisory activities in 2010/11

## Authorised deposit-taking institutions

Authorised deposit-taking institutions (ADIs) in Australia benefitted from a broadly supportive economic environment during 2010/11. The global economy continued to expand and conditions in global funding markets were generally favourable. The Australian economy showed underlying strength, with low unemployment and the boost of a record terms of trade, but the growth pattern was uneven. The resources sector boomed but cautious behaviour by households and businesses and the high level of the exchange rate had a significant dampening effect in other sectors. Growth was also disrupted for a time by a series of natural disasters. For the ADI industry, the prevailing tone of caution was reflected in two developments. One was the continued subdued pace of credit growth, still at its lowest rate since the early 1990s recession. Housing lending grew only moderately and business lending, despite some more recent positive signs, remained in the doldrums. The second development was the strong growth in deposits, well in excess of the growth in credit, which has had important and positive implications for ADI funding patterns. Asset quality remained sound and non-performing loan ratios, incorporating some temporary impacts from the natural disasters, were steady overall. Provisions as a percentage of total lending declined slowly from their earlier peak.

Notwithstanding the subdued growth in credit, the profitability of the ADI industry as a whole strengthened in 2010/11, largely as a consequence of further reductions in bad debt expenses. Interest margins were broadly steady. For the largest ADIs, profits were above pre-crisis levels but the recovery in profits by some other ADIs has been slower. Continued profit retention and dividend reinvestment schemes have pushed total capital ratios for the ADI industry to their highest levels since the early 1990s, and Tier 1 ratios (the best quality capital) to record levels. The substantial industry consolidation spurred by the crisis appears to have run its course to this point but credit union numbers have continued to decline through mergers.

### Liquidity and funding

Since the severe dislocations to global funding markets that first marked the crisis, the management of liquidity and funding by ADIs has remained under APRA's close supervisory watch. An enhanced range of supervisory activities related to liquidity and funding is now embedded in APRA's routine supervision work. At least annually, supervisors expect ADIs to prepare a forward-looking plan with specific quantitative funding targets. Benchmarking analysis conducted by APRA allows supervisors to compare expectations for asset growth across ADIs and how they expect this growth will be funded. Supervisors are alert to issues such as aggressive expectations about deposit growth relative to peers, or increasing reliance on short-term wholesale funding or securitisation. Regular discussions are held with ADI treasurers on their funding plans and targets.

In addition, supervisors monitor a range of liquidity measures on a monthly (or in some cases more frequent) basis including, for example, liquid asset levels and composition, upcoming wholesale funding maturities, the average duration of wholesale funding and trends in the share of funding sourced from offshore. Unusual changes or outliers are raised for explanation, in some cases at the ADI board level. APRA is increasingly seeing liquidity metrics, such as stable funding ratios or deposit/loan ratios, incorporated into the liquidity risk appetite targets of ADIs.

During 2010/11, APRA asked all large, locally incorporated ADIs to undertake a self-assessment of their liquidity risk management, including the identification of funding gaps and closure plans, against the Basel Committee on Banking Supervision's *Principles for Sound Liquidity Risk Management and Supervision*. APRA established a team of frontline supervisors, liquidity risk specialists and policy staff to consider these self-assessments, allowing a detailed institution-specific review and an industry-wide comparison. Generally speaking, the ADIs involved either meet the principles already or are well placed to enhance their risk management frameworks where current practice falls short. Common areas for further development relate to stress-testing, contingency planning and liquidity risk transfer pricing. APRA has observed that many ADIs need to enhance the range and severity of their current stress-testing suite, link stress-tests more explicitly to contingency planning and use stress-testing to assist the board in determining its risk appetite. ADIs recognise the value of the discipline of transfer pricing for liquidity risks but acknowledge a need to drive this discipline deeper into the decision-making of the institution. APRA has been following up on any significant issues with relevant ADIs as part of its normal supervision of liquidity risk management.

Since the crisis, ADIs have substantially improved their funding positions. They have built up their liquidity buffers as a contingency against market disruptions and have made significant changes to the structure of their liabilities. In particular, ADIs have been able to reduce their reliance on short-term wholesale funding because of strong growth in retail deposits and they have taken advantage of good market opportunities to lengthen the maturity profile of their funding books.

These improvements have left ADIs better placed to meet new global liquidity and funding requirements, although these remain some way off (see Chapter 3). With an eye to the requirements, ADIs have been looking carefully at the stability characteristics of different types of funding instruments and their underlying terms and conditions. In the case of term deposit contracts between ADIs, APRA identified instances of asymmetric treatment, where the ADI that had placed the term deposit was treating it as an asset that can be readily converted into cash but the ADI that had received the deposit was treating it as a liability with a contractual final maturity. APRA wrote to ADIs in December 2010 setting out its expectations for the symmetric treatment of term deposit contracts. The consequence has been a material reassessment of liquid asset holdings by some ADIs.

More immediately, the improved funding position of ADIs will help them better withstand the stresses in global funding markets that have re-emerged over recent months. These stresses had initially been confined to bank funding markets in the euro area, reflecting increasing concerns about the exposure of European banks to sovereign debt problems in Europe and to each other, but stresses have now extended to all term funding markets. The larger Australian ADIs that tap global funding markets have retained good access to short-term funding, although spreads have been widening, and they are, in any event, ahead of targets on their wholesale funding. As a consequence, ADIs could survive a period without access to global funding provided domestic markets continue to operate relatively normally. However, any protracted dislocation that extended well into 2012 would start to coincide with wholesale debt maturities, in a market likely to be crowded by sovereigns and banks offshore.

The securitisation market in Australia, an important source of funding and capital management for regional banks and other ADIs before the crisis, showed further signs of improvement in 2010/11. The volume of new issuance was at its highest since the crisis, spreads tightened and support from the Australian Office of Financial Management was not needed for a number of issues. Notwithstanding this improvement, investor caution is still such that the originating ADI has been required to retain all, or nearly all, of the most subordinated tranche(s) of the issue, where credit risks associated with the securitisation transaction are concentrated. Longstanding prudential policy, in Australia and globally, is that ADI originators can only claim regulatory capital relief on securitisations if there has been significant credit risk transfer to third parties. In reviewing recent securitisations, APRA found that some originating ADIs had been applying this policy appropriately while others had not. Against this background, APRA wrote to ADIs in August 2010 restating its policy in this area and clarifying those features of securitisations that would not be consistent with the requirements for capital relief. Following discussions with industry, APRA wrote again to ADIs in December 2010 outlining an alternative capital treatment it was prepared to approve, as an interim measure, for securitisations that did not meet APRA's prudential requirements because of inadequate credit risk transfer.

## Credit quality

APRA's traditionally close oversight of ADI credit quality has changed in focus though not in intensity over the past couple of years. In the early phase of the crisis, APRA paid greatest attention to corporate and commercial property exposures. The latter exposures were the cause of significant losses for ADIs in previous downturns and that proved the case again for some ADIs. Commercial property exposures have been the main source of the increase in ADI impaired assets since 2007 and were over-represented on ADI 'watch lists'. In response, affected ADIs have scaled back both the volume and the concentration of their commercial property lending and have tightened underwriting requirements, applying more conservative loan-to-valuation ratios (LVRs) and stronger covenants. They have also given clear priority to maintaining existing relationships with longer-term property borrowers over the pursuit of new financing opportunities. The rise in the share of commercial property and corporate exposures that is impaired appears to have peaked.

During 2010/11, APRA shifted its attention to credit quality in ADI housing lending. Non-performing loan ratios for housing lending remain low by historical and international standards but ratios have been drifting steadily upwards, particularly amounts past due, for which the (temporary) impact of recent natural disasters provides only part of the explanation. This upward drift has occurred in the context of higher mortgage interest rates, unprecedented low growth in housing lending, intensifying competition and signs of pressure on credit standards. APRA is also well aware of a view abroad that the ADI industry in Australia has a particular vulnerability in housing lending because balance sheets have become concentrated on this form of lending and, on some objective measures, Australian housing prices are viewed as overvalued.

Against this background, APRA wrote to the boards of the larger ADIs active in housing lending to remind them of the need to be alert to any deterioration in housing lending standards. APRA also sought assurances from each board that:

- it is actively monitoring its housing lending portfolio, with a clear focus on the quality of new lending;
- it is comfortable with its current credit standards, particularly with regard to high LVR lending, the conservatism built into debt serviceability calculations and the robustness of valuation practices;
- it is tracking and closely scrutinising the level and type of lending policy exceptions, which for some ADIs can be substantial in number;
- its provisioning practices are being reviewed to ensure they are consistent with current credit standards and that assessments of expected loss are not based on assumptions of house price appreciation; and
- planning and remuneration arrangements are reflective of the more subdued market environment and that growth or market share targets that are being achieved by substantially higher risk-taking will not be rewarded.

Each of the boards concerned provided those assurances. One theme to emerge from the responses was that, although boards are active in monitoring the performance of housing lending portfolios, they do not always involve themselves in a pre-emptive way in setting housing lending standards; many are only informed of material changes to policy after the event. APRA expects that boards will take a close interest in housing lending standards and not intervene to amend these standards only after signs of trouble. In its follow-up, APRA will be seeking further information from a number of ADIs about the basis on which their boards provided the assurances APRA sought. APRA will also be reviewing the supervisory action plans for those ADIs that could be lapsing into poor underwriting practices, to ensure that the quality of housing lending remains at the forefront of APRA's supervision.

## Living wills

In the wake of the global financial crisis, global policymakers have committed to strengthening the powers and tools available to supervisory agencies to restructure or resolve financial institutions in crisis. This initiative is encapsulated in the term 'living will'. A living will refers to two separate but related matters: recovery plans and resolution plans. Recovery planning focuses on measures that would enable a financial institution to survive a severe crisis, such as through strategies for raising additional capital, accessing liquidity or disposing of non-core business. Resolution planning focuses on measures that would enable a cost-effective resolution of the institution by the authorities where recovery is not possible, such as through simplifying complex group structures to facilitate resolution. Recovery and resolution planning are related in that both deal with distress events that threaten the viability of a financial institution and both seek to achieve a resolution that minimises adverse systemic impact, at the lowest risk to taxpayers.

In July 2011, the Financial Stability Board released for consultation a set of proposals on resolution that encompass recovery and resolution plans; though aimed at systemically important financial institutions, the proposals also apply in principle to any regulated financial institution. The living will concept has been adopted by supervisory agencies in a number of countries and is increasingly becoming a core element of prudential supervision.

Against this background, APRA has begun its own work on living wills. Its initial priority is recovery planning in the ADI industry. In the latter part of 2010/11, APRA established a pilot program on recovery planning for a number of the larger ADIs. This will require the ADIs to prepare a comprehensive recovery plan that sets out the specific actions they would take to restore themselves to a sound financial condition in the face of a major depletion of capital and associated liquidity pressures. Draft recovery plans will be required by the end of 2011. Finalised plans, signed off by the board of each ADI, will be required by mid 2012. APRA intends to extend its recovery planning program to a wider set of ADIs in 2012/13 once the results of the pilot program have been analysed. Recovery planning is also likely to be extended to the larger general insurers and life insurers in due course, modified to suit the nature of their business. APRA will also be undertaking an assessment of institution-specific resolution planning, but only after it is satisfied that substantial progress has been made on recovery planning.

## Executive remuneration

During 2010/2011, APRA took its oversight of executive remuneration arrangements a step further by meeting with the Board Remuneration Committees of the largest listed ADIs and insurers.

APRA's prudential requirements on remuneration, which came into force in April 2010 as extensions to APRA's governance standards, have at their heart two basic objectives: to promote a strong alignment between remuneration and risk-taking, and to ensure that boards are actively involved in determining the remuneration framework and outcomes for senior executives and other key individuals. Reflecting this focus on the role of the board, the purpose of APRA's meetings with the Board Remuneration Committees was to assess first-hand the involvement of the board in establishing sound remuneration practices and to discuss any challenges facing boards in implementing APRA's remuneration requirements.

APRA has concluded that the remuneration practices of the institutions it met are generally sound. All of these institutions had well-established Board Remuneration Committees with clear and robust governance arrangements. Typically, there was also a strong linkage between the Board Remuneration Committee and the Board Risk Committee, usually via a number of common members. APRA was able to confirm that the Board Remuneration Committees sought advice from external sources independent of the advice obtained by management, as required by the governance standards. As a trend, institutions are increasing the proportion of variable reward that is subject to deferral and vesting arrangements, and vesting periods are being lengthened.

Nonetheless, APRA saw scope to improve the alignment of risk and reward. One area for improvement is the application of the governance standards to APRA-regulated subsidiaries, which have to meet the standards in their own right. While many subsidiary boards have elected to adopt the remuneration policies and guidelines of their parent/group, which is allowed, it was not clear in all cases that the remuneration arrangements for responsible persons of the subsidiary were receiving scrutiny at subsidiary board level. Secondly, most of the Board Remuneration Committees had introduced performance assessment arrangements based on a scorecard approach, in which financial, risk and operational objectives and benchmarks are established against which to assess performance. However, the application of these scorecard approaches varied widely, with quite different balancing of objective and subjective measures of performance. This made it difficult to assess the robustness of some individual approaches. Finally, while all institutions concerned have risk-based performance measures, in many cases the measures focus on group or organisation-wide performance rather than on the contribution of the individual to overall outcomes. Such approaches do not necessarily provide a strong link between individual risk-taking and remuneration outcomes.

### Operational risk

A number of material operational risk incidents during 2010/11 required supervisory attention. Most significant were the natural disasters in Queensland, which tested the business continuity plans of ADIs, particularly those headquartered or with activities concentrated in the areas affected. A number of ADIs experienced significant disruptions and many were forced to close branches for a period of days. APRA was in regular contact with the ADIs affected as to the status of their operations. Overall, disaster coordination arrangements worked well to ensure reasonable continuity of banking services. This no doubt owes in part to the considerable attention APRA and the ADI industry have paid to business continuity and disaster recovery capabilities in the last few years.

Other operational risk issues included security breaches, payment system outages and deficient information technology (IT) outsourcing arrangements. A number of the larger ADIs have ageing core banking systems and are in the process of replacing these systems or planning to do so. Technological innovation can be a powerful basis for differentiating customer service and controlling costs. That said, APRA has been monitoring progress on system upgrades because of the significant risks, investment costs, management distraction and IT development fatigue that can be associated with replacing old, large-scale and complex banking platforms. APRA also wrote to the ADI industry (and the other APRA-regulated industries) in November 2010 outlining its expectations for the outsourcing or off-shoring of any material business activity, including the use of cloud computing.

APRA has also been reviewing the extent to which the operational risk capital models of the 'advanced' ADIs – those ADIs with APRA approval to determine their operational risk capital requirements using an internal model – have adequately captured, and are sufficiently sensitive to, changes in operational risk profiles. Generally speaking, APRA has found that current models have not been particularly sensitive to material changes in risk profiles. In addition, in a number of instances scenarios appear to be insufficiently stressed, especially in light of the operational risk issues highlighted above. As a consequence, APRA will be reviewing model inputs and outputs, and therefore the regulatory capital requirements, in the year ahead to ensure they generate appropriate and risk-sensitive capital holdings.

## General insurance

The general insurance industry remained profitable and well capitalised over 2010/11, despite the adverse impact of a spate of natural disasters in Australia and New Zealand.

A large proportion of the industry's premium revenue is derived from property classes of business; as a consequence, the financial performance of the industry is heavily influenced by the number and size of natural disasters. Gross claims from the natural disasters in 2010/11, which were unprecedented in their rapid succession, already dwarf the claims experience of previous natural disasters underwritten by the industry, and the final claims figures from the New Zealand earthquakes will not be known for some time. However, a large amount of these claims was covered by reinsurance and this has significantly dampened the impact of the natural disasters on industry profitability. Profitability was also supported by strong increases in premium rates for some classes of business over the previous year and by stable investment earnings. The aggregate capital ratio fell over the year, largely reflecting increases in required capital for the higher reinsurance recoveries and insurance concentration risk. It was nonetheless around 1.75 times APRA's minimum capital requirements, a strong position.

Given the unprecedented sequence of natural disasters, APRA established a small team of specialist staff to monitor the insurance claims from these events and to assess the impact of these claims on individual insurers and on the industry as a whole. APRA wanted to satisfy itself that each insurer had the financial capacity to meet its capital requirements and, ultimately, its claims from policyholders. The team examined insurers one-by-one and worked closely with those insurers most impacted. Some smaller insurers, where the relative claims cost was larger, secured additional capital from their foreign parents to cover future claims. Broader issues identified by this review process were the varying quality of the Reinsurance Arrangements Statements provided to APRA and the need for more robust stress-testing. APRA has highlighted these issues to industry through a range of forums and as part of APRA's ongoing supervisory reviews.

One particular market development that APRA is monitoring closely is the increasing presence of price comparison platforms (or 'aggregators') in the Australian insurance market. Experience in the personal lines market in the United Kingdom has shown that growth in the market shares of aggregators has been linked to falling underwriting profits and soft market conditions. By its very nature, insurance pricing involves an element of uncertainty; hence, the premium for identical risks will vary across insurers depending on the assumptions that underpin their pricing process. Aggregators highlight to customers the insurer offering the lowest premium for their particular risk characteristics. As a result, insurers tend to only 'win' business in the segments in which they are the cheapest, and customers are likely to switch insurers more frequently. This makes it more difficult for insurers to underwrite a profitable portfolio of risks.

The impact of aggregators in the Australian personal lines market (particularly motor insurance) has been relatively modest to date. In the commercial lines market, broker groups have recently developed price comparison platforms for products sold to small to medium enterprises (SMEs), although it is too early to assess their impact. In this more competitive environment, it is incumbent on insurers to maintain prudentially sound approaches to underwriting and pricing business.

## Counterparty exposure

The exposure of the general insurance industry to reinsurers is a material source of counterparty risk and that risk is heightened after a series of domestic or global catastrophes. Hence, this risk has been receiving particular attention from APRA. APRA regularly receives information on reinsurance counterparties of individual reinsurers through the Reinsurance Arrangements Statement and sometimes through the Financial Condition Report. However, this information is difficult to aggregate; in particular, it is not possible to quantify the impact on the capital of the industry of any downgrade in the rating of a significant reinsurer. To overcome this information gap, APRA undertook a special data collection during 2010/11 to assist its assessment of the degree of industry exposure to particular reinsurers ('concentration risk'). The data collection showed that most reinsurers were rated AA- or A+; under APRA's prudential requirements, a downgrade of a reinsurer by one notch from AA- would have an impact on the capital requirements of an insurer that has ceded risk to that reinsurer. That said, the data collection also indicated that there was a reasonable spread of reinsurers used across the industry and that most insurers did not have material concentrations of exposure to particular reinsurers. The majority of large reinsurance exposures are to major overseas insurance groups, particularly those located in Bermuda, the United States, Germany and Switzerland. APRA is currently considering whether additional data on reinsurance exposures should be collected on a regular basis.

## Reinsurance placement risk

The recent spate of natural disasters in Australia and New Zealand has increased the possibility that key reinsurers might withdraw or restructure their capacity (either partially or totally) in this region. Some reinsurers have already raised prices significantly for reinsurance cover, which will flow into direct premium rate increases and a tightening of underwriting standards for property classes of business. Furthermore, some reinsurers are now likely to be less willing to underwrite the lower layers of insurers' catastrophe reinsurance programs or provide aggregate or other types of reinsurance protection programs. This provides opportunities for overseas reinsurers, possibly of lower credit quality, to enter the Australian market to underwrite reinsurance arrangements in which existing reinsurers no longer wish to participate. In this environment, insurers might opt to retain increased catastrophe risk on their balance sheet by increasing their retention, or accept higher credit risk by using reinsurers of lower credit quality. Both outcomes potentially weaken the capital position of insurers and increase their capital requirements. In the case of insurers with material property exposures, APRA's priority has been to monitor their reinsurance strategy and its alignment with their risk and capital management strategy, and assess how reinsurance arrangements operate under different claims scenarios and the stress-testing being undertaken in this area. APRA has also been reviewing insurers' systems and processes for managing aggregate exposures and concentrations of exposures.

## Adequacy of pricing processes

The adequacy of the pricing processes of insurers receives significant supervisory attention from APRA. Its review of these processes during 2010/11, using information provided in Financial Condition Reports and from on-site visits, found wide variation in the adequacy of pricing processes across industry; in many cases, pricing processes have weaker management and controls than other aspects of insurers' activities. Specific areas for improvement include enhancements to the quality of input data used for pricing, identification of technical prices to achieve a target profit margin rather than relying on market rates, and more comprehensive monitoring. Examples of better practice in monitoring include analysis of quote conversion, comparison of book and actual prices to technical prices, and segment analysis of actual versus expected business written to detect inadequate pricing.

A number of recent developments may increase the risk that inadequate pricing processes expose insurers to the possibility of significant losses. These include:

- the introduction of broker aggregator sites in the SME market which, as discussed above, allow customers to more readily identify and exploit insurers' pricing structures;
- the prospect of higher reinsurance retentions following the recent spate of catastrophes, which will require more robust approaches for determining appropriate allowance in premiums for natural perils; and
- deterioration in the profitability of some long-tail classes of business that may have been masked by reserve releases over recent years. Such releases are expected to decline or cease altogether over coming years.

## Life insurance and friendly societies

The continued recovery in domestic and global equity markets from crisis lows over much of 2010/11, though faltering in the later months, underpinned a further strengthening in profitability and capital in the life insurance industry (including friendly societies). Industry profitability returned to levels prior to the crisis, driven mainly by higher investment income attributable to shareholders and continued strong growth in risk insurance business. Over the year, life insurance assets rose only slightly, with the increase in asset values largely offset by net cash outflows.

The improvement in profitability and in asset values, in turn, enabled the capital position of the life insurance industry to stabilise around pre-crisis levels. The industry is therefore well placed to cope with the renewed turbulence in equity markets over more recent months. The capital strength of the industry had been a major focus of APRA throughout the crisis and it worked closely with life insurers, particularly those most heavily invested in equities, to secure improvements in capital management and reporting. As a consequence, though APRA is on heightened alert status, it remains confident that the industry has adequate capital resources and sufficiently robust capital management to absorb further shocks. That said, life insurance boards and management will need to remain especially vigilant about their capital positions.

Consolidation in the industry has continued apace, with the acquisition of the Australian business of AXA Asia-Pacific by AMP Limited, and other ownership changes. Further rationalisation of multiple licences held by a number of financial groups is expected over the next couple of years. At the same time, the industry is witnessing the recent entry of a small number of major foreign life insurers after a long period in which foreign insurers, particularly those headquartered in the United Kingdom, had exited the Australian market. Friendly society numbers fell to 14 and friendly society assets remained unchanged over 2010/11 despite the positive investment performance.

Two recent sets of Government reforms will have potentially significant impacts on the business models and distribution systems of life insurers (and other wealth management entities). The Future of Financial Advice reforms, the first tranche of which was released in August 2011, propose changes to remuneration arrangements for the provision of financial advice. The Stronger Super reforms, originally announced in December 2010 and firmed-up in September 2011, include proposals for a new type of simple, cost-effective superannuation option that a member could choose or be assigned to by default ('MySuper'). APRA will be working with life insurers to ensure that they fully understand the prudential implications of these reforms and their flow-on consequences for governance, operational risk and product risk.

## Product rationalisation

Over a number of years, APRA has been in discussions with the Government, Treasury and the life insurance industry about the development of a more effective mechanism for the rationalisation of legacy products in the life insurance and superannuation industries. During 2009/10, the Government released a proposals paper that offered a specific product rationalisation mechanism involving a 'no disadvantage' test for investors. However, there is little follow-up work to report at this point.

## Group risk insurance

Group risk insurance, largely through superannuation funds, now accounts for a little over one-third of risk insurance business, although its contribution to profit is proportionately lower. In its 2010 *Report*, APRA noted that the consolidation of the larger industry superannuation funds in recent years has led in turn to a concentration in buying power in the purchase of group risk insurance from the life insurance industry, and price and service competition in this market has become intense. Group risk contracts are now reaching a size that is testing the capital and operational capacity of some of the participating life insurers, giving rise to operational and strategic risk when these contracts are won and concerns that premiums will not prove sustainable. APRA is continuing to monitor developments in this market, with a particular focus on the capital support for, pricing disciplines in, and operational management of these contracts. An additional area of attention will be the pricing and capital management practices that insurers put in place for reserving against shocks such as a pandemic or a marked increase in disability claims.

## Directly marketed business

Recent years have witnessed an increase in the number of life insurers marketing products directly to the public through call centres, the internet and television advertising. Often, the products are being offered through third-party providers. APRA has no issue with the use of direct marketing channels as such, but is concerned to ensure that appropriate governance, pricing and operational management frameworks are being applied to the design, distribution, underwriting and claims management of these products. APRA is increasing its dialogue with the industry to ensure that the risks associated with direct marketing, including reputational risk, are being appropriately managed by insurers.

## Experience studies

APRA has continued its discussions with the life insurance industry over the importance of industry-based mortality and morbidity experience studies and on the quality of data used to produce them. Such studies establish a sound foundation for pricing and reserving. To this end, APRA welcomes the production of an industry lump sum mortality/morbidity experience study that covers the majority of the yearly renewable term insurance market. Another experience study covering one year of disability income protection has recently been completed and a three-year period of analysis will commence shortly. Against a background of deteriorating results for many life insurers from their income protection business, findings from these types of studies will provide supplementary indicators for insurers that are crucial to appropriate pricing of their portfolios.

APRA continues to support a research project at the University of New South Wales to develop an integrated framework for the economic, actuarial and regulatory aspects of longevity. This four-year project is now fully staffed and has produced 14 working papers to date.

## Superannuation

Notwithstanding the recurring bouts of volatility, the overall strengthening in domestic and global equity markets in 2010/11 and higher fixed-interest earnings meant that most superannuation funds earned positive returns over the year. The balances of superannuation fund members generally improved, for the second consecutive year, as did the funding position of many defined benefit funds. This improvement, however, has been reversed in more recent months as a consequence of sharp declines in equity markets. Over the year, fund mergers and acquisition activity saw the number of trustees with Registrable Superannuation Entity (RSE) licences fall by 26 to 225 (compared to 307 licences when the superannuation licensing regime began on 1 July 2006) and the number of registered funds under their trusteeship fall by 401 to 4,017 (6,886 on 1 July 2006).

In its supervision of the superannuation industry during 2010/11, APRA's main priority was to encourage more robust governance and risk management practices. Activities have covered investment risk and governance, liquidity management, operational risk including IT issues and data integrity, and risks associated with mergers and acquisitions. The Government's Stronger Super reforms, which will have a significant bearing on the future shape and direction of the superannuation industry, are discussed in the following chapter of this *Report*.

### Investments

The large swings in domestic and global equity markets over the past six months and more, and the continuing fragility of investor sentiment, pose ongoing challenges for trustees for managing investments and the associated risks, and for APRA's supervision.

APRA had been encouraging trustees to pay greater attention to investment risk since the onset of the crisis, but its supervisory reviews still identify concerns about the level of trustee understanding of the more complex aspects of investment risk and the management of specific risks of some asset classes. In particular, APRA sees scope for further improvement in respect of unlisted assets, with some trustees yet to demonstrate a strong understanding of the inherent valuation risks with such investments. In August 2010, APRA wrote to trustees emphasising that trustees should have a strong governance framework for valuation of unlisted assets, should give due consideration to equity issues between members and should be mindful of the inherent valuation risks associated with investments that have multiple management layers, complex investment structures and/or underlying assets that are opaque in nature. Valuation methodologies for unlisted assets receive more attention during APRA's on-site visits and the issue has now been imbedded in APRA's regular supervisory reviews. During 2010/11, APRA surveyed a number of funds with significant exposure to unlisted assets and in some cases noted a lag in repricing, relative to other assets, that had the potential to impact on published returns.

APRA has also noted instances where trustees have not been adequately reviewing investment strategies or where the strategies they have adopted are not properly implemented and monitored. On-site reviews also continue to identify weakness in the application and assessment of controls on unit pricing and crediting rate processes, despite efforts by APRA over many years to highlight these areas for attention.

During the year, APRA continued its work with the Australian Securities and Investments Commission (ASIC) and industry associations to develop guidance for trustees on the labelling of investment options offered by superannuation funds. APRA's aim is to improve member understanding by increasing consistency in the measurement of fund performance by trustees and by standardising the descriptors of risk that trustees use for their investment offerings. In August 2011, the Financial Services Council and the Association of Superannuation Funds of Australia (ASFA) issued a guidance paper for trustees, recommending use of a seven-level classification system of investment risk based on the expected number of negative annual returns over a 20-year period. APRA fully supports this guidance as a step in improving risk descriptors and is considering how it will be incorporated into APRA's prudential regime for superannuation. Further work in this area will also be progressed as part of the Stronger Super reforms.

## Liquidity

Despite the strong net inflows to superannuation, continuing market volatility requires the management of liquidity to remain 'front of mind' for trustees in their consideration of the best interests of members. Even though the general economic environment is much improved, APRA continues to assess and grant applications for relief from the portability requirements under the *Superannuation Industry (Supervision) Regulations 1994* (SIS Regulations). An increasing number of these applications have related to investments in ASX-listed securities where the company has gone into administration or has been suspended. Moreover, the number of trustees with funds in frozen or suspended managed investment schemes, predominantly property and mortgage schemes, has not fallen significantly.

APRA has provided guidance to trustees on its expectations for liquidity management and has observed improvements in this area. However, liquidity management practices have not reached the level of sophistication APRA observes in the other industries it supervises. Some trustees maintain a business-as-usual mentality in liquidity management and do not undertake comprehensive liquidity stress-testing (including crisis scenarios).

## Management of information security and data

The management of IT system issues and data integrity is receiving increasing attention from APRA, given that many trustees outsource fund administration to unregulated IT providers. Evidence from APRA's on-site reviews and supervisory activities indicates that while IT risk is generally included in risk management frameworks, the measurement and management processes surrounding this risk are still immature. Trustees need a clear understanding of the security practices of administrators and of their own responsibilities to ensure that these practices provide adequate security for member and fund information. A lack of pre-emptive testing of data across the industry also suggests that trustees need to give more focus to data integrity. Issues arising from incorrect or poor data tend to be addressed on a needs or recovery basis, instead of forming a key part of a trustee's forward-looking risk management framework.

As noted earlier in this Chapter, in November 2010 APRA wrote to all trustees (and to all other APRA-regulated institutions) outlining its expectations for the management of IT security and, in particular, the outsourcing or offshoring of any material business activity, including the use of cloud computing. Trustees have been requested to consult with APRA before entering into any offshoring agreement. The recent spate of natural disasters in Australia has highlighted potential deficiencies in disaster recovery and business continuity for IT facilities, another area for trustee attention.

## Mergers and acquisitions

In February 2011, APRA wrote to trustees about the implications of the continuing consolidation in the superannuation industry. APRA set out its expectations of trustees when they are considering and implementing mergers, restructures, successor fund transfers or changes to service providers. Trustees should ensure they have a well-documented change management plan in place that has adequate regard to due diligence, adequacy of resources and legal issues, particularly where interaction with APRA is required.

Although the Government's Stronger Super reforms have no specific recommendations regarding mergers, APRA expects that trustees will regularly examine the scale, viability and strategy of their institution. Some trustees have already concluded that, from a scale perspective, their members' best interests would be served by being part of a larger merged institution.

## Early release of superannuation benefits

Under longstanding arrangements in the SIS Regulations, APRA could approve the early release of superannuation benefits on specified compassionate grounds. These arrangements have been changed. Since February 2011, Medicare Australia, as a portfolio agency within the Department of Human Services, has acted as APRA's delegate to determine applications for early release of superannuation on specified compassionate grounds. This arrangement was introduced as a precursor to the formal transfer of the function to the Department of Human Services. The role of dealing with the early release of superannuation on compassionate grounds fitted better with Medicare Australia rather than with a prudential regulator; in addition, APRA would have needed to substantially upgrade the technology and infrastructure used to process applications, while Medicare Australia is able to use its existing technology.

The Superannuation Legislation Amendment (Early Release of Superannuation) Bill 2011, which gives effect to the formal transfer, has now been approved by Parliament. Medicare Australia will take over formal responsibility for the function by the end of 2011.

APRA, industry and government remain concerned about schemes that promote the illegal early release of superannuation benefits. The majority of these early release schemes involve a request to an APRA-regulated fund to roll-over a member's benefit to a self-managed superannuation fund (SMSF) and the subsequent cashing out of the benefit, in breach of the preservation standards. APRA also notes there is increasing evidence of identity theft, where an individual's details are obtained and their benefits accessed by an unrelated party. APRA and the Australian Taxation Office (ATO) continue to work together to reduce the incidence of illegal early release of superannuation benefits. In October 2010, APRA wrote to trustees to alert them to the new SMSF member verification system provided by the ATO.

### Early release of superannuation benefits

| Financial year | Number of applications received | Applications approved in part or full | Amount approved for release $ | Average amount released per application $ |
|---|---|---|---|---|
| 2006/07 | 18,245 | 15,412 | 156,905,338 | 10,181 |
| 2007/08 | 20,524 | 14,947 | 173,602,110 | 11,615 |
| 2008/09 | 17,918 | 11,776 | 144,739,434 | 12,291 |
| 2009/10 | 16,331 | 10,539 | 111,121,975 | 10,544 |
| 2010/11 | 15,795 | 10,141 | 122,975,798 | 12,127 |

APRA's letter details the practical steps that trustees or their authorised administrators need to follow to satisfy themselves that transfers were being made to legitimate members of SMSFs in a timely manner. This member verification system is in addition to the Super Fund Lookup facility that confirms the regulatory and complying status of SMSFs. Trustees will still need to have proof of identity through their identification procedures to ensure they are dealing with the correct member.

The number of applications for early release of superannuation benefits received by APRA fell in 2010/11 for the third consecutive year, after rising strongly over earlier years.

## Enforcement activities

APRA's supervisory approach is based in the first instance on a cooperative and open working relationship with boards and management of supervised institutions to resolve prudential issues that may affect an institution's ability to meet its financial promises to beneficiaries (depositors, policyholders and superannuation fund members). However, APRA may take enforcement action if this cooperative approach does not resolve the issues in a way that appropriately protects the interests of beneficiaries. Enforcement actions available to APRA include instigating formal investigations into the affairs of a supervised institution, appointing a third party to manage an institution's affairs, imposing conditions on an institution's licence, issuing directions related to the conduct of the institution's affairs, or accepting enforceable undertakings. Where necessary, APRA can initiate criminal proceedings, seek restraining orders or seek to disqualify individuals from holding senior roles within supervised institutions. APRA can also take action to prevent unlicensed entities from conducting business that can only be conducted by a financial institution that APRA has authorised.

During 2010/11, APRA undertook 377 enforcement actions. This was a decrease on the 432 actions reported the previous year and reflects the fact that, although APRA had more investigations underway during 2010/11, the majority were smaller investigations requiring less enforcement action.

APRA continued its investigation in relation to Trio Capital Limited, which was formerly the trustee of four superannuation funds and one pooled superannuation trust. APRA had previously frozen the assets of and appointed an Acting Trustee to the Trio superannuation entities due to concerns surrounding the valuation of assets and indications of fraudulent conduct, particularly in regard to investments in offshore hedge funds. Further enforcement action is being considered. APRA continues to work closely with ASIC, which is conducting a concurrent investigation into Trio's role as a Responsible Entity of various managed investment schemes. APRA has accepted enforceable undertakings from four of the former Trio directors to remain out of the superannuation industry for periods ranging from four to 15 years. In April 2011, in response to an application by Trio's Acting Trustee and on the recommendation of APRA, the Assistant Treasurer announced his decision to grant approximately $55 million in financial assistance to over 5,000 members of the Trio superannuation entities as a result of funds being lost to fraud or theft. APRA worked with the Acting Trustee to obtain independent verification of the amount sought in the application and will continue to work with the Acting Trustee to oversee the distribution of the financial assistance to members.

In the superannuation industry, the Commonwealth Director of Public Prosecutions acting on behalf of APRA took action against the former executive director of a superannuation trustee company. This person had been charged with committing an act of victimisation and was committed to stand trial. The criminal charges arose from APRA's investigation into allegations that two directors of the company were victimised because they carried out their duties as trustee directors to act in the best interests of fund members. Under the SIS Act, it is a criminal offence to commit an act of victimisation against a responsible officer of a corporate trustee of an employer-sponsored superannuation fund. The criminal trial resulted in the acquittal of the former executive director.

During 2010/11, APRA received 28 complaints relating to the failure by employers to remit employees' voluntary post-tax employee superannuation contributions to their superannuation fund. The number of complaints received by APRA was significantly lower than the previous year. Although it has no specific prudential powers in this area, APRA's investigations resulted in the successful recovery of all outstanding contributions, except where the employer had gone into administration or liquidation. APRA also continued to investigate cases of fraudulent early release, resulting in one conviction and other cases either in the early stages of investigation or nearing finalisation.

Legal proceedings instigated by APRA on behalf of an Acting Trustee of a superannuation fund were successfully concluded during the year. APRA had used its powers under the SIS Act to bring proceedings on behalf of the Acting Trustee to challenge the ownership of a major asset of the fund. APRA had been successful in obtaining orders both at first instance and on appeal. An application for special leave to the High Court for a further appeal was refused.

During the previous year, the Minister for Financial Services, Superannuation and Corporate Law and Minister for Human Services had determined that the Financial Claims Scheme in the general insurance industry (the Policyholder Compensation Facility) be triggered in relation to one of two small general insurers to which a judicial manager had been appointed. The aim of the Scheme is to ensure claims by eligible policyholders can be met. During 2010/11, an amount of around $73,000 was paid out under the Scheme. The Scheme has been extended for a further 12 months to enable the lodgement of claims and APRA continues to work through claims applications. APRA has also been working closely with the judicial manager (now liquidator) of the other small general insurer to assess the likelihood of any policyholder shortfall in the liquidation.

In the banking industry, APRA considered 31 matters during 2010/11 relating to the use of restricted words 'bank', 'banker', 'banking' or like names under s66 of the *Banking Act 1959*. A significant proportion of these related to the use of the restricted words by an unauthorised institution.

## Enforcement actions[1]

| | ADIs | | Superannuation | | General insurance | | Life insurance | | Friendly societies | | Other[2] | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2010 | **2011** | 2010 | **2011** | 2010 | **2011** | 2010 | **2011** | 2010 | **2011** | 2010 | **2011** | 2010 | **2011** |
| AAT/Federal Court review | | | | | 3 | | | | | | | | 3 | |
| Appointment of Acting Trustee | | | 5 | | | | | | | | | | 5 | |
| Appointment of liquidator/inspector | | | 5 | | 7 | | | | | | 3 | | 15 | |
| Civil litigation | | | 2 | | 1 | | | | | | | | 3 | |
| Directions and contravention notices[3] | 12 | **9** | 91 | **164** | 46 | **2** | | | | | 15 | **5** | 164 | **180** |
| Enforceable undertaking | 1 | | | | | | | | | | | | 1 | |
| Follow-up delayed contributions | | | 102 | **40** | | | | | | | | **2** | 102 | **42** |
| Investigation action | 2 | | 5 | **73** | 11 | | | | | | 30 | | 48 | **73** |
| Other actions[4] | 28 | **37** | 8 | **13** | | | | | | | 31 | **11** | 67 | **61** |
| Refer to other agency/police | 2 | **1** | 10 | **15** | 5 | | | | | | 5 | **5** | 22 | **21** |
| Removal, withdrawal or revocation of license | | | 1 | | | | | | | | | | 1 | |
| Show cause letter | | | | | 1 | | | | | | | | 1 | |
| **Total** | **45** | **47** | **229** | **305** | **74** | **2** | **0** | **0** | **0** | **0** | **84** | **23** | **432** | **377** |

1 Year ending 30 June.

2 Includes institutions not regulated by APRA suspected of conducting unauthorised activity.

3 Includes consents to use restricted words.

4 Includes monitoring of foreign bank representative offices.

Chapter three

# The prudential framework

The prudential framework in Australia, as is now well acknowledged, played an important role in ensuring that the Australian financial system coped successfully with the unprecedented stresses created during the global financial crisis. Its mettle has continued to be tested, by the recent spate of natural disasters and by the renewed turbulence in global financial markets over recent months. The robustness of the framework in the face of these pressures is anchored in APRA's behavioural standards that support strong governance and prudent risk management, and in its conservative, risk-sensitive approach to setting capital requirements for its regulated industries.

A prudential framework cannot afford to stand still. APRA had a substantial prudential policy workload in 2010/11 that is intensifying in the current year and is stretching its policy resources. Much of this workload has been generated by the global regulatory response to the crisis, now moving into the implementation phase, but APRA also has substantial initiatives under way to improve the coverage of risks through harmonised prudential standards and to prepare for the Government's Stronger Super reforms.

The core of the global reform agenda, an agenda to which the G-20 Leaders have been strongly committed, was finalised at their Seoul Summit in November 2010. As noted earlier in this *Report*, the first pillar of that agenda is a strong global regulatory framework that will materially raise the level of resilience of banking systems and enable banking institutions to withstand severe distress without extraordinary government support. The Basel Committee on Banking Supervision and the Financial Stability Board have had carriage of reform measures under this pillar. The Basel Committee's comprehensive reforms aimed at increasing capital and liquidity buffers held by internationally active banks were largely finalised and released after their endorsement at the Seoul Summit. APRA has been actively involved in these initiatives and, with its fellow Committee member the Reserve Bank of Australia (RBA), has sought to ensure that, where relevant, the unique circumstances of the Australian financial system have been taken into account. The complex task of implementing the new global capital and liquidity framework in Australia is now underway.

In addition to its multi-year project to implement the Stronger Super reforms, APRA's domestic policy agenda includes two major initiatives. One is an updating and, where possible, harmonisation of capital requirements for general and life insurers, which offers scope for a significant improvement in the risk-sensitivity of the capital framework. This path-breaking work is drawing on a significant amount of APRA's (and the industry's) intellectual capital. The other major initiative is the development of a prudential framework for conglomerate groups.

Changes to the prudential framework are finalised by APRA only after it has consulted extensively with industry and other interested stakeholders. Such consultation is vital if APRA is to achieve high-quality reforms within reasonable implementation timetables. Consultation can take a number of forms, including formal submissions, quantitative impact studies, workshops, presentations by APRA staff and targeted consultation with select stakeholders if appropriate. APRA has also been making increasing use of industry-wide public conferences on its proposals. It has already conducted one such conference on the new global capital and liquidity framework in banking and is planning a second, both hosted by the Financial Services Institute of Australia (Finsia). Three conferences have been held on the proposed reforms to general and life insurance capital, hosted jointly by the Insurance Council of Australia, the Financial Services Council and the Institute of Actuaries of Australia. APRA's proposals must also comply with the Government's policy on best practice regulation and, in this regard, APRA has always fully met the requirements of the Office of Best Practice Regulation.

## Response to the global financial crisis

### Enhancements to the Basel II Framework

As the first stage of its comprehensive reform program, the Basel Committee announced a package of measures to enhance the three Pillars of the Basel II Framework in July 2009 (as adjusted in June 2010). These included, under Pillar 1 (minimum capital requirements), an improved coverage of risks arising from complex structured products and from securitisation as well as higher capital for market risk, resulting in part from the requirement to use data from periods of financial stress in the modelling of such risk. Under Pillar 2 (the supervisory review process), supplementary guidance was issued to address flaws in risk management practices revealed by the global financial crisis. The guidance covers institution-wide governance and risk management processes, management of risk concentrations and the capture of risk from off-balance sheet and securitisation activities. Enhancements to Pillar 3 (market discipline) strengthen disclosure requirements for these same activities. The Basel Committee expected banks and supervisors to begin implementing the Pillar 2 guidance immediately but set the start-date for the Pillar 1 and Pillar 3 changes at no later than the end of 2010. That date was subsequently deferred by 12 months.

Following consultation with industry, APRA released amendments to relevant ADI prudential standards and prudential practice guides in May 2011 that give effect to these Basel II enhancements. APRA also made other amendments to its capital adequacy requirements for ADIs to clarify existing provisions and to support the implementation of the enhancements. The prudential standards and revised reporting requirements come into effect from 1 January 2012, in line with the internationally agreed timetable. The Basel II enhancements are expected to have only a limited impact on ADIs in Australia, which have largely avoided higher-risk trading activities in the lead up to and since the global financial crisis.

## Strengthening banking system capital requirements

The more significant milestone in the Basel Committee's comprehensive reform program was the release of a package of proposals (now known as 'Basel III') to strengthen capital and liquidity requirements for internationally active banks in December 2009. The capital reforms covered a number of key areas and included proposals:

- to raise the quality, consistency and transparency of the capital base and harmonise other elements of capital;
- to improve the risk coverage of the Basel II Framework by strengthening the capital requirements for counterparty credit risk exposures arising from derivatives, repurchase transactions and securities financing activities;
- to introduce a leverage ratio as a supplementary measure to the risk-based Basel II Framework to help contain the build-up of excessive leverage in the banking system and safeguard against model risk and measurement error; and
- to introduce a series of measures to promote the build-up of capital buffers in good times that can be drawn upon in periods of stress. The Basel Committee is also promoting more forward-looking approaches to provisioning for credit losses.

After reviewing the various potential impacts of the proposals, the Basel Committee announced in July 2010 that it had reached broad agreement on the overall design of the capital reforms including, in particular, the definition of capital, the treatment of counterparty risk and the leverage ratio. Broad agreement on the calibration and transition arrangements for the capital reforms was announced in September 2010. The minimum requirement for common equity (after deductions) was set at 4.5 per cent of risk-weighted assets and the minimum requirement for Tier 1 capital at six per cent. (This compares with minima of two and four per cent, respectively, that apply currently.) A capital conservation buffer was set at 2.5 per cent above these new minimum requirements. When capital levels fall within the buffer range, banking institutions will be subject to constraints on capital distribution that increase in severity as the buffer reduces. In addition, a countercyclical buffer up to 2.5 per cent will apply when excessive credit growth and other indicators point to a system-wide build-up of risk. A minimum leverage ratio of three per cent based on Tier 1 capital will be tested during a parallel run period from 1 January 2013 to 1 January 2017.

The Basel Committee's proposals were endorsed by the G-20 Leaders at their Seoul Summit in November 2010 and the Basel III rules text was released in December 2010. The timetable envisages that implementation of the reforms in member countries will begin on 1 January 2013 and the new minimum capital requirements will be phased in by 1 January 2015; implementation of the broader package of reforms will be substantially completed by 1 January 2019. However, the Basel Committee also emphasised that national authorities have the discretion to impose shorter transition periods and should do so where appropriate. After the Basel III rules text was released, APRA wrote to ADIs reiterating its full support for the new global standards and advising of its intention to begin consultations in 2011 on their application in Australia.

That process began formally in September 2011, when APRA released its proposals for implementing the Basel III capital reforms. APRA proposes to broadly adopt the minimum Basel III requirements for the definition and measurement of capital for ADIs. This will require APRA to amend its current policies in a number of areas, taking a stricter approach than at present in some but a less conservative approach in others. In certain areas, however, there are strong in-principle reasons to continue APRA's current policies. These areas are the treatment of deferred tax assets, investments in non-consolidated financial institutions and investments in commercial institutions. APRA also proposes to introduce the new Basel III capital buffer regimes and the leverage ratio. Following consideration of submissions received on this paper, APRA will undertake a second round of consultation in early 2012 on detailed prudential and reporting requirements.

In APRA's view, ADIs in Australia are well placed to meet the new minimum capital requirements and APRA is therefore proposing to accelerate aspects of the Basel Committee's timetable. It is proposing to require ADIs to meet the revised Basel III minimum requirement for common equity (after deductions) from 1 January 2013, and the capital conservation buffer from 1 January 2016, without any additional phase-in arrangements.

## Strengthening banking system liquidity requirements

The comprehensive reform package released by the Basel Committee in December 2009 also included a global framework for promoting stronger liquidity buffers to ensure that banking systems are more resilient to liquidity stresses. The centrepiece of this framework is a new standard for liquidity risk (the Liquidity Coverage Ratio) that aims to ensure that banking institutions have sufficient high-quality liquid assets to survive an acute stress scenario lasting for one month. This standard aims to strengthen short-term resilience. A second global standard, the Net Stable Funding Ratio, aims to promote longer-term resilience by requiring banking institutions to fund their activities with more stable sources of funding on an ongoing basis. The proposals also include a common set of metrics for identifying and analysing liquidity risk trends.

In anticipation of the Basel Committee's liquidity reforms, APRA had released a consultation package in September 2009 on its proposed enhancements to its prudential framework for ADI liquidity risk management. The key changes involved more demanding stress-testing parameters, introduction of a standardised reporting framework to improve APRA's ability to assess ADIs' liquidity risk profiles, and enhanced qualitative requirements consistent with the Basel Committee's revised *Principles for Sound Liquidity Risk Management and Supervision* of September 2008.

In parallel with the Basel III capital reforms, and after reviewing the various impacts of its proposals, the Basel Committee announced revisions to its Liquidity Coverage Ratio requirement in July 2010 and foreshadowed modifications to its Net Stable Funding Ratio. After endorsement by the G-20 Leaders, the final rules text for the new global liquidity framework was released in December 2010. The framework incorporates scope for alternative treatments for jurisdictions, such as Australia, that do not have sufficient high-quality liquid assets (particularly sovereign debt) for inclusion in liquidity buffers.

Within that scope, the RBA and APRA announced in December 2010 that an ADI will be able to establish a committed secured liquidity facility with the RBA, sufficient in size to cover any shortfall between the ADI's holdings of high-quality liquid assets and the Liquidity Coverage Ratio requirements. The facility will incur a market-based commitment fee. For its part, APRA will require participating ADIs to demonstrate that they have taken all reasonable steps towards meeting their liquidity requirements through their own balance sheet management, before relying on the RBA facility. In February 2011, APRA clarified the treatment of high-quality liquid assets it will apply when implementing the new global liquidity framework.

Under the Basel Committee's timetable, the Liquidity Coverage Ratio (including any revisions) will be introduced on 1 January 2015 after an observation period beginning in 2011. The Net Stable Funding Ratio (including any revisions) will move to a minimum global standard by 1 January 2018. APRA intends to release a discussion paper setting out its proposals for implementation of the Basel Committee's liquidity reforms in the latter part of 2011. APRA's quantitative requirements for ADI liquidity risk management proposed in its 2009 discussion paper will be subsumed into the new global liquidity framework but its enhanced qualitative requirements, which reflect the Basel Committee's revised principles in this area, will be unchanged.

## Financial Claims Scheme implementation

During 2010/11, APRA continued to deal with a number of implementation issues associated with the Financial Claims Schemes in the ADI and general insurance industries. APRA has responsibility for administering the two Schemes.

The Financial Claims Scheme for the ADI industry provides depositors with timely access to their deposit funds up to a defined cap. The original cap was set at $1 million per depositor per institution but was to be reviewed by the Government by October 2011. In May 2011, the Government released a consultation paper canvassing a number of proposed changes to the design of the Scheme, including the cap on the size of protected deposits and other refinements to the existing framework. In September 2011, the Government announced a new permanent cap of $250,000 per depositor per institution, to be introduced from 1 February 2012. This new cap reflected advice from the Council of Financial Regulators and feedback from public consultation.

APRA has been consulting with the ADI industry and other parties on the proposed reporting requirements needed to make the Early Access Facility for Depositors (EAFD) operational, and on options to facilitate payout. APRA released a discussion paper on these issues in January 2010 and a response to submissions on that paper in August 2010. Submissions generally supported APRA's proposed framework for operating the EAFD but also identified operational issues and suggested changes to minimise compliance costs. Most operational issues related to the essential requirement that ADIs be able to generate aggregate deposit data at short notice on a 'single customer view' basis. This requirement and the mechanics of prompt payout raise a number of IT challenges for ADIs and APRA that will be taken into account in implementation of the final arrangements. APRA conducted workshops in September and December 2010 to seek industry's views on how best to bring the EAFD into operation. Further details on APRA's proposed framework, including a draft prudential standard, were released in September 2011.

The Financial Claims Scheme for the general insurance industry ensures that claims from eligible policyholders and other claimants, with no defined cap, will be met in the event of the failure of a general insurer. It also provides a limited period of time within which policyholders of the failed insurer remain covered against claims pending their establishment of new insurance policies with another insurer. During 2010/11, APRA developed its internal arrangements for putting the Scheme into operation. These arrangements include guidance on matters such as eligibility assessment, claims determination and payout arrangements.

## Harmonised prudential standards

### General and life insurance capital standards

APRA is proposing to update its capital standards for the general insurance and life insurance industries. APRA's intention, set out in an initial discussion paper in May 2010, is to make the capital standards more risk-sensitive, improve their alignment across regulated industries where appropriate, and consider the standards in light of international developments.

For general insurance, APRA is completing the refinements commenced in 2008. The proposed changes will ensure that all material types of risks, including asset/liability mismatch, asset concentration, insurance concentration and operational risks, are adequately addressed within the capital standards.

For life insurance, the proposed changes are more fundamental. APRA is proposing to simplify the current dual reporting requirements for solvency and capital adequacy and, by introducing the concept of a 'capital base' for life insurers, to align the capital structure for life insurers with that for general insurers and ADIs. This improved alignment of capital requirements will also facilitate adoption of APRA's proposed framework for the supervision of conglomerate groups.

APRA has also confirmed that, in undertaking these reforms, it would carefully assess their individual and industry impacts. To this end, it undertook a quantitative impact study (QIS) for insurers and released three supplementary technical papers in the first part of 2010/11. In March 2011, APRA issued a response to the main issues raised in submissions and arising from assessments of the QIS responses. APRA proposed revisions to a number of aspects of its original proposals to simplify them (where appropriate), reduce some of the procyclical effects and address areas where the proposals were overly conservative; in other aspects, however, its proposals have been retained. APRA has also undertaken a second QIS to assess the impact of the revised proposals.

APRA is currently reviewing submissions on the revised proposals and the QIS results and expects to release a further response paper and draft prudential standards for consultation in late 2011. Final prudential standards are expected to be released in the first half of 2012, to take effect from 1 January 2013.

## Supervision of conglomerate groups

During 2010/11, APRA made further progress on its proposed prudential framework for conglomerate ('Level 3') groups. These are groups (containing APRA-regulated institutions) that have material operations in more than one APRA-regulated industry and/or have one or more material unregulated entities. The objective of this substantial initiative is to better protect the interests of depositors and policyholders by limiting the risks to APRA-regulated institutions (from contagion, reputation and operational risks in particular) that may arise from that institution's membership of a conglomerate group and by ensuring that both APRA and the group itself have a broader understanding of the financial and operational soundness of the group, irrespective of its structure and industry location.

APRA outlined its proposals for the supervision of conglomerate groups in a discussion paper released in March 2010. The proposals seek to ensure that a conglomerate group holds adequate capital to protect the APRA-regulated institutions from potential contagion and other risks within the group and that the parent company meets a range of principles-based risk management standards. The proposals, which build on APRA's existing requirements for stand-alone institutions (Level 1) and single-industry groups (Level 2), would put in place a complementary layer of prudential requirements that harmonise existing standards and industry-specific supervision frameworks at the group level, to provide a group-wide view.

APRA conducted a QIS with potential Level 3 groups during 2010/11 to assess the impact of its capital adequacy proposals and it has been reviewing the QIS submissions prior to finalising its policy direction. In May 2011, APRA advised industry that it was revising the timetable for this reform so that it would be appropriately sequenced with related initiatives in the ADI and insurance industries. APRA aims to release draft conglomerate prudential standards for comment in the second half of 2011/12 and, after further consultation, to finalise these standards in the second half of 2012/13. The new standards are intended to take effect shortly after they are finalised.

### Consolidation of prudential standards

Since its establishment, APRA has been committed to harmonising its prudential standards across its regulated industries where appropriate. Behavioural standards, in particular, lend themselves to a harmonised approach since prudence should be a fundamental attribute of boards and management across all these industries. Accordingly, APRA's prudential standards for governance, fitness and propriety, business continuity management and outsourcing, though developed on an industry-by-industry basis, contain nearly identical requirements across the ADI, general insurance and life insurance industries in many areas. However, minor variations have remained.

To simplify compliance, particularly for groups operating across industries, APRA proposed to consolidate these behavioural standards and associated guidance material. In December 2010, it released a discussion paper proposing that the 12 industry-specific prudential standards be consolidated into four cross-industry standards. The substantive content of the standards would not change but some changes were proposed in order to clarify the standards or to ensure consistent application across industries. Following consultation, APRA released the finalised prudential standards in September 2011, for implementation by 1 July 2012. APRA will consult on supporting guidance material for these cross-industry standards over 2011/12.

## Superannuation

### Implementing Stronger Super reforms

In December 2010, the Government announced its Stronger Super reforms to strengthen the governance, integrity and regulatory settings of the superannuation system in Australia. The reforms were a response to the recommendations of the *Review into the governance, efficiency, structure and operations of Australia's superannuation system* (Cooper Review) delivered to the Government in June 2010.

The Stronger Super reforms envisage amendments to the *Superannuation Industry (Supervision) Act 1993* (SIS Act) to strengthen trustee duties. They also involve the establishment of a new superannuation product ('MySuper') and the streamlining of superannuation transactions ('SuperStream'). As noted earlier in this *Report*, MySuper is a new type of simple, cost-effective superannuation option that will take the place of existing default products; it will have a basic set of product features designed to improve fund member and employer understanding, aid comparability between products and reduce costs. SuperStream is a major initiative intended to make the processing of superannuation transactions easier, cheaper and faster, provide better information to trustees, employers and fund members, and facilitate consolidation of unnecessary additional superannuation accounts.

Since the reforms were announced, APRA has participated in the Stronger Super industry consultation process led by the Treasury and involving a peak group of chief executive officers of industry associations, consumer advocates and employer representatives. APRA also participated in four working groups dealing with governance, MySuper, SuperStream and self-managed superannuation funds. Following these consultations, the Government announced its decisions on key design aspects of the Stronger Super reforms in September 2011.

To give effect to relevant aspects of the Stronger Super reforms, APRA has commenced a multi-year project that will involve significant changes to the prudential and reporting framework for superannuation. In particular, the reforms propose that APRA be granted power to make prudential standards in superannuation. Prudential standards are the centrepiece of APRA's prudential supervision framework in the ADI and insurance industries and a standards-making power in superannuation will strengthen the protection of fund member interests. Subject to enactment of the appropriate SIS Act amendments, APRA intends to consult on the content of the prudential standards during 2011/12 and will follow this with consultation on revisions to its reporting framework and superannuation guidance material. That consultation process began with the release in September 2011, after the Government's announcement, of a discussion paper introducing APRA's proposals for prudential standards for the superannuation industry.

APRA is also preparing for the MySuper regime, which under the proposed amendments to the SIS Act will require trustees wishing to offer MySuper products to have APRA authorisation to do so.

In the context of the Stronger Super reforms, APRA will substantially enhance its superannuation data collection. The enhanced collection will allow APRA to publish data about MySuper products and promote transparency, comparability and accountability in relation to fees, costs and investments. The data will be of value to superannuation trustees, employers and superannuation fund members, and will provide APRA with more detailed information needed to supervise trustees.

## Review of superannuation guidance material

APRA is continuing to update its existing superannuation guidance material and, where appropriate, harmonising the material with other APRA-regulated industries. The need for updated APRA guidance has arisen from changes in the structure of the industry and the increase in the size and sophistication of funds since the superannuation licensing regime was introduced in 2006. APRA is adopting the format of prudential practice guides as used in the other industries, in place of existing Superannuation Circulars and guidance notes.

In August 2010, APRA released in final form four prudential practice guides covering capital, risk management, adequacy of resources, and fitness and propriety. In August 2011, APRA released for consultation two draft prudential practice guides on contribution and benefit accrual standards, and on payment standards. Subject to feedback, APRA intends to finalise these guides by December 2011. As the Stronger Super reforms proceed towards implementation, APRA's guidance material will be updated as necessary.

# Authorised deposit-taking institutions

## Use of the term 'bank'

The *Banking Act 1959* restricts the use of the terms 'bank', 'banker' and 'banking' in Australia. Under APRA's guidelines, the restricted terms 'bank' and 'banker' can only be used in the business names of ADIs that have APRA's approval to do so and hold at least $50 million in Tier 1 capital. This latter 'substance test', which has been in place since 1992, applies equally to foreign bank subsidiaries, potential Australian-owned entrants and existing credit unions and building societies wishing to change their status to a bank.

During 2010/11, in the context of its *Competitive and Sustainable Banking System* package, the Government asked APRA to review its guidelines for use of the term 'bank'. The Productivity Commission had recently undertaken an assessment of the same issue and had expressed reluctance to recommend any change to the *status quo*. In its review, after weighing up competition and financial stability concerns, APRA concluded that any lowering of entry standards for new bank entrants, through reducing the minimum capital requirement, would run counter to the general thrust of global reform initiatives to strengthen capital in banking systems and would put at risk the enhanced reputation of the Australian banking system and Australia's regulatory arrangements. The current guidelines provide scope for a number of credit unions and building societies that already meet the substance test to become a bank if they so wish. APRA has had approaches from several institutions in this group and has recently granted authority to two credit unions to become a bank.

During 2010/11, APRA also reviewed an existing consent under the *Banking Act 1959* under which a number of non-regulated financial businesses operating in the short-term money market can describe themselves as 'merchant banks'. APRA's concern is that the term 'merchant bank' has little current meaning (very few of those businesses entitled to use the term do so) and could cause confusion in the minds of the public when used by entities that are not authorised to carry on banking business in Australia. The global financial crisis has highlighted the importance of a clear demarcation between the regulated banking system and the non-regulated or 'shadow' financial sector. APRA has been consulting with relevant institutions on its proposal to revoke the existing consent and expects to finalise its approach within the next few months.

In June 2011, APRA reissued an exemption under which specified charitable religious development funds can provide limited banking services to further their charitable aims. APRA proposes to review the operation of this exemption before it expires in June 2013.

## General insurance

### General insurance Level 2 refinements

APRA is proposing a number of refinements to the prudential and reporting framework for general insurance groups (Level 2 groups) and released a discussion paper on this topic in May 2011. The proposals make minor amendments to the Level 2 group prudential standards and align aspects of the reporting framework between Level 2 groups and individual APRA-authorised general insurers (Level 1 insurers).

The final prudential standards, reporting forms and instructions are expected to be effective from 1 December 2011. The first reporting under the revised framework will be for the six-month period ending 31 December 2011.

## APRA-regulated institutions

| | Number | | | Assets ($ billion)[1] | | |
|---|---|---|---|---|---|---|
| | 30 June 10 | 30 June 11 | % change | 30 June 10 | 30 June 11 | % change |
| ADIs[2] | 182 | **177** | -2.7 | 2,693.2 | **2,813.4** | 4.5 |
| Banks | 55 | **56** | 1.8 | 2,612.5 | **2,722.9** | 4.2 |
| Building societies | 11 | **10** | -9.1 | 23.7 | **26.4** | 11.4 |
| Credit unions | 108 | **103** | -4.6 | 49.4 | **55.8** | 13.0 |
| Other ADIs, including SCCIs | 8 | **8** | 0.0 | 7.6 | **8.3** | 9.2 |
| Representative offices of foreign banks | 17 | **18** | 5.9 | | | |
| General insurers | 130 | **127** | -2.3 | 99.2 | **114.9** | 15.8 |
| Life insurers | 32 | **31** | -3.1 | 227.7 | **235.0** | 3.2 |
| Friendly societies | 16 | **14** | -12.5 | 6.2 | **6.2** | 0.0 |
| Licensed trustees | 251 | **225** | -10.4 | | | |
| Superannuation entities[3] | 4,458 | **4,054** | -9.1 | 722.6 | **802.6** | 11.1 |
| Public offer funds | 196 | **183** | -6.6 | 546.8 | **619.1** | 13.2 |
| Non-public offer funds | 191 | **164** | -14.1 | 168.2 | **176.3** | 4.8 |
| Small APRA funds | 3,869 | **3,519** | -9.0 | 2.0 | **2.0** | 0.0 |
| Approved deposit funds | 107 | **95** | -11.2 | 0.2 | **0.1** | -50.0 |
| Eligible rollover funds | 16 | **16** | 0.0 | 5.4 | **5.2** | -3.7 |
| Pooled superannuation trusts[4] | 79 | **77** | -2.5 | 79.1 | **86.5** | 9.4 |
| Non-operating holding companies | 21 | **25** | 19.0 | | | |
| **Total** | **5,107** | **4,671** | **-8.5** | **3,748.9** | **3,972.1** | **6.0** |

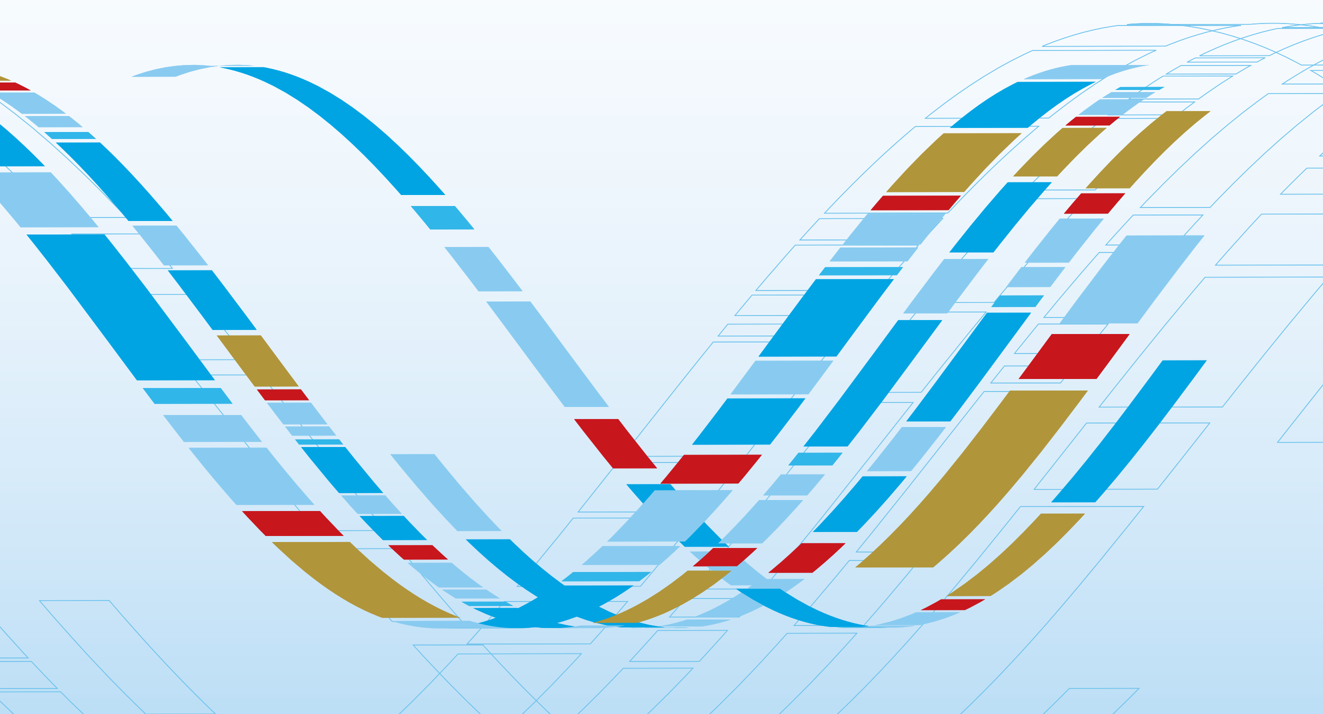
Notes:

1 Asset figures for end-June 2011 are based on most recent returns. Asset figures for end-June 2010 have been revised slightly from APRA's 2010 *Report* in line with the audited returns received during the year.

2 The ADI classification does not include representative offices of foreign banks.

3 The total does not include uncontactable funds that are in the process of being formally wound-up or transferred to the Australian Taxation Office. As at end-June 2011, there were 12 such funds.

4 Pooled superannuation trust assets are not included in totals as these assets are already recorded in other superannuation categories.



Chapter four

# APRA's supervisory capabilities

The second pillar of the G-20's reform agenda is effective supervision. The global financial crisis highlighted the importance of looking beyond regulatory frameworks to how effectively they were applied. Financial systems tended to fare better in countries where supervisors maintained active programs of prudential oversight, built on continuous engagement with financial institutions, comprehensive on-site reviews, extensive analysis of financial data and prompt but balanced intervention, where necessary, to address emerging risks. Australia is one such example.

The quality of supervision has now become a key focus of global policymakers, including the International Monetary Fund (IMF) and the Financial Stability Board (FSB). In November 2010, ahead of the Seoul Summit of the G-20 Leaders, the FSB set out a series of recommendations for making the supervision of financial institutions more intense, effective and reliable. The recommendations, which built on the themes of an IMF paper issued in May 2010, were primarily aimed at making systemically important financial institutions less susceptible to failure, but the FSB also saw implications for the supervision of financial institutions more generally. In endorsing those recommendations, the G-20 Leaders agreed 'that supervisors should have strong and unambiguous mandates, sufficient independence to act, appropriate resources, and a full suite of tools and powers to proactively identify and address risks, including regular stress testing and early intervention'.

APRA contributed to the IMF paper and the FSB report and APRA's risk-based approach to supervision, tested before and during the crisis, broadly satisfies the FSB's recommendations. APRA's active and interventionist style also meets the IMF's strong argument that supervisors must have both the *ability* and the *willingness* to redress instances of excessive risk-taking by financial institutions.

Supervisory approaches are not set in stone. They need to evolve in the face of changing economic and market circumstances and the emergence of new risks. There are also lessons to absorb from the crisis. APRA therefore pursues continuous improvement in its supervisory approach and the recent reports of the IMF and FSB will serve as benchmarks for that effort.

## APRA's supervisory approach

Risk-based supervision is not 'rocket science' and nor is it infallible. It is simply a structured and methodical process designed to identify and assess those areas of greatest risk to a regulated institution (or to the financial system as a whole) and then direct supervisory resources and attention to those risks. Under this approach, more supervisory resources are devoted to those regulated institutions that have higher risk profiles or identified risk management weaknesses, or that pose a potential systemic threat. Faced with the unbounded nature of potential risks and limits on its resourcing, risk-based supervision enables a supervisory agency to apply its resources to maximum effect. A successful risk-based approach is characterised by high-quality and astute analysis leading to the early identification of key risks and issues, a capacity to escalate the intensity of supervision rapidly, and the ability and willingness to intervene promptly and assertively as and when required.

The essential building blocks of APRA's risk-based approach to supervision are set out in the *APRA Supervision Blueprint* (published in January 2010) and were elaborated on in last year's *Report*. The approach drives APRA's strategic planning as well as the direction and intensity of its supervisory activities. In summary, the building blocks are:

- a forward-looking supervisory action plan for each regulated institution that addresses the key risks facing the institution;
- a structured risk assessment and decision-making process to ensure that the risk judgments that underpin supervisory action plans are rigorous and consistent, and that supervisory interventions are targeted and timely; and
- a 'thematic' or industry-wide approach to the analysis of risks that identifies the main emerging risks and supervisory issues for each APRA-regulated industry.

Over the course of 2010/11, APRA undertook a comprehensive strategic review of the supervisory processes and systems that support its risk-based approach. With the assistance of a firm of external consultants, working in partnership with APRA's Supervision Framework Team, each of APRA's main supervisory processes was subject to detailed examination. The review looked at ways to improve the effectiveness and efficiency of each process and, importantly, at how the conduct and outcomes of each process aligned with APRA's broader objectives. A second phase of the review examined the adequacy of the systems and tools that APRA uses to put these processes into effect. By bringing together the skills of a seasoned group of supervisors and external consultants with considerable experience in process efficiency and systems design – and an independent set of eyes able to challenge existing mindsets – the review produced a set of recommendations for improvement in APRA's supervisory processes that are focussed, practical and relevant.

The strategic review, which was completed in April 2011, has laid the foundation for progressive improvement in APRA's supervisory framework. The review recommendations identified how APRA can better organise, align and integrate its supervisory processes and systems, and these recommendations will be implemented in stages over the next few years under a substantial supervision renewal program. The streamlining of supervisory processes is now well under way and should be largely completed by the end of 2011/12. Changes to APRA's core IT systems and tools will be implemented over a longer time horizon as part of an integrated program of technology improvements.

Improvements to supervisory approaches can be both inward-looking, such as APRA's supervision renewal program, or outward-looking, dealing with the nature and intensity of interactions with regulated institutions. The FSB report flagged a number of improvements to supervisory techniques that supervisors could pursue, drawing on the lessons from the crisis. Some of these initiatives were already on APRA's agenda.

One aspect of APRA's supervisory approach that it has been seeking to reinforce is its engagement with boards. Boards have primary responsibility for ensuring the prudent management of regulated institutions and APRA's prudential standards make boards accountable for a range of prudential matters. As discussed earlier in this *Report*, APRA increased its engagement with boards over 2010/11 on matters such as risk appetite, remuneration and credit standards in housing lending. As APRA has learned, direct access to the board, and an effective relationship built on mutual trust and respect in good times, can be crucial in managing situations when times turn sour. More face-to-face contact will help to strengthen relationships and, at the same time, allow APRA to properly test board capabilities and director contributions.

A second aspect relates to APRA's capabilities for identifying quickly the next generation of risky products and businesses. Prudential supervisors can never expect to be ahead of the market in terms of new product development and innovation; however, close and continuous supervision will help supervisors to at least keep abreast of developments. APRA is stepping up its focus on the risks that might be inherent in new product trends and business activities. The crisis taught the danger of misleading positive signals from apparently well-performing business lines because underlying risks were being underestimated.

A third aspect being reinforced is the 'thematic' or industry-wide analysis of risks. One of the most powerful tools available to a supervisor is a strong 'compare and contrast' function, which enables it to readily and with confidence identify areas in which a regulated institution is an outlier. The FSB acknowledges that thematic reviews provide useful relative rankings of institutions and, certainly, APRA has found that advising a board that its institution lags its peers in a particular aspect of risk management or exposure quickly focuses that board's mind. APRA has been strengthening the capacity of its Industry Analysis Team and has recently changed its location and reporting lines to improve its visibility within APRA and its access to the frontline supervisory divisions.

A fourth aspect on which APRA is increasing its supervisory focus is stress-testing. There are three components to this work. The first is macroeconomic stress-testing. In 2009/10, APRA undertook a comprehensive stress-test of the 20 larger ADIs to test their resilience to a severe economic downturn, and it is now planning a second macroeconomic stress-test that will cover a larger group of ADIs and will add funding dislocations to a severe downturn scenario. Secondly, APRA's 'bottom up' stress-testing capabilities, either desk-based by APRA or by each institution at APRA's direction, have been expanded. This type of stress-testing gives APRA a much better understanding of a regulated institution's sensitivity to various shocks – for example, an ADI's exposure to property price falls or a life insurance company's exposure to equity and/or interest rate volatility. Such stress-testing has been valuable in enabling APRA to quickly assess the resilience of the life insurance industry, in particular, to recent financial market volatility. The third component is APRA's assessment of each regulated institution's own stress-testing capabilities and programs, which need to be robust and factored into decision-making, strategic planning and capital budgeting.

## APRA's staffing

The development of a robust prudential framework and the effectiveness of a risk-based approach to supervision requires APRA to harness the collective experience and expertise of staff able to bring a range of skills and perspective to their work. In the face of strong competition from the finance industry, APRA has succeeded over time in building a cadre of high-quality staff across its policy, supervisory and corporate areas, and it has been able to augment its staff resources to cope with the crisis, in numbers and in calibre, through the four-year special funding provided by the Government. Subdued hiring conditions elsewhere also assisted APRA's recruitment efforts in the early period of the crisis.

At end-June 2011, APRA's total permanent staffing was 592, while the addition of fixed-term and casual employees brought staffing levels to around 602 on a full-time equivalent basis. Both numbers are lower than the previous year, mainly due to the transfer of APRA's role in the early release of superannuation benefits to Medicare Australia in February 2011 (see Chapter 2). APRA also experienced a pick-up in turnover from crisis-low levels as the finance industry resumed hiring programs, particularly in the areas of risk management and compliance. Notwithstanding the higher turnover, the average supervisory experience of staff in APRA's operational divisions has increased to over eight years, on top of an average of around five and a half years of relevant industry experience.

The talent pool available and suitable to a prudential regulator is unlikely ever to be a large one. For that reason, APRA has continued to invest heavily in its training and development programs to support the skills formation of its staff. In benchmark surveys, APRA consistently ranks around the $90^{th}$ percentile of organisations in terms of training expenditures; over 80 per cent of staff training is targeted at the development of core supervisory skills. During 2010/11, in parallel with its strategic review of supervisory processes and systems, APRA continued to roll-out a revised training curriculum and associated training programs aimed at honing the analytic skills of frontline supervisors. This suite of training programs, which uses external facilitators with strong industry experience and knowledge, is supported by improvements to the business intelligence tools available to supervisors to access and review the financial information submitted by regulated institutions. The improved toolset will provide a superior data suite to supervisors and facilitate the in-depth analysis of risk issues.

Other initiatives to improve staff development and retention include career progression and mobility programs, overseas secondments to regulatory agencies or global standard-setting bodies, domestic secondments to other regulators and agencies, enhanced recognition and rewarding of performance, and leadership and management development. APRA is also well aware of the importance of workplace flexibility as a key to attracting and retaining valued staff, and continues to be a recognised leader in this area.

### APRA's training activities in 2010/11

| | |
|---|---|
| **Training by type (%)** | |
| Internal technical training | 41 |
| External training | 41 |
| Management training | 18 |
| **Studies support** | |
| Employees undertaking formal post-graduate studies | 136 |
| **Key training metrics** | |
| Training spend per employee | $3,270 |
| Training spend as a per cent of base salary (%) | 3 |
| Per cent of staff provided with training (%) | 100 |
| Training sessions per employee | 9 |
| Training days per employee | 4 |
| Number of internal classroom courses offered | 522 |

## APRA's statistical capabilities

APRA is a central repository of statistical information on the Australian financial sector and it collects financial statistics from a wide range of financial institutions, both regulated and unregulated. APRA's statistical collections provide supervisors with access to relevant, timely and accurate data on APRA-regulated institutions and are a vital input into supervisory action plans.

APRA also collects data on behalf of the Reserve Bank of Australia (RBA), the Australian Bureau of Statistics (ABS) and the Australian Securities and Investments Commission (ASIC), and about 80 per cent of data collected are shared with other agencies. The statistics APRA publishes inform many decision-makers in the Australian financial system, including policy-makers, other regulators, market analysts, researchers and senior management of financial institutions. APRA follows international standards aimed at ensuring that users can have confidence in the integrity of the data and that statistics are made available on an impartial basis.

APRA's current priorities in the statistics area are to improve reporting from regulated institutions, reduce reporting burden on these institutions and encourage greater use of the data collected. APRA's statistics unit was restructured at the start of 2011 in recognition of these priorities.

For regulated institutions, APRA targets a rate of 95 per cent for submission of returns by the statutory due dates, and the remainder to be submitted within the following week. Over 98 per cent of APRA returns were submitted on time or within one week of the due date during 2010/11. In the interests of improving reporting, APRA stepped up its engagement with the RBA and ABS and worked with a small number of institutions on the quality of submitted data; the outcome was an enhancement to the integrity of data used in Australia's financial accounts and monetary statistics.

APRA delivered a number of improvements during 2010/11 that reduced the reporting burden on institutions. Firstly, an improved data quality assurance system was introduced for returns submitted via APRA's electronic data collection system, Direct to APRA (D2A). Institutions can now identify and fix data errors, and explain data anomalies, within D2A at the same time they submit data to APRA. Previously, they resubmitted incorrect data and explained anomalies in the days or weeks after submission, in response to email queries from APRA. As part of this improvement, APRA also revised the materiality of the data quality assurance checks to minimise any unnecessary reporting burden. APRA published details of all quality assurance checks on its website and provided guidelines on use of the new system. Over 98 per cent of regulated institutions submitted their first returns under the new system by the due date. A number of institutions noted the improvement and acknowledged the increased efficiency of reporting to APRA. As a result of the improvement, 96 per cent of all quarterly returns are now fit for use by APRA supervisors, the RBA and ABS on the due date, rather than within two weeks of the due date as was the case previously.

Secondly, APRA reduced the reporting burden on ADIs accredited to use the 'advanced' Basel II approaches by revoking a number of reporting standards linked to the transitional arrangements for the Basel II Framework. These standards required advanced ADIs from 2008 onwards to calculate and report prudential capital ratios under that Framework as well as under the original Basel Capital Accord.

Thirdly, APRA continued its active involvement in the development of the Government's Standard Business Reporting (SBR) program. This whole-of-government initiative, which went live on 1 July 2010 for a range of reports to government, seeks to eliminate duplication and reduce reporting burden by streamlining and automating reporting between businesses and government agencies. During the year, APRA incorporated all D2A reporting requirements into the single SBR taxonomy and provided clarification of the requirements in APRA's Plain English Taxonomy (PET). The Chairman of APRA is on the SBR Board and the Chief Information Officer is a member of the SBR Steering Group.

APRA produces a suite of 13 statistical publications that provide regular updates on the financial performance of APRA-regulated industries. To encourage greater use of the data collected, APRA brought forward the regular release date of four of these publications.

In July 2010, APRA introduced a new *Half Yearly Life Insurance Bulletin*, its second statistical publication dedicated to life insurers. The publication was developed in consultation with the life industry and a wide range of other stakeholders. The Bulletin provides industry data as well as individual life insurer data, allowing users to make their own assessments of individual life insurers and the industry as a whole.

During 2010/11, APRA updated its general insurance statistics to incorporate the simplified reporting framework that came into effect on 1 July 2010. Accordingly, statistics in the *Quarterly General Insurance Performance Statistics* are now aligned with accounting standards set out in *AASB 1023 General Insurance Contracts*. In response to feedback from industry, APRA also added two tables of additional statistics to the publication, which provide users with information on premiums and claims by class of business, and the solvency of the industry.

During the year, APRA also established a data collection on general insurance business handled by insurance intermediaries. Under this new reporting regime, general insurance intermediaries are required to provide aggregate data on all insurance contracts with APRA-authorised general insurers, Lloyd's underwriters and unauthorised foreign insurers (UFIs). APRA collects these data on behalf of ASIC. For the first data collection, covering the six months to June 2010, some 87 per cent of returns were submitted on time or within one week of the due date; that figure has now risen to 97 per cent. In June 2011, APRA released a discussion paper on how its statistical publications could be expanded to include information on intermediated general insurance from the new data collection. By publishing such information, APRA's aim is to provide a central source of complete, useful and trusted intermediated general insurance statistics. These statistics will fill a gap in the market for this information and will improve the quality of external analysis of intermediated general insurance. They will also help identify inappropriate use of UFIs. The first release of the new statistics is expected later in 2011.

APRA's statistics unit fulfilled over 200 requests for customised statistics over the past year. These statistics give more detailed insight into particular aspects of the financial system than APRA's regular publications. The statistics are provided to external users such as government agencies, including the Treasury, to assist in the provision of advice and policy formulation. The statistics are also provided to international agencies such as the Organisation for Economic Co-operation and Development (OECD), the IMF and the Bank for International Settlements (BIS), for inclusion in international statistics that facilitate comparisons of various aspects of the Australian financial system with those of other countries.

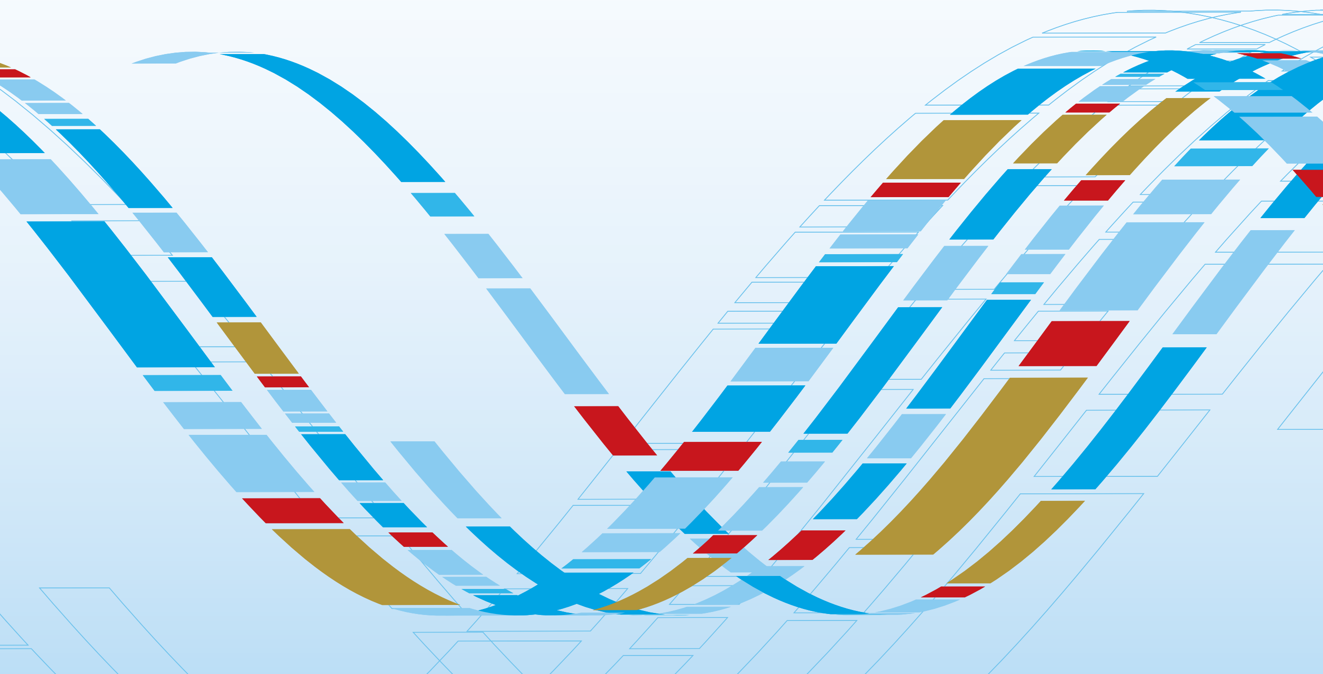
## APRA's research capabilities

APRA has a small research unit that undertakes empirical research into matters relevant to APRA's mandate. The unit's principal output consists of working papers published on the APRA website, which are presented at academic and industry conferences and often published in reputable journals. The unit also supports other divisions within APRA by conducting rigorous analysis of issues relating to prudential policy development and supervisory practices.

In 2010/11, the unit's primary focus was on superannuation. Two working papers on superannuation outsourcing were published in July 2010 and presented at the 2010 Superannuation Colloquium of the University of New South Wales (UNSW) and at the annual conference of the Accounting and Finance Association of Australia and New Zealand. Four more superannuation-related papers – on issues ranging from trustee governance to whether larger funds realise economies of scale – are nearing completion. The unit has also contributed to APRA's preparations for the implementation of the Government's Stronger Super reforms by identifying the types of data that could be used to assess whether the Government's policy objectives in this area have been met.

On other fronts, a working paper published in November 2010 explored the interconnectedness between directors of US banks receiving public injections of capital; this paper was presented at the 2010 Australian Centre for Financial Studies Banking Conference and the 2010 Australasian Finance and Banking Conference organised by UNSW. Another working paper on internal transfer pricing for bank liquidity published in March 2011 grew out of APRA's participation in the Basel Committee's Working Group on Liquidity. The paper was presented in March at an Asian research network workshop hosted by the BIS and has now been accepted in the Occasional Paper series by the Financial Stability Institute of the BIS.

The unit's full-time staff is supplemented by up to four PhD candidates whom APRA cosponsors through the Capital Markets Cooperative Research Centre. APRA also supports other university research relevant to prudential regulation. A four-year Australian Research Council (ARC) Linkage Grant, partly funded by APRA, supports a team of academics from the Centre of Excellence in Population Ageing Research at UNSW to research longevity risk. Under its Research Grants Program, APRA also funds external researchers directly. Three studies relating to Australian banks are in progress, addressing wholesale funding, syndicated lending and so-called 'VaR violations' when a bank's trading losses exceed the Value-at-Risk.



Chapter five

# Cooperation and liaison

The global financial crisis demonstrated the critical importance of cooperation between regulatory agencies, domestically and internationally, and APRA's activities in this sphere showed no slowing in tempo during 2010/11 and the subsequent episodes of acute market volatility. Domestically, close and effective coordination between the key agencies has been the hallmark of Australia's financial regulatory arrangements over a number of years. Internationally, APRA maintained its active involvement in global reform initiatives during the year but pressure on its resourcing required it to be selective in participating in the plethora of working groups spawned by these initiatives, and to focus on those groups of greatest importance to Australia. APRA also took part in a number of supervisory colleges and crisis management groups for major complex cross-border financial institutions that have a significant Australian presence and, during 2010/11, hosted supervisory colleges for two APRA-regulated institutions with global reach.

## Australia

Under Australia's financial regulatory arrangements, three specialist agencies – APRA, the Australian Securities and Investments Commission (ASIC) and the Reserve Bank of Australia (RBA) – have separate functional responsibilities for oversight of the Australian financial system but shared responsibilities for the stability and integrity of the system. All three agencies are independent statutory authorities.

APRA has a close bilateral working relationship with each of ASIC and the RBA as well as with the Australian Treasury, which provides advice to the Government on policy and possible reforms that promote a sound financial system. The relationship with each of these agencies is based on a Memorandum of Understanding (MoU) and on a structured coordination process involving meetings between staff at different operational levels, from agency heads down; however, much of the regular contact occurs via informal as well as formal mechanisms. This frequent and constructive dialogue between the agencies, in place well before the crisis struck, has been a major reason for the effectiveness of Australia's arrangements.

Together, the four agencies make up the membership of the Council of Financial Regulators, a non-statutory body with objectives of contributing to the efficiency and effectiveness of regulation and promoting stability of the Australian financial system. The Council, chaired by the Governor of the RBA, operates as a forum for coordination and information exchange between its members on financial policy and regulatory issues. During the global financial crisis, which raised issues that touched all four agencies and required, at times, prompt and coordinated responses, the Council became the focal point for agency cooperation. It has continued to play a very active role since, in reviewing conditions in global funding markets, coordinating advice to the Government on various global reform initiatives and in enhancing Australia's crisis management arrangements.

Over 2010/11, the Council examined the design of the Financial Claims Scheme for ADIs, taking into account international developments and the impact of the global financial crisis on deposit insurance arrangements. That examination formed the basis of recommendations from the Council as input to the Government's review of the parameters of the Scheme. The Government announced a number of changes to the Scheme in September 2011. Agencies also shared views on funding of the Australian banking system, developments in the residential mortgage-backed securities (RMBS) market in Australia, and on the size and potential significance of the 'shadow' banking system in Australia. The Council continued to work closely with the New Zealand Treasury and the Reserve Bank of New Zealand (RBNZ) on trans-Tasman crisis management arrangements (see page 66).

APRA also participates in two Council working groups on financial market infrastructure. One is considering the question of central clearing of over-the-counter (OTC) derivatives transacted in Australian financial markets. This is in response to the substantial reforms in this area underway in many offshore jurisdictions and to the G-20 commitment to see all standardised OTC derivatives transactions centrally cleared by the end of 2012. The Council published a discussion paper on this topic in June 2011. The other working group is reviewing the appropriateness of current regulation of clearing and settlement facilities in Australia. This work will also culminate in a discussion paper intended for release later in 2011.

APRA's engagement with the other agencies under the aegis of the Council has not supplanted its bilateral relationships. Indeed, APRA's relationship with the RBA, through the formal channel of the RBA/APRA Coordination Committee and other regular contacts at individual officer level, has become even closer through shared membership of the Basel Committee on Banking Supervision (see page 66). In this latter context, a particular focus for joint effort has been the development of an alternative approach to the holding of liquid assets that will enable ADIs in Australia to meet the new global liquidity standard. Over 2010/11, the RBA/APRA Coordination Committee discussed a range of other policy, market, institutional and technical developments. The Basel III reforms featured prominently, along with capital requirements for life and general insurers and conglomerate supervision. Other matters included global and domestic liquidity conditions, the housing market and credit standards, securitisation markets, insurance claims experience given various natural disasters and global reinsurance issues, and OTC derivatives.

The relationship between APRA and ASIC is maintained through three primary contact points. *Ad hoc* high-level discussions are held between the APRA Members and the ASIC Commissioners on emerging issues of mutual concern. Regulatory liaison meetings focus on policy issues or operational supervision matters concerning industries and institutions regulated by both agencies. These meetings are also a forum for discussion on practical supervision outcomes due to changes to legislative and administrative procedures. Finally, deterrence liaison meetings discuss broad enforcement-related issues, to coordinate specific actions related to jointly regulated institutions and to discuss cases identified by one agency that may have relevance to the other. During 2010/11, issues under discussion between the two agencies, in addition to joint enforcement actions (see Chapter 2), included risk disclosure for superannuation investment returns, the Government's Stronger Super proposals, cross-border bank resolution and development of a covered bond framework.

As one of the main mechanisms for joint consultation with industry, the APRA Members and ASIC Commissioners meet annually with the Finance Industry Council of Australia (FICA), an umbrella body for a number of finance industry associations, to discuss significant regulatory and other issues facing the industry. Such liaison allows the two regulatory agencies to brief industry on their current priorities and to identify and test industry concerns. FICA comprises the Australian Bankers' Association, Abacus – Australian Mutuals, the Australian Finance Conference, the Australian Financial Markets Association, the Australian Securitisation Forum, the Financial Services Council and the Insurance Council of Australia.

APRA and the Treasury continued their close liaison on legislative initiatives, particularly those related to strengthening APRA's crisis management powers, and on policy initiatives, particularly those related to the Government's Stronger Super reforms. Since the announcement of these reforms in December 2010, APRA officials have participated actively in the Treasury's consultation with industry, the first stage of implementation of the reforms. Other areas of coordination included the Government's *Competitive and Sustainable Banking System* package, the natural disaster insurance review and the collection and publication of data from insurance brokers. Senior APRA and Treasury officials also held regular liaison meetings at which a major topic was global regulatory reform, including the work of the G-20, the Financial Stability Board and the Basel Committee.

APRA also interacts with a number of other Australian agencies. APRA and the Australian Transaction Reports and Analysis Centre (AUSTRAC) coordinate their activities through the AUSTRAC/APRA Coordination Committee, which meets to update each agency on relevant regulatory developments and to share findings from supervisory activities. Referrals on specific regulatory matters and exchanges of information between the agencies are conducted using protocols established to meet relevant legislative requirements. To avoid duplication and minimise burden, there is also regular communication at the working level on visit schedules to jointly regulated institutions. A senior APRA executive spoke at the 2011 AUSTRAC Supervision Conference.

The longstanding commitment to cooperation between APRA and the Australian Taxation Office (ATO) has been strengthened with the signing of a new MoU on superannuation matters in September 2010. This underpins regular consultation across a range of superannuation administration and policy issues, including ATO rulings, determinations, interpretative decisions and APRA prudential practice guides on the application of superannuation legislation, illegal early access to superannuation benefits, limited recourse borrowing arrangements, the development and application of longevity risk products and the public register of superannuation funds maintained by the ATO. The regular interaction (including data interchange on superannuation matters) between APRA and ATO staff is augmented by operational and technical liaison meetings as well as *ad hoc* meetings on specific issues as required. APRA continues to participate in the ATO's Superannuation Consultative Committee and the superannuation technical subcommittee of the National Tax Liaison Group.

APRA cooperates closely with the Private Health Insurance Administration Council (PHIAC), which has responsibility for supervising providers of health insurance. Over the year, APRA provided support to PHIAC in relation to its supervisory functions, covering a range of subject matters including prudential standards, group supervision and the development of PHIAC's crisis management plan. PHIAC accessed APRA's training and development programs during the year and was provided with assistance to develop its cost recovery function. The two agencies regularly exchange information on jointly supervised institutions and discuss common industry issues. A new MoU between the two agencies was signed in December 2010.

APRA liaises regularly with the Motor Accidents Authority of New South Wales (MAA) and the Motor Accident Insurance Commission of Queensland (MAIC). These State regulatory bodies administer compulsory third-party (CTP) motor vehicle insurance schemes in these states. The MAA and MAIC provide APRA with scheme information and consult with APRA on the financial condition of the CTP insurance providers; in turn, APRA provides both agencies with solvency data on these providers. APRA also keeps these agencies informed of policy developments in the prudential supervision of general insurers. APRA also liaises with WorkCover State authorities on prudential matters relevant to workers' compensation insurance.

APRA has continued its liaison with the Financial Reporting Council and the two Boards the Council oversees: the Australian Accounting Standards Board (AASB) and the Australian Auditing and Assurance Standards Board (AuASB). APRA Member Ian Laughlin is a member of the Council, having succeeded the former APRA Member John Trowbridge. APRA also contributed to the AASB's work on reporting by superannuation funds.

APRA is a permanent member of the Banking and Finance Sector Group (BFSG) and currently provides the Deputy Chair. Established under the Government's Trusted Information Sharing Network, the BFSG aims to strengthen the financial system's ability to respond to an industry-wide operational disruption by providing a framework for sharing security-related information that affects critical infrastructure. Membership comprises representatives from major financial institutions, financial markets participants, industry associations and State and Australian Government agencies. During 2010/11, the BFSG continued its focus on strengthening the resilience of the banking and finance sector and further streamlining business and government coordination in disasters. In early 2011, the BFSG played an active role supporting the banking and finance sector and various State and Federal Government agencies in their response to the spate of natural disasters. These activities included arranging for subject matter experts to provide specialist information to assist affected organisations manage their response and the recovery phase of these disasters. The BFSG also continued to support the Federal Government in electronic security initiatives through participation in the Cyber Storm III Exercise. This was a joint international cyber security exercise conducted in September 2010 between Australia, the United States, the United Kingdom, Canada and New Zealand.

In addition to its meetings with FICA, APRA liaises directly with a number of industry organisations including the Australian Bankers' Association, Abacus – Australian Mutuals, the Australian Finance Conference, the Financial Services Council, the Insurance Council of Australia, the Association of Superannuation Funds of Australia, the Corporate Superannuation Association and the Australian Institute of Superannuation Trustees. APRA also liaises with professional associations and institutes such as those for accountants, actuaries, administrators, auditors, company directors, compliance professionals, financial planners, risk managers and trustees. APRA's regional offices also have wide-ranging liaison programs with regional offices of ASIC, industry bodies and professional associations.

The actuarial profession plays an important role in financial management and prudent risk management in the general insurance, life insurance and superannuation industries, both through statutory Appointed Actuary roles and through providing advice on financial and risk management issues to boards and management of institutions. APRA has regular and extensive dialogue on matters of mutual interest with the Institute of Actuaries of Australia (IAAust) and the profession generally. During 2010/11, the principal topic of interest has been APRA's proposals to update its prudential capital requirements for life and general insurers. In addition to regular meetings with representatives of the relevant practice committees of the IAAust and with its Executive, APRA has more formal dialogue with life insurance Appointed Actuaries as a group. APRA's own actuarial staff are actively involved in various committees and taskforces of the IAAust.

## International liaison

APRA's international liaison activities take two main forms. The first are its traditional direct links with overseas regulatory agencies associated with the supervision of specific financial institutions. The second, which has stepped up in intensity since APRA joined the Basel Committee on Banking Supervision, is its participation in international groups and fora that have carriage of global reform initiatives being pursued by the Leaders of the G-20.

Direct links with overseas regulatory agencies provide important input into APRA's risk assessment of regulated institutions that also operate in other jurisdictions and of foreign financial institutions for which APRA is 'host' supervisor. The need for effective two-way dialogue that can be 'dialled-up' readily at times of stress was emphasised during the global financial crisis when some sound APRA-regulated institutions were destabilised by problems emanating from their foreign parent. In the wake of the crisis, global efforts to reinforce regulatory cooperation have centred on the establishment of supervisory colleges of relevant supervisors and central banks for the largest cross-border banks and insurance companies, and APRA participates in several of these colleges. APRA also has established its own colleges for a number of large, internationally active financial institutions headquartered in Australia and it hosted two of these colleges during the year. APRA now has formal bilateral information-sharing arrangements with 20 overseas regulators and has several other arrangements under discussion, some of which will facilitate the activities of supervisory colleges. APRA is one of 17 signatories to the multilateral MoU put in place by the International Association of Insurance Supervisors (IAIS) and has provided staff resources to assist the IAIS in the validation of applications from other jurisdictions.

The traditional direct link of most importance to APRA is that with the RBNZ, the prudential supervisor of banks and, now, insurance companies in New Zealand. The importance flows from the high degree of interconnectedness between the Australian and New Zealand financial systems. The four major Australian banking groups have just below a 90 per cent share of New Zealand banking system assets and New Zealand banking assets comprise around 10 per cent of the groups' total assets. New Zealand also provides an important source of premium income for some of the larger Australian insurers.

In this context, APRA has a close and cooperative working relationship with the RBNZ on a range of supervisory issues. There is regular liaison on matters relating to the supervision of the major Australian banks, including regular information exchange and coordination of supervisory measures where appropriate. APRA staff often undertake prudential reviews of the New Zealand subsidiaries of the Australian banks and the RBNZ typically participates in these. During the year, APRA also provided advice and assistance to the RBNZ on matters relating to the supervision of insurance, as the RBNZ takes on its new role in this area; an APRA officer has been seconded to the RBNZ from January 2011 to help build its insurance supervision team.

Over recent years, APRA and the RBNZ have given high priority to the detection of emerging stress in trans-Tasman banks and ensuring a coordinated response that would maintain financial system stability in both countries. Considerable work has gone into the development of a structured approach to the handling of any episode of trans-Tasman financial distress, which will be tested in 2011/12 in a trans-Tasman crisis management exercise. This work is being coordinated under the auspices of the Trans-Tasman Council on Banking Supervision, which comprises APRA, the RBA, the RBNZ and the Treasuries of Australia and New Zealand. The Council met once in 2010/11 and several times at deputy and working group levels.

APRA's participation in global reform initiatives is mainly through its involvement in global standard-setting bodies and in other fora. These include:

- Basel Committee on Banking Supervision. The Basel Committee on Banking Supervision is the global standard-setting body for bank regulation and supervision and it provides a forum for regular cooperation on banking supervision matters. Australia joined the Basel Committee in March 2009 as part of a broadening of the membership base to include all G-20 countries as well as Hong Kong SAR and Singapore. APRA and the RBA are both members and the APRA Chairman represents Australia on prudential supervision matters. The primary focus of the Basel Committee over the past year has been the finalisation of new global regulatory standards on bank capital adequacy and liquidity (Basel III), which are discussed elsewhere in this *Report*. The Basel Committee has also been involved in the development of additional policy measures for systemically important banks whose failure would have significant cross-border repercussions (so-called G-SIBs).

APRA is also represented on the Basel Committee's three key sub-committees: the Policy Development Group, the Standards Implementation Group and the Accounting Task Force. The Policy Development Group identifies and reviews emerging prudential issues and develops policies to promote strong prudential standards. Its work program during 2010/11 was dominated by the development of the Basel III reforms but the Group was also involved in producing additional guidance on operational risk management and new standards for disclosure on remuneration. The Standards Implementation Group shares information and promotes consistency in the implementation of Basel Committee standards and guidance. Its main priority has been ensuring a consistent and effective implementation of both the Basel II and Basel III frameworks and improving the workings of supervisory colleges. The Accounting Task Force engages with accounting and auditing standard-setters to help ensure that global accounting and auditing standards and practices promote sound risk management at banks, support market discipline through transparency, and reinforce the safety and soundness of the banking system. In the past year, it has remained closely involved in proposals from the International Accounting Standards Board (IASB) to move from the current incurred loss approach to an expected loss approach for provisioning, and in the major convergence projects between the IASB and the Financial Accounting Standards Board (FASB) aimed at achieving convergence in global accounting standards.

In addition, APRA is an active participant in a number of other sub-committees and working groups of the Basel Committee. APRA is represented on three groups dealing with key aspects of the Basel III reforms – the Definition of Capital Subgroup, the Working Group on Liquidity and the QIS Working Group, which will monitor the impact of the reforms through semi-annual quantitative impact studies during the transition to Basel III. APRA is also a member of the Core Principles Group, established to review and assess the need for changes to the Basel Committee's *Core Principles for Effective Banking Supervision*, and of the Operational Risk sub-group of the Standards Implementation Group (SIGOR), which investigates issues related to the management and measurement of operational risk. During 2010/11, SIGOR finalised a series of papers providing supervisory guidance on the advanced measurement approaches for operational risk and on the use of insurance as a risk mitigant within these approaches, and outlining principles for the sound management of operational risk. These papers have now been published.

Given its interest in crisis management arrangements, APRA has joined the Cross-border Bank Resolution Group (CBRG), which compares the national policies, legal frameworks and allocation of responsibilities for the resolution of banks with significant cross-border operations. During 2010/11, the CBRG coordinated a survey of Basel Committee members on their capacity to resolve systemically important financial institutions operating in their jurisdictions under their existing resolution regimes, and on legislative and other changes that might be needed to improve these regimes. An Interim Report published in July 2011 summarised the findings of the survey and identified issues where further work may be desirable.

A senior officer of APRA completed a two-year secondment to the Basel Committee Secretariat during 2010/11.

- International Association of Insurance Supervisors (IAIS). The main objectives of the IAIS are to promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders, and to contribute to global financial stability. These objectives align directly with APRA's supervisory objectives and APRA (and its predecessor the Insurance and Superannuation Commission (ISC)) has had a significant involvement with the IAIS since its formation in 1994. APRA has had continued representation on the IAIS Executive Committee (at APRA Member level) and Technical Committee; it is also an active participant on the Financial Stability Committee, established in response to the global financial crisis, and on a number of sub-committees most relevant to APRA's supervisory mandate and the Australian insurance industry.

During 2010/11, a major IAIS initiative with which APRA has been closely involved has been the development of a common framework ('ComFrame') for the supervision of internationally active insurance groups. This work aims to make group-wide supervision more effective and more reflective of actual business practices, and to establish a comprehensive framework for supervisors to address group-wide activities and risks. Another key area of work has responded to G-20 and Financial Stability Board requests in relation to systemically important financial institutions. The IAIS has been developing a list of potential indicators that might be used to determine if an insurer, or insurance group, has systemic importance.

APRA has also continued its involvement in the Accounting, Insurance Contracts, Solvency and Actuarial Issues, Insurance Groups and Reinsurance sub-committees. Such involvement has gained added importance given that the IAIS has been revising, and redeveloping in many cases, its *Insurance Core Principles*.

- Joint Forum. APRA and ASIC represent Australia on the Joint Forum, a body working under the umbrella of the Basel Committee, the IAIS and the International Organisation of Securities Commissions (IOSCO).

  The work of the Joint Forum encompasses issues relating to financial conglomerates and other issues that are common to, or have cross-sectoral implications for, the banking, insurance and securities sectors. During 2010/11, the Joint Forum released a major report on developments in modelling risk aggregation and its current workstreams are addressing intra-group support measures, asset securitisation incentives and a review of its *Principles for the Supervision of Financial Conglomerates*, in which APRA is actively participating.

- International Organisation of Pension Supervisors (IOPS). IOPS is an independent body representing agencies involved in the supervision of private pension arrangements. It was formed in 2004 to become the global standard-setter for the pensions industry, to promote international cooperation on pension supervisory issues, and to provide a global forum for policy dialogue and exchange of information on these matters. IOPS now has around 70 members and observers representing around 60 countries and territories at different levels of economic development and with a variety of pension and supervisory systems.

  APRA has been on the board of IOPS since its foundation and is a member of the Technical Committee. In late 2009, the APRA Deputy Chairman was re-elected President of IOPS for a second two-year term. During 2010/11, APRA continued to contribute actively to the work of IOPS; this included publication of further working papers in the Effective Supervision series, the revision of the IOPS *Principles of Private Pension Supervision* and completion of a 'toolkit' on risk-based supervision of pension funds, which was launched at the IOPS Annual General Meeting in Sydney in November 2010.

  An APRA staff member has been seconded to the IOPS Secretariat for 12 months to assist in the development of further guidance on pension supervision.

- OECD Insurance and Private Pensions Committee (IPPC). APRA is represented on the IPPC, which focuses on liberalisation of insurance markets, governance and regulatory frameworks in insurance and private pensions, and the collection and publication of cross-country statistics in insurance and pensions. The APRA Deputy Chair is Vice-Chairman of the IPPC Working Party on Private Pensions (WPPP). During 2010/11, the IPPC and WPPP continued their analysis of appropriate policy and regulatory responses to the impact of the global financial crisis on insurance companies and private pension funds, commenced work on effective design for defined contributions pensions schemes that reduced risk to members, considered how the level and quality of insurance and pension statistics collections could be improved and undertook accession reviews of and engagement with a number of countries seeking to join the OECD.

- International Association of Deposit Insurers (IADI). In 2009/10, APRA joined IADI, an international body with responsibility for promoting principles and guidance in the design and administration of deposit insurance and guarantee arrangements. Membership of IADI complements APRA's role as the agency responsible for the administration of Australia's Financial Claims Schemes in the ADI and general insurance industries. In particular, APRA's membership of IADI has provided access to targeted training on deposit insurance systems, which was followed-up in 2010/11 with visits to four leading deposit insurers to understand best practice in this area. This involvement will assist APRA in the implementation phase of the Schemes. Membership of IADI also enables APRA to participate in the evolving international thinking on deposit insurance design and administration in the aftermath of the global financial crisis.
- International Credit Union Regulators Network (ICURN). ICURN is an independent network of regulators of financial cooperatives. Its objective is to share information on topics critical to sound financial regulation; it also initiates research on financial cooperatives and their oversight, identifies best practice and issues recommendations to its members to improve regulations, safety and soundness. In 2010/11, ICURN focussed on the topics of capital for cooperatives, governance and risk management; it also worked closely with the World Council of Credit Unions in assisting the development of supervisory systems and approaches in developing countries. ICURN is governed by a steering committee of representatives from six regions around the world and APRA is currently the representative for the Asia-Pacific region.

APRA meets annually with integrated supervisory agencies from a range of countries to discuss matters of common interest. The main topics at the 13th such conference in June 2011 were the steps being taken to improve the quality and effectiveness of banking and insurance supervision, global regulatory reforms, the role of supervisors in macroprudential analysis, and media management during a financial crisis.

Together with the RBA, APRA is a member of the Working Group on Banking Supervision of the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP), which brings together central banks, monetary authorities and banking supervisors within the region. The Working Group provides a forum to discuss regional financial and prudential developments. Its main focus in 2010/11 was the implications of the global capital and liquidity reforms for countries in the region. EMEAP also facilitates a number of training initiatives to which APRA provides speakers from time to time.

## Technical assistance

APRA continues to support the deepening of institutional capacity among its Asian and Pacific regulatory counterparts through a series of tailored technical assistance programs, principally funded by AusAID. These programs seek to assist regulators to improve standards of prudential supervision, as part of a broader whole-of-government effort to strengthen public sector governance in the Asian and Pacific regions.

In the Pacific, APRA administers two distinct but complementary projects under the auspices of the Government's multilateral Pacific Sector Linkages Program. The Pacific On-Site Prudential Supervision Project provides for APRA supervisors to travel to Pacific countries for two weeks at a time to conduct training programs with on-site review teams comprised of local and other visiting Pacific prudential regulators. During 2010/11, APRA supervisors undertook two on-site training programs in each of Papua New Guinea, Fiji and the Solomon Islands ranging across banking and other credit providers, insurance and provident funds. The Pacific Prudential Regulator Internship Project places staff from Pacific prudential regulators within APRA's frontline supervisory divisions for a period of about three months to learn about prudential supervision techniques. The project, which had been placed on hold during the global financial crisis, resumed in 2010/11 with a participant from the Financial Supervisory Commission of the Cook Islands and from the Central Bank of the Solomon Islands hosted in APRA's office in Brisbane. Taken together, the two projects make a worthwhile contribution to deepening capacity and strengthening prudential supervision across the Pacific region.

In Asia, APRA's engagement is primarily focussed on, but not limited to, technical assistance activities with Indonesia. APRA has been engaged with BAPEPAM-LK, Indonesia's integrated regulator of securities markets and non-bank financial institutions, for the past six years. Building upon the successful introduction of a new risk-rating model (adapted from APRA's PAIRS framework) by BAPEPAM-LK's Pension Fund Bureau in 2008, APRA is continuing to assist the Bureau to refine procedures around the benchmarking of risk-rating scores; it is also assisting BAPEPAM-LK's Insurance Bureau to develop a risk-rating model. APRA's capacity-building engagement with Bank Indonesia continued in 2010/11, with two Bank Indonesia interns placed within APRA's frontline supervisory divisions for a period of around six months. This was the third instalment of a longer-term engagement between APRA and Bank Indonesia that began in 2006. Other visits from Bank Indonesia staff focussed on adapting regulatory tools. In total, APRA hosted 23 interns from Indonesia during the past year.

APRA's assistance to BAPEPAM-LK and Bank Indonesia is funded by a multi-year initiative, renewed in late 2010, under the auspices of the Government Partnership Fund II (GPF II) as part of the Australia-Indonesia Program for Reconstruction and Development. By improving economic governance and public sector management, the GPF program aims to contribute to a healthy financial sector, which is an essential prerequisite to economic development and the efficient flows of resources within and between economies. From time to time, APRA also undertakes training visits to other prudential regulators in the region and, in 2010/11, it provided two APRA experts to present on operational risk management to the Bank of Thailand.

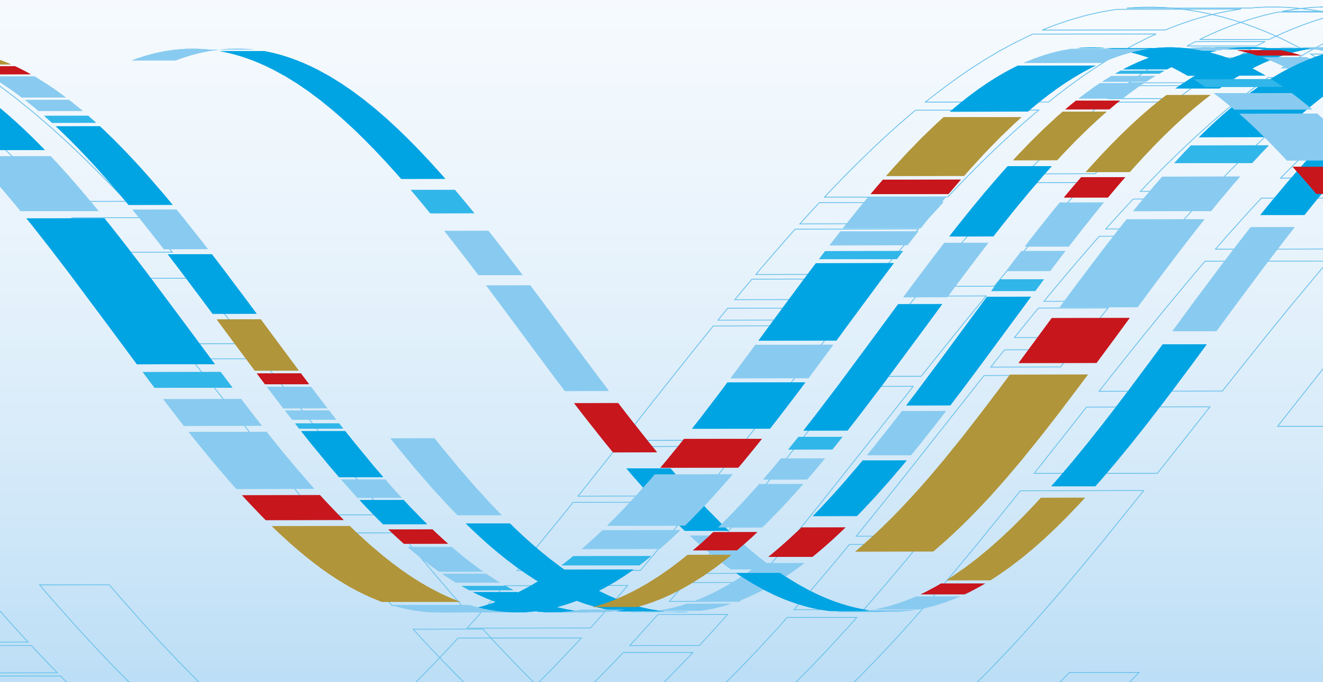
The Association of Financial Supervisors of Pacific Countries facilitates cooperation between regulators in the region. APRA represents Australia as an observer at Association meetings and supports its training activities through sponsoring speakers on topical issues at the Association's annual meeting and training workshops. APRA is also a member of:

- the Asian Forum of Insurance Regulators;
- the South-East Asia New Zealand and Australia (SEANZA) Forum of Banking Supervisors;
- the Financial Regulators Training Initiative of the Banking Supervisors' Advisory Group of Asia-Pacific Economic Cooperation (APEC), coordinated through the Asian Development Bank; and
- the Australian APEC Study Centre Advisory Group.

Given the importance of Australian banks within the South Pacific, APRA was invited to attend the 25th Meeting of South Pacific Central Bank Governors, held in New Zealand in December 2010.

APRA continues to support the international broadening of knowledge on prudential supervision by providing expert speakers to various institutes, including the Financial Stability Institute (of the Bank for International Settlements), the APEC Study Centre at RMIT University, the APEC Financial Regulatory Training Initiative and the ASEAN Insurance Training and Research Institute (AITRI). During 2010/11, APRA provided 11 speakers to conferences organised by the Financial Stability Institute, which are often co-hosted with other regional bodies, and one speaker to programs organised by each of the APEC Study Centre, AITRI and the International Federation of Pension Administrators. APRA hosted a workshop on liquidity management in Brisbane for the APEC Financial Regulatory Training Initiative and a workshop on risk-based supervision of pension funds in Sydney in conjunction with the Annual Meeting of IOPS. APRA also hosted an executive development program in Sydney for two groups of 25 senior staff from the China Banking Regulatory Commission and co-hosted, with the RBA, a meeting of the EMEAP Working Group on Banking Supervision. APRA values the opportunity to develop the skills of its staff, as both participants and speakers in such programs.

During the year, APRA hosted some 100 international delegations from regulatory agencies, central banks, multilateral organisations, industry bodies and private sector organisations. Around half of the delegations were from developing countries and just under one-fifth from China. Delegation visits from South Korea and Indonesia were also prominent. Areas of interest included APRA's functions and operations, prudential policy developments, risk-based supervision, Australia's handling of the global financial crisis, and prudential policy and supervisory practice in superannuation. In addition, there were a significant number of visits by individual financial institutions to discuss the requirements for establishing operations in Australia.



Chapter six

# APRA's costs and performance

## Financial performance

APRA's expenditure is devoted to implementing and enhancing the prudential framework in Australia and to its ongoing supervisory and enforcement activities. APRA's income derives mostly from annual levies on its supervised entities.

### APRA's expenditure

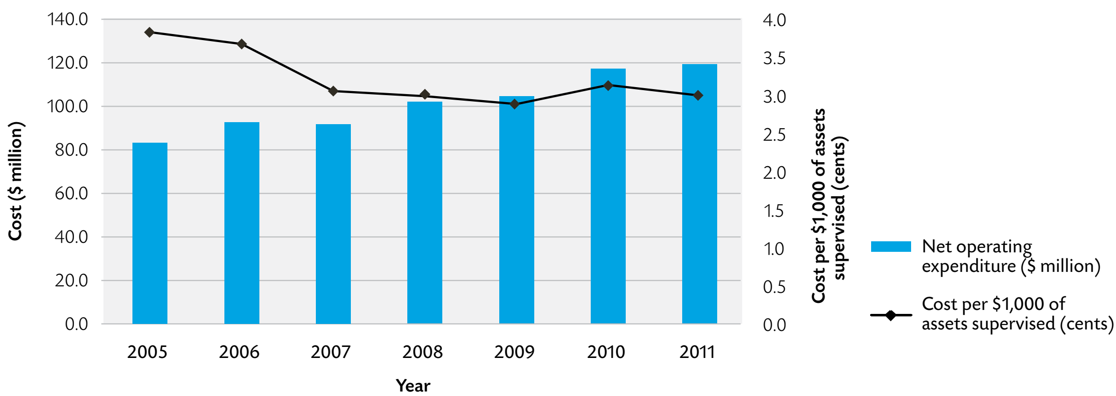
APRA's total operating expenditure in 2010/11 was $118.3 million compared with the budget of $119.7 million. Expenditure included an amount of $1.9 million in relation to the Government's Standard Business Reporting program.

APRA's operating expenditure has risen over the past four years as a consequence of the build-up in supervisory numbers and capacity during the global financial crisis. However, relative to the value of assets supervised by APRA, costs have remained at about three cents per $1,000 of assets supervised.

### APRA's income

In addition to levies collected from supervised institutions, APRA's income includes interest earnings, fees for services and miscellaneous cost recoveries. Included in revenue in 2010/11 was $9.0 million of a Special Appropriation from the Government to deal with the global financial crisis. This was part of a total appropriation for this purpose of $45.5 million over four years, provided in the 2008/09 Additional Estimates.

APRA's costs



Levies are raised according to the *Financial Institutions Supervisory Levies Collection Act 1998* and six other Acts applying to the regulated industries. Prior to the beginning of each financial year, and after consultation with the main industry representative groups, the Minister announces the levy determinations for each industry. The levy rate is applied on assets, subject to a minimum and maximum amount per institution, except for non-operating holding companies that are levied at a flat rate. The levies collected by APRA also cover some costs of ASIC and the ATO. Levies are based on the costs incurred for each industry. In addition, levies are collected to cover the costs of the National Claims and Policies Database, with a rate applied to the gross earned premiums of general insurance entities that contribute to it. The total levies collected by APRA for all three agencies in 2010/11 were $116.4 million compared with the plan of $117.6 million.

APRA's total income in 2010/11 was $107.3 million compared with the budget of $108.2 million.

## Reserves

APRA had an operating deficit from ordinary activities of $11.1 million in 2010/11, which was funded largely out of the operating surplus of $10.7 million in 2009/10. As a consequence, total reserves decreased to $31.3 million. Included in this amount is a $6.0 million Contingency Enforcement Fund that is available to be used for large unexpected investigation and enforcement activities, and an Asset Revaluation Reserve of $6.6 million that has increased following the triennial revaluation of assets. A part of APRA's total reserves will also be used to fund APRA's expenditures in 2011/12.

## Business planning

In July 2009, APRA launched its 2009-12 Strategic Plan, which aimed to consolidate progress under its first strategic plan (2006-09) and look beyond the challenging environment created by the crisis. The Plan did not involve any major change in APRA's strategic direction but gave priority to taking on board the lessons from the unprecedented period of stress in global financial markets. The Plan is reviewed each year in light of developments in APRA's operating environment.

The Plan identifies six strategic objectives and the initiatives APRA will undertake to meet them. The objectives are to:

- sharpen APRA's risk-based approach to supervision by ensuring its supervisory processes are sufficiently flexible and responsive in challenging economic circumstances;
- enhance and support the capabilities of APRA's people to ensure that it maintains high standards in all areas and remains an attractive employer for people whose skills are also in demand in the finance sector;
- enhance APRA's document and data management capabilities by continuing to invest in new and existing solutions to ensure that appropriate technologies, processes and training are in place;
- improve the resilience and effectiveness of APRA's infrastructure to support its supervisory and regulatory activities;

- strengthen the resilience of the prudential framework in response to global reform initiatives and APRA's own reform agenda; and
- strengthen APRA's engagement with stakeholders through actively communicating APRA's position and priorities.

The Strategic Plan forms the basis for annual divisional business plans and relevant objectives are also incorporated into individual performance plans. Overall performance against the Plan is reviewed on a quarterly and annual basis by the Executive Group.

## Supervisory performance

Although the global financial crisis shone a strong and, in a number of cases, unflattering spotlight on the effectiveness of supervisory agencies, the development of useful objective indicators of supervisory intensity and effectiveness is still in its embryonic stages around the globe. That said, APRA publishes information from two different sources to provide broad quantitative indicators of its supervisory performance.

Firstly, APRA has developed 'transition matrices' to track the migration of institutions between the four supervision stances in APRA's Supervisory Oversight and Response System (SOARS), which guides supervisors in responding to identified risks. As an institution moves out of a Normal stance, routine supervision is likely to give way to greater use of APRA's more specialised intervention and enforcement powers. Institutions in Oversight are not expected to fail but there are aspects of their risk position that may create vulnerabilities in extremely adverse circumstances and that require more extensive examination by APRA. APRA does not expect institutions to be permanently classified as Mandated Improvement. Institutions in Restructure are those in which APRA has lost confidence that financial promises to beneficiaries will be met in the absence of vigorous intervention, or which have long ceased to be viable operating businesses and are being assisted to exit the industry in an orderly fashion.

Over the past four years, around half of the institutions in Normal remained in that stance. Institutions in Oversight mostly remained where they were, though a significant percentage either improved or exited the industry in an orderly manner. Around half of the institutions in Mandated Improvement have exited the industry while a number have moved towards an improved supervision stance, confirming APRA's 'behind the scenes' work to improve the risk position of institutions. The majority of institutions in Restructure have remained in that stance, with all others exiting the industry.

### SOARS matrix (2007/11) (%)

| From/to | Normal | Oversight | Mandated Improvement | Restructure | Exit |
|---|---|---|---|---|---|
| Normal | 50 | 21 | 0 | 0 | 28 |
| Oversight | 25 | 49 | 1 | 1 | 23 |
| Mandated Improvement | 0 | 29 | 24 | 0 | 47 |
| Restructure | 0 | 0 | 0 | 60 | 40 |

Over the past eight years, a total of 218 institutions have been in Mandated Improvement and/or Restructure (of which 10 institutions moved through both SOARS categories). Of that total, 50 have improved stance to Normal or Oversight, 24 remain in their SOARS category, 138 have exited without loss to beneficiaries and six institutions have failed (four of which moved through both Mandated Improvement and Restructure during that time). While it is not possible to compare these outcomes with what would have happened had APRA not intervened, the direction of movement of institutions in these two supervisory stances is consistent with timely and effective intervention on APRA's part.

### Entities in Mandated Improvement (2003/11)

| Current stance | Total |
|---|---|
| Normal | 20 |
| Oversight | 27 |
| Mandated Improvement | 13 |
| Restructure | 3 |
| Exit | 105 |
| Failure | 5 |
| **Total** | **173** |

### Entities in Restructure (2003/11)

| Current stance | Total |
|---|---|
| Normal | 0 |
| Oversight | 3 |
| Mandated Improvement | 0 |
| Restructure | 11 |
| Exit | 36 |
| Failure | 5 |
| **Total** | **55** |

At end-June 2011, around 56 per cent of institutions were in the Normal stance, 41 per cent in Oversight, one per cent in Mandated Improvement and two per cent in Restructure. Over the past four years, the proportion of institutions in Oversight has risen significantly and the proportion in Normal has fallen as the global financial crisis exposed various weaknesses in a number of institutions.

The second set of quantitative indicators of supervisory performance is linked to financial failures and losses to beneficiaries. APRA publishes two headline performance indicators:

- the Performing Entity Ratio (PER), which is the number of APRA-regulated institutions that met their commitments to beneficiaries in a given year, divided by the total number of APRA-regulated institutions; and
- the Money Protection Ratio (MPR), which is the dollar value of liabilities to beneficiaries in Australia that remained safe in a given year, divided by the total dollar value of liabilities to beneficiaries in Australia in APRA-regulated institutions.

These indicators are, however, silent about target outcomes against which APRA's performance can be assessed. The Government's *Statement of Expectations* of APRA (2007) confirmed that prudential regulation should not pursue a 'zero failure' objective. Rather, the objective is to maintain a low incidence of failure of supervised institutions while not impeding continued improvements in efficiency or hindering competition. APRA fully supports this objective. APRA's aim is to identify likely failures early enough so that corrective action can be initiated to prevent the failure, or at the least to set in train appropriate wind-up or other exit strategies to minimise losses to beneficiaries. Since APRA's inception in 1998, the annual PER has averaged 99.90 per cent and the annual MPR, which is dominated by the losses associated with HIH Insurance, has averaged 99.96 per cent.

## 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 | 887,172 | 99.91 | 100.00 |
| 2000 | 3 | 308 | 4,407 | 993,369 | 99.93 | 99.97 |
| 2001 | 8 | 5,328[4] | 4,350 | 1,043,111 | 99.82 | 99.49 |
| 2002 | 6 | 140 | 3,803 | 1,009,373 | 99.84 | 99.99 |
| 2003 | 5 | 19 | 3,252 | 1,068,081 | 99.85 | 100.00 |
| 2004 | 1 | 0[5] | 2,745 | 1,207,119 | 99.96 | 100.00 |
| 2005 | 0 | 0 | 2,099 | 1,346,253 | 100.00 | 100.00 |
| 2006 | 0 | 0 | 1,596 | 1,548,454 | 100.00 | 100.00 |
| 2007 | 1 | 0[5] | 1,244 | 1,837,363 | 99.92 | 100.00 |
| 2008 | 0 | 0 | 1,129 | 1,943,376 | 100.00 | 100.00 |
| 2009 | 0 | 0 | 1,028 | 2,049,612 | 100.00 | 100.00 |
| 2010 | 1 | 1 | 965 | 2,232,254 | 99.90 | 100.00 |
| 2011 | 4 | 55 | 898 | 2,461,557 | 99.55 | 100.00 |

1 In the case of superannuation, failures refer to the number of funds affected and include failures due to employer sponsors.

2 The number of institutions excludes Small APRA Funds, representative offices of foreign banks and non-operating holding companies.

3 Protected Accounts is an estimate of the funds protected by APRA as defined by relevant legislation and is less than the total assets held by APRA-regulated institutions, which were $3,972.1 billion at end-June 2011.

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. In the first case, the superannuation fund was not included in the PAIRS/SOARS database.

## Stakeholder survey

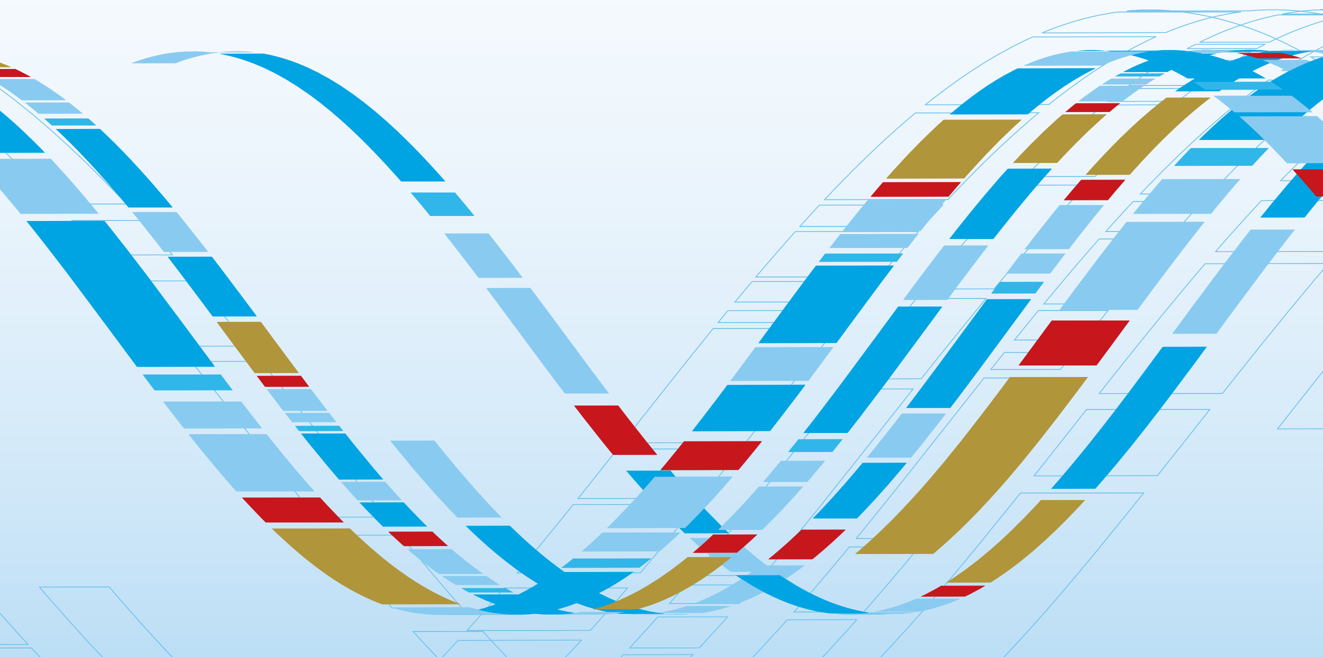
During 2011, APRA conducted its second stakeholder survey, following an earlier survey in 2009. Such surveys are foreshadowed in APRA's Service Charter, which states that APRA will undertake surveys of regulated institutions, industry bodies and other stakeholders to assist its understanding of the impact of APRA's prudential framework and the effectiveness of its supervision. Conducted by Australian Survey Research (ASR), the 2011 survey collected responses from two groups of stakeholders using a similar questionnaire: one of regulated institutions and a shorter one of industry representatives and other knowledgeable observers. APRA published the results of the ASR survey in July 2011.

ASR noted that, overall, the results were very similar to those of the 2009 survey. According to ASR, the results were '... an excellent result and further endorsement of APRA's prudential framework and approach to supervision. Regulated entities agree that APRA has had a positive impact on their industry'. Within the questionnaire there were 45 rated items that used a five-point rating scale, from 1 (strongly disagree) through to 5 (strongly agree). Only two items scored below 3.0 (neutral) on the five-point scale and 23 of the 45 items had 75 per cent or more positive responses.

As with the 2009 survey, APRA will use the results of the 2011 Stakeholder Survey as an important performance tool.

| Stakeholder survey – highest scoring items | Mean |
|---|---|
| A single supervisory team responsible for all group companies is an appropriate way to supervise groups | 4.6 |
| APRA staff's demonstration of integrity | 4.5 |
| APRA staff's demonstration of professionalism | 4.4 |
| APRA's enforcement of its prudential requirements has had an impact on your industry | 4.2 |
| APRA's framework is effective in achieving its mission | 4.2 |
| APRA's guidance material is of value to your organisation | 4.2 |
| APRA's harmonisation of the prudential framework is important | 4.2 |
| APRA staff's demonstration of collaboration | 4.1 |
| APRA is effective in communicating the findings of supervisory visits to your organisation | 4.1 |
| The APRA supervisory team responsible for your organisation has a good understanding of your organisation | 4.1 |

| Stakeholder survey – lowest scoring items | Mean |
|---|---|
| APRA's PAIRS rating reflects your organisation's view of its risk profile | 3.6 |
| Standards and guidance material clearly communicate requirements | 3.6 |
| APRA meets its stated approach of being consultative in its supervision | 3.6 |
| APRA meets its stated approach of being consistent in its supervision | 3.6 |
| The instructions to APRA's statistical forms are helpful | 3.6 |
| D2A is easy to use when lodging data with APRA | 3.5 |
| The effort required of your organisation during APRA's prudential reviews is appropriate | 3.5 |
| During supervisory visits to your organisation, APRA supervisors focus on principles rather than detailed prescription | 3.5 |
| Changes to APRA's prudential framework consider the costs of regulation | 2.8 |
| APRA has successfully harmonised its prudential framework | 2.8 |



Chapter seven

# Governance

## Governance structure

APRA's governance structure comprises a full-time Executive Group of at least three and no more than five Members, as specified in Part 3 of the *Australian Prudential Regulation Authority Act 1998*. The Executive Group is responsible and accountable for the operation and performance of APRA.

APRA has the dual role of regulating institutions in the financial sector and developing the administrative practices and procedures to be applied in performing that regulatory role. 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 balancing these objectives, is to promote financial system stability in Australia.

APRA's responsibilities include the development of regulatory and supervisory policies relating to the performance of its role as prudential regulator, including the making of prudential standards under relevant legislation.

APRA also acts as a national statistical agency for the Australian financial system and is responsible for administering the Financial Claims Schemes provided for in relevant banking and general insurance legislation.

The Executive Group meets formally on a monthly basis, and more frequently as required, to discuss and resolve the major prudential policy, supervisory and strategic issues facing APRA at the time. It also holds Management Group meetings with APRA's senior management team at least weekly for high-level information-sharing and decisions on more routine supervisory and organisational matters.

### Members' attendance at Executive Group meetings from 1 July 2010 to 30 June 2011

| | Meetings | Attended |
|---|---|---|
| John Laker | 12 | 12 |
| Ross Jones | 12 | 11 |
| Ian Laughlin | 12 | 10 |

Details on APRA Members are provided on pages 88-89 of this *Report*.

## Risk management in APRA

### Risk Management and Audit Committee

APRA's Risk Management and Audit Committee provides independent assurance and assistance to the Executive Group on APRA's risk management and compliance framework and its external accountability responsibilities.

The Committee comprises an external chair, one external member, one member of APRA's Executive Group and one Executive General Manager. In addition, regular attendees at Committee meetings are the General Manager – Risk Management and Internal Audit, the Chief Financial Officer and a representative of the Australian National Audit Office. The Chairman of APRA may attend by invitation.

During 2010/11, the Committee met four times and at those meetings all audit reports were reviewed. The Committee also approved the Risk Management and Internal Audit annual plans and monitored APRA's Enterprise Risk Management Framework.

The members of the Committee in 2010/11 were:

**Ms Elizabeth Alexander AM**
BCom (Melb), FCA, FCPA, FAICD
Chair (until 31 August 2010)

Ms Alexander was appointed Chair of the Committee in 2003 and in 2008 was reappointed for a further two-year term. Ms Alexander is Chancellor of the University of Melbourne, Chair of CSL Ltd and a non-executive director of the Dexus Property Group and Medibank Private. She is an advisor to Blake Dawson and a former member of the Takeovers Panel. Ms Alexander is a former National President of the Australian Institute of Company Directors and of CPA Australia and an immediate former Deputy Chair of the Financial Reporting Council. A former partner of PricewaterhouseCoopers, she specialised in risk management and corporate governance issues.

**Mr W Peter Day**
LLB (Hons), MBA, FCPA, FCA, FTIA, GAICD
Chair (from 1 September 2010)

Mr Day was appointed for a five-year term in 2008 and assumed the role of Chair of the Committee from 1 September 2010. He is Chairman of Orbital Corporation Limited and Centro Retail Limited and a non-executive director of Ansell Limited, SAI Global Limited and Multiple Sclerosis Limited. He also serves as a non-executive director of the Accounting Professional and Ethical Standards Board.

Mr Day was, for seven years until 2007, Chief Financial Officer of Amcor Limited. He is a former Chairman of the Australian Accounting Standards Board, has participated in the setting of international accounting standards and was Deputy Chairman of the Australian Securities and Investments Commission from 1997 to 1999.

**Ms Fiona Bennett**
BA(Hons), FCA, FAICD, FAIM
External member (from 1 January 2011)

Ms Bennett was appointed for a three-year term on 1 January 2011. She is a non-executive director of two ASX-listed companies – Hills Holdings Limited and Boom Logistics Limited – and a number of other entities including Alfred Health, the Institute of Chartered Accountants and the Legal Services Board (Victoria). During her executive career, Ms Bennett held senior executive positions at BHP Billiton Limited and Coles Group Limited and has been Chief Financial Officer at several organisations in the health sector.

**Mr Ian Laughlin**
APRA Member

**Mr Keith Chapman**
Executive General Manager
– Supervisory Support Division

### Attendance at Risk Management and Audit Committee meetings from 1 July 2010 to 30 June 2011

| | Meetings | Attended |
|---|---|---|
| Elizabeth Alexander | 1 | 1 |
| Peter Day | 4 | 4 |
| Keith Chapman | 4 | 3 |
| Fiona Bennett | 2 | 2 |
| Ian Laughlin | 4 | 4 |

## Risk Management and Internal Audit unit

The Risk Management and Internal Audit unit plays an important role in APRA's governance, assurance and compliance framework through a detailed and structured approach to the monitoring and assessment of risks and the review of APRA's systems and processes. The unit is independent of APRA's management structure and has a direct reporting line to the Chair of the Risk Management and Audit Committee and direct access to the Executive Group. It is staffed by officers with extensive experience in risk management, audit, regulated industries and prudential supervision.

Central to risk management in APRA, and to the work of the unit, is an Enterprise Risk Management Framework for the identification, monitoring and management of risk. The Framework and its reporting processes were implemented in 2009/10 and enhanced during the past year. This APRA-wide approach has established defined risk categories that capture any substantial risk to APRA's mandate and objectives. For each risk category, an appropriate member of APRA's Management Group is allocated responsibility for the ongoing review, management and reporting of that risk. Risks are reassessed on a regular basis. The unit provides APRA's Executive Group and its Risk Management and Audit Committee with consolidated risk reports on a quarterly basis. Further enhancements to the Framework in which the unit is involved include a refinement to APRA's risk appetite statement, which lies at the heart of the Framework.

Each year, following consultation with APRA management and staff and an assessment of APRA's strategies and risks, a broad-ranging and robust program of internal audits is developed and subsequently approved by the Executive Group and endorsed by the Risk Management and Audit Committee. The program covers specific aspects of APRA's supervisory and operational processes and its financial systems, and includes reviews of compliance with both internal and external requirements. Audit reviews identify and rate risks, and make recommendations aimed at improving APRA's internal controls and processes. The reviews also set out detailed and agreed management action plans and timetables to address issues identified. The unit monitors the implementation of agreed actions, undertakes follow-up reviews and reports the results of those reviews to the Executive Group and the Risk Management and Audit Committee.

Fraud risk management is an ongoing focus within APRA and a comprehensive fraud control framework in line with Government requirements is in place. All audits undertaken by the unit assess whether potential fraud exposures are appropriately addressed by APRA's processes and controls. There were no incidents of internal fraud reported for the year. Compulsory annual online fraud awareness training is delivered to all staff and APRA management makes formal six-monthly attestations on any fraud identified and actions taken.

## Other governance matters

The *Statutory report* on pages 146 provides details of various other aspects of governance in APRA, including executive and consultative committees.

## APRA Members

### Dr John Laker AO

**BEc (Hons 1) (Syd), MSc PhD (London)**
**Chairman and Member**

Dr Laker was appointed as a Member and Chairman of APRA on 1 July 2003, and was reappointed for a second five-year term commencing 1 July 2008.

Dr Laker is APRA's representative on the Reserve Bank of Australia's (RBA) Payments System Board, the Council of Financial Regulators, the Basel Committee on Banking Supervision and the Trans-Tasman Council on Banking Supervision. Dr Laker worked in the Commonwealth Treasury and International Monetary Fund before joining the RBA in 1982. He held senior positions in the economic, bank supervision and international areas before becoming the RBA's London-based Chief Representative in Europe from 1991 to 1993. On his return to Australia, Dr Laker took up the position of Assistant Governor (Corporate Services) and, in 1998, was appointed Assistant Governor (Financial System) and Deputy Chair of the RBA's Payments System Board. Dr Laker was made an Officer of the Order of Australia on Australia Day 2008 for services to the regulation of the Australian financial system and to the development and implementation of economic policies nationally and internationally.

### Mr (Kerry) Ross Jones

**BA, MCom (Newcastle)**
**Deputy Chairman and Member**

Mr Jones was appointed as a Member and Deputy Chairman of APRA on 1 July 2003, and was reappointed for a second five-year term commencing 1 July 2008.

Mr Jones is also President of the International Organisation of Pension Supervisors, Deputy Chairman of the OECD Working Party on Private Pensions and a member of the International Network for Financial Education. Prior to joining APRA, Mr Jones held the position of Commissioner at the Australian Competition and Consumer Commission (ACCC) with responsibilities for mergers and acquisitions and telecommunications. Mr Jones was also an Associate Professor in the School of Finance and Economics at the University of Technology Sydney (UTS).

## Mr Ian Laughlin

**BSc (Qld), FIA, FIAA, FAICD**
**Member**

Mr Laughlin was appointed as a Member of APRA on 1 July 2010 for a three-year term.

Mr Laughlin is APRA's representative on the Executive Committee of the International Association of Insurance Supervisors and on the Financial Reporting Council. Mr Laughlin has extensive experience in the financial services industry. He has been a non-executive director of AMP Life Limited, serving as Chairman of its Board Audit Committee, Managing Director of the United Kingdom life insurance subsidiaries of AMP (Pearl, London Life and NPI), director of HHG plc and non-executive director of Diligenta Ltd in the United Kingdom. Before then, he held senior management positions in AMP, Suncorp and National Mutual in Australia, New Zealand and Hong Kong. Mr Laughlin has also served on the Council of the Institute of Actuaries of Australia.

## Statement by Members and the Chief Financial Officer

In our opinion, the attached financial statements for the year ended 30 June 2011 are based on properly maintained financial records and give a true and fair view of the matters required by the Finance Minister's Orders made under the *Financial Management and Accountability Act 1997*, as amended.

**Dr John F. Laker**
Chairman
23 August 2011

**Mr K. Ross Jones**
Deputy Chairman
23 August 2011

**Mr Ian Laughlin**
Member
23 August 2011

**Mr Steve Matthews**
Chief Financial Officer
23 August 2011

Chapter eight

# Financial statements

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# Statement of comprehensive income
## for the year ended 30 June 2011

| | Notes | 2011 $'000 | 2010 $'000 |
|---|---|---|---|
| **Expenses** | | | |
| Employee benefits | 4A | **82,175** | 81,557 |
| Supplier expenses | 4B | **31,785** | 30,059 |
| Depreciation and amortisation | 4C | **4,193** | 4,542 |
| Finance costs | 4D | **103** | 99 |
| Write-down and impairment of assets | 4E | **53** | – |
| Losses from asset disposals | 4F | **40** | 11 |
| **Total expenses** | | **118,349** | 116,268 |
| **Less:** | | | |
| **Own-source income** | | | |
| **Own-source revenue** | | | |
| Rendering of services | 5A | **3,757** | 4,255 |
| Rental income | 5B | **9** | 38 |
| Other revenue | 5C | **727** | 654 |
| **Total own-source revenue** | | **4,493** | 4,947 |
| **Gains** | | | |
| Other gains | 5D | **125** | 118 |
| **Total gains** | | **125** | 118 |
| **Total own-source income** | | **4,618** | 5,065 |
| **Net cost of services** | | **113,731** | 111,203 |
| Revenue from Government | 5E | **102,634** | 121,940 |
| **Operating surplus/(deficit)** | | **(11,097)** | 10,737 |
| **Other comprehensive income** | | | |
| Changes in asset revaluation reserves | 6A | **2,828** | – |
| **Total other comprehensive income** | | **2,828** | – |
| **Total comprehensive income/(loss)** | | **(8,269)** | 10,737 |

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

# Balance sheet
## as at 30 June 2011

| | Notes | 2011 $'000 | 2010 $'000 |
|---|---|---|---|
| **Assets** | | | |
| **Financial assets** | | | |
| Cash | 7A | **41,758** | 49,533 |
| Trade and other receivables | 7B | **3,831** | 4,376 |
| **Total financial assets** | | **45,589** | 53,909 |
| **Non-financial assets** | | | |
| Property, plant and equipment | 8A,B | **6,164** | 5,399 |
| Intangibles | 8C,D | **11,622** | 9,133 |
| Other non-financial assets | 8E | **2,028** | 2,174 |
| **Total non-financial assets** | | **19,814** | 16,706 |
| **Total assets** | | **65,403** | 70,615 |
| **Liabilities** | | | |
| **Payables** | | | |
| Suppliers | 9A | **388** | 328 |
| Unearned fees and charges | 9B | **1,133** | 1,718 |
| Other payables | 9C | **4,394** | 3,085 |
| **Total payables** | | **5,915** | 5,131 |
| **Provisions** | | | |
| Employee provisions | 10A | **26,135** | 25,126 |
| Other provisions | 10B | **2,025** | 2,218 |
| **Total provisions** | | **28,160** | 27,344 |
| **Total liabilities** | | **34,075** | 32,475 |
| **Net assets** | | **31,328** | 38,140 |
| **Equity** | | | |
| Contributed equity | | **7,469** | 6,012 |
| Reserves | | **12,637** | 9,809 |
| Retained surpluses | | **11,222** | 22,319 |
| **Total equity** | | **31,328** | 38,140 |

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

# Statement of changes in equity
## for the year ended 30 June 2011

| | Retained surpluses | | Asset revaluation reserves | | Contingency Enforcement Fund | | Contributed equity/capital | | Total equity | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **2011 $'000** | 2010 $'000 | **2011 $'000** | 2010 $'000 | **2011 $'000** | 2010 $'000 | **2011 $'000** | 2010 $'000 | **2011 $'000** | 2010 $'000 |
| **Opening balance** | | | | | | | | | | |
| Balance carried forward from previous period | **22,319** | 11,582 | **3,809** | 3,809 | **6,000** | 6,000 | **6,012** | 4,055 | **38,140** | 25,446 |
| **Adjusted opening balance** | **22,319** | 11,582 | **3,809** | 3,809 | **6,000** | 6,000 | **6,012** | 4,055 | **38,140** | 25,446 |
| **Comprehensive income** | | | | | | | | | | |
| Other comprehensive income | **–** | – | **2,828** | – | **–** | – | **–** | – | **2,828** | – |
| Surplus/(deficit) for the period | **(11,097)** | 10,737 | **–** | – | **–** | – | **–** | – | **(11,097)** | 10,737 |
| **Total comprehensive income** | **(11,097)** | 10,737 | **2,828** | – | **–** | – | **–** | – | **(8,269)** | 10,737 |
| **Contributions by owners** | | | | | | | | | | |
| Equity injection - appropriations | **–** | – | **–** | – | **–** | – | **1,457** | 1,957 | **1,457** | 1,957 |
| **Sub-total: transactions with owners** | **–** | – | **–** | – | **–** | – | **1,457** | 1,957 | **1,457** | 1,957 |
| **Closing balance as at 30 June** | **11,222** | 22,319 | **6,637** | 3,809 | **6,000** | 6,000 | **7,469** | 6,012 | **31,328** | 38,140 |

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

# Statement of cash flows
## for the year ended 30 June 2011

| | Notes | 2011 $'000 | 2010 $'000 |
|---|---|---|---|
| **Operating activities** | | | |
| **Cash received** | | | |
| Appropriations | | **110,467** | 127,307 |
| Rendering of services | | **4,686** | 6,612 |
| Rental income | | **9** | 38 |
| Net GST received | | **2,995** | 2,400 |
| Other | | **727** | 772 |
| **Total cash received** | | **118,884** | 137,129 |
| **Cash used** | | | |
| Employees | | **(80,736)** | (77,637) |
| Suppliers | | **(34,064)** | (32,357) |
| Section 31 receipts transferred to Official Public Account | | **(8,417)** | (4,294) |
| **Total cash used** | | **(123,217)** | (114,288) |
| **Net cash from/(used by) operating activities** | 11 | **(4,333)** | 22,841 |
| **Investing activities** | | | |
| **Cash used** | | | |
| Purchase of property, plant and equipment | | **(191)** | (1,448) |
| Purchase of intangibles | | **(4,708)** | (5,120) |
| **Total cash used** | | **(4,899)** | (6,568) |
| **Net cash (used by) investing activities** | | **(4,899)** | (6,568) |
| **Financing activities** | | | |
| **Cash received** | | | |
| Contributed equity – capital injections | | **1,457** | 1,957 |
| **Total cash received** | | **1,457** | 1,957 |
| **Net cash from financing activities** | | **1,457** | 1,957 |
| **Net increase/(decrease) in cash held** | | **(7,775)** | 18,230 |
| Cash at the beginning of the reporting period | | **49,533** | 31,303 |
| **Cash at the end of the reporting period** | 7A | **41,758** | 49,533 |

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

# Schedule of commitments
## as at 30 June 2011

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| **By type**[1] | | |
| **Commitments receivable** | | |
| Net GST recoverable on commitments | **(984)** | (1,835) |
| **Total commitments receivable** | **(984)** | (1,835) |
| | | |
| **Other commitments** | | |
| Operating leases | **10,825** | 20,189 |
| **Total other commitments** | **10,825** | 20,189 |
| **Net commitments by type** | **9,841** | 18,354 |
| | | |
| **By maturity** | | |
| **Commitments receivable** | | |
| **GST recoverable on commitments** | | |
| One year or less | **(657)** | (743) |
| From one to five years | **(327)** | (1,088) |
| Over five years | **–** | (4) |
| **Total net GST recoverable on commitments** | **(984)** | (1,835) |
| | | |
| **Operating lease commitments** | | |
| One year or less | **7,229** | 8,170 |
| From one to five years | **3,596** | 11,972 |
| Over five years | **–** | 47 |
| **Total operating lease commitments** | **10,825** | 20,189 |
| | | |
| **Net commitments by maturity** | **9,841** | 18,354 |

| Nature of lease | General description of leasing arrangement |
|---|---|
| Leases for office accommodation | Lease payments in Sydney (except for one level) and Perth are subject to prevailing market rates. Leases for all other offices are subject to fixed annual increments. Office leases, with current expiry dates shown in brackets, are current for space in Sydney (various levels 2012), Canberra (2015), Melbourne (2012), Adelaide (2012), Brisbane (2012) and Perth (2014). |

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

1 Commitments are stated inclusive of GST where relevant.

# Schedule of contingencies
## as at 30 June 2011

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| **Contingent assets** | | |
| Claims for damages/costs | – | – |
| **Total contingent assets** | – | – |
| **Contingent liabilities** | | |
| Claims for damages/costs | – | – |
| **Total contingent liabilities** | – | – |
| **Net contingent assets/(liabilities)** | – | – |

Details of each class of contingent assets and liabilities, including those not included above because they cannot be quantified or are remote, are disclosed in Note 12: *Contingent assets and liabilities.*

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

# Schedule of asset additions
## as at 30 June 2011

### The following non-financial non-current assets were added in the year ended 30 June 2011:

| | Property, plant and equipment $'000 | Intangibles $'000 | Total $'000 |
|---|---|---|---|
| **Additions funded in the current year** | | | |
| By purchase – equity appropriation | – | 1,840 | 1,840 |
| By purchase – appropriation ordinary annual services | 191 | 2,868 | 3,059 |
| **Total funded additions** | 191 | 4,708 | 4,899 |

### The following non-financial non-current assets were added in the year ended 30 June 2010:

| | Property, plant and equipment $'000 | Intangibles $'000 | Total $'000 |
|---|---|---|---|
| **Additions funded in the current year** | | | |
| By purchase – equity appropriation | – | 783 | 783 |
| By purchase – appropriation ordinary annual services | 1,448 | 4,337 | 5,785 |
| **Total funded additions** | 1,448 | 5,120 | 6,568 |

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

# Schedule of administered items

| | Notes | 2011 $'000 | 2010 $'000 |
|---|---|---|---|
| **Income administered on behalf of Government** for the year ended 30 June 2011 | | | |
| **Taxation revenue** | | | |
| Financial Institutions Supervisory Levies | 17A | **116,382** | 124,891 |
| Financial Assistance Levy | 17B | **54,925** | – |
| **Total revenue administered on behalf of Government** | | **171,307** | 124,891 |
| **Expenses administered on behalf of Government** for the year ended 30 June 2011 | | | |
| Supervisory Levy Waivers | 18 | **615** | 879 |
| **Total expenses administered on behalf of Government** | | **615** | 879 |
| **Assets administered on behalf of Government** as at 30 June 2011 | | | |
| **Financial assets** | | | |
| Receivables | 19 | **54,555** | 38 |
| **Total assets administered on behalf of Government** | | **54,555** | 38 |
| **Liabilities administered on behalf of Government** as at 30 June 2011 | | | |
| **Total liabilities administered on behalf of Government** | | **–** | – |

This schedule should be read in conjunction with the accompanying Notes.

# Schedule of administered items

| | Note | 2011 $'000 | 2010 $'000 |
|---|---|---|---|
| **Administered cash flows** | | | |
| for the year ended 30 June 2011 | | | |
| **Operating activities** | | | |
| **Cash received** | | | |
| Financial Institutions Supervisory Levies | | **115,857** | 124,070 |
| Cash received from Official Public Account for refunds | | **395** | – |
| **Total cash received** | | **116,252** | 124,070 |
| **Cash used** | | | |
| Refunds for overpayment of Supervisory Levies | | **(75)** | (11) |
| **Total cash used** | | **(75)** | (11) |
| | | **116,177** | 124,059 |
| **Net cash flows from operating activities** | | **116,177** | 124,059 |
| Cash at the beginning of the reporting period | | **–** | – |
| Cash from Official Public Account for: | | | |
| – *section 28 FMA Act* refund appropriations | | **75** | 11 |
| | | **75** | 11 |
| Cash to Official Public Account for: | | | |
| – Financial Institutions Supervisory Levies | | **(115,857)** | (124,070) |
| – Financial Assistance Levy | | **(395)** | – |
| | | **(116,252)** | (124,070) |
| **Cash at the end of the reporting period** | | **–** | – |

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 be used by APRA for its own purposes. The revenues from the Financial Assistance Levy are not available to be used by APRA for its own purposes. All administered collections are remitted to the Government's Official Public Account. Transactions and balances relating to levies are reported in Note 17: *Income administered on behalf of Government.*

This schedule should be read in conjunction with the accompanying Notes.

# Notes to and forming part of the financial statements
for the year ended 30 June 2011

## Note 1: Summary of significant accounting policies

### 1.1 Objectives of Australian Prudential Regulation Authority

The role of APRA is developing and enforcing a robust prudential framework that promotes prudent behaviour by authorised deposit-taking institutions (ADIs), insurance companies, superannuation funds and other financial institutions it supervises, with the key aim of protecting the interests of depositors, policyholders and superannuation fund members. In carrying out its role, APRA's objective is to enhance public confidence in Australia's financial institutions through a prudential framework that balances financial safety and efficiency, competition and competitive neutrality. Prudential regulation focuses on the quality of an institution's systems for identifying, measuring and managing the various risks in its business. In addition, APRA is responsible for administering the Financial Claims Schemes provided for in relevant banking and general insurance legislation.

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.

### 1.2 Basis of preparation of the financial statements

The financial statements and notes are required by section 49 of the *Financial Management and Accountability Act 1997* and are general purpose financial statements.

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

- Finance Minister's Orders (FMOs) for reporting periods ending on or after 1 July 2010; and
- Australian Accounting Standards and Interpretations 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 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 and values are rounded to the nearest thousand dollars unless otherwise specified.

Unless an alternative treatment is specifically required by an accounting standard or the FMOs, assets and liabilities are recognised in the *Balance Sheet* when and only when it is probable that future economic benefits will flow to APRA or a future sacrifice of economic benefits will be required and the amounts of the assets or liabilities can be reliably measured. Liabilities and assets that are unrecognised are reported in the *Schedule of Commitments* and the *Schedule of Contingencies*.

Unless alternative treatment is specifically required by an accounting standard, income and expenses are recognised in the *Statement of Comprehensive Income* when and only when the flow, consumption or loss of economic benefits has occurred and can be reliably measured.

## 1.3 Significant accounting judgements and estimates

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

- the fair value of leasehold improvements has been taken to be the market value of similar installations as determined by an independent valuer in May 2011.

No accounting assumptions and estimates have been identified that have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities within the next accounting period.

APRA has assessed the value of its non-financial assets as at 30 June 2011 and is satisfied that they reflect the fair value.

## 1.4 Changes in Australian Accounting Standards

**Adoption of new Australian Accounting Standard requirements**

No accounting standard has been adopted earlier than the application date as stated in the standard. No new accounting standards, amendments to standards and interpretations issued by the AASB that were issued prior to the signing of the financial statements by Members and the Chief Financial Officer and that are applicable in the current period, have had a material financial effect on APRA and are not expected to have a future financial impact on APRA.

**Future Australian Accounting Standard requirements**

New accounting standards, amendments to standards and interpretations that were issued prior to the signing of the financial statements by Members and the Chief Financial Officer and are effective for future reporting periods have been issued by the AASB. It is expected that these changes, when effective, will have no material financial impact on future reporting periods.

## 1.5 Revenue

**Revenue from Government**

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 providing market integrity and consumer protection functions for prudentially regulated institutions, functions that are conducted by other Australian Government entities. The calculation of the Special Appropriation is shown at Note 3.

Amounts appropriated for APRA's outputs for the year (adjusted for any formal additions and reductions) are recognised as Revenue from Government when APRA 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.

# Notes to and forming part of the financial statements
for the year ended 30 June 2011

## Note 1: Summary of significant accounting policies (Continued)

**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 reference to the proportion that costs incurred to date bear to the estimated total costs of the transaction.

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.

**Parental leave payments scheme**

Amounts received under the Parental Leave Payments Scheme not yet paid to employees are presented gross as cash and a liability (payable) by APRA. The total amount received under this scheme is disclosed as a footnote to Note 5E: *Revenue from Government.*

### 1.6 Gains

**Resources received free of charge**

Resources received free of charge are recognised as 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.

Contributions of assets at no cost of acquisition or for nominal consideration are recognised as gains at their fair value when the asset qualifies for recognition.

Resources received free of charge are recorded as either revenue or gains depending on their nature

**Sale of assets**

Gains or losses from disposal of assets are recognised when control of the asset has passed to the buyer.

### 1.7 Transactions with the Government as owner

**Equity injections**

Amounts appropriated as 'equity injections' for a year (less any formal reductions) are recognised directly in contributed equity in that year.

### 1.8 Employee benefits

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

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

**Leave**

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

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

The liability for long service leave has been recognised and measured at the present value of the estimated future cash flows to be made in respect of all employees at the end of the financial year. 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 by the Department of Finance and Deregulation as an administered item. APRA makes employer contributions to the employees' superannuation scheme at rates determined by an actuary to be sufficient to meet the current cost to the Government of the superannuation entitlement of APRA's employees. APRA accounts for the contributions as if they were contributions to defined contribution plans.

APRA also makes employer contributions to the Reserve Bank Officers' Superannuation Fund and to State-based superannuation schemes for former employees of the Reserve Bank of Australia and State-based regulators, respectively.

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

The liability for superannuation recognised at the balance date represents outstanding contributions for the remaining days following the last payroll in June 2011.

## 1.9 Leases

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. In operating leases, the lessor effectively retains substantially all such risks and benefits.

Operating lease payments are expensed on a straight-line basis that is representative of the pattern of benefits derived from the leased assets. APRA has no finance leases.

# Notes to and forming part of the financial statements
for the year ended 30 June 2011

## Note 1: Summary of significant accounting policies (Continued)

### 1.10 Cash

Cash is recognised at its nominal amount. Cash includes cash on hand and cash in special accounts.

### 1.11 Financial assets

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

**Loans and receivables**

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

**Impairment of financial assets**

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

### 1.12 Financial liabilities

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

Other payables, are initially measured at fair value, net of transaction costs. These liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis. The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period.

### 1.13 Contingent assets and contingent liabilities

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

### 1.14 Acquisition of assets

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

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

## 1.15 Property, plant and equipment

**Asset recognition threshold**

Purchases of property, plant and equipment are recognised initially at cost in the *Balance Sheet*, except for purchases costing less than $5,000, which are expensed in the year of acquisition.

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 'make good' 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 'make good' recognised. Adjustments to the value of the provision are recognised in the *Statement of Comprehensive Income* as expenses or gains as incurred.

**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 amount of each class of asset is not materially different, at reporting date, from its fair value. Valuations are undertaken every three years as at 30 June (last valuation 2010/11).

Fair values for each class of asset are determined as shown below:

| Asset class | Fair value measured at: |
|---|---|
| Leasehold improvements | Depreciated replacement cost |
| Computer hardware and office equipment | Market selling price |

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 reverses a previous revaluation decrement of the same asset class that was previously recognised in the *Statement of Comprehensive Income*. Revaluation decrements for a class of assets are recognised directly in the *Statement of Comprehensive Income* except to the extent that they reversed a previous revaluation increment for that 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 plant and equipment assets are written off to their estimated residual values 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.

# Notes to and forming part of the financial statements
## for the year ended 30 June 2011

## Note 1: Summary of significant accounting policies (Continued)

Depreciation rates (useful lives), 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:

| Asset class | 2011 | 2010 |
|---|---|---|
| Leasehold improvements | Lesser of 10 years or lease term | Lesser of 10 years or lease term |
| Computer hardware and office equipment | 3 to 12 years | 3 to 12 years |

**Impairment**

All assets were assessed for impairment at the balance date. 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 to sell 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**

An item of property, plant and equipment is derecognised upon disposal or when no further future economic benefits are expected from its use or disposal.

### 1.16 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 the lesser of five years or assessed useful life (2009/10: lesser of five years or assessed useful life).

All software assets were assessed for indications of impairment as at 30 June 2011.

### 1.17 Taxation

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

Revenues, expenses and assets are recognised net of GST except where the amount of GST incurred is not recoverable from the Australian Taxation Office. Receivables and payables are recognised inclusive of GST.

### 1.18 Reporting of administered activities

Administered revenues, expenses, assets, liabilities and cash flows are disclosed in the *Schedule of Administered Items* and related Notes.

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.

**Administered cash transfers to and from the Official Public Account (OPA)**

Revenue collected by APRA for use by the Government rather than by APRA is administered revenue. Collections are transferred to the OPA maintained by the Department of Finance and Deregulation. Conversely, cash is drawn from the OPA to make payments under Parliamentary appropriation on behalf of Government. These transfers to and from the OPA are adjustments to the administered cash held by APRA on behalf of the Government and reported as such in the *Administered Cash Flows* in the *Schedule of Administered Items* and in the *Administered reconciliation table* in Note 20.

**Revenue**

All administered revenues relate to the ordinary activities performed by APRA on behalf of the Australian Government. These revenues are not directly available to be used by APRA for its own purposes and are remitted to the OPA.

APRA undertakes the collection of certain levies on behalf of the Government. These comprise Financial Institutions Supervisory Levies, the Financial Assistance Levy and late payment penalties collected under the *Financial Institutions Supervisory Levies Collection Act 1998*. These administered items are distinguished from departmental items throughout these financial statements by background shading.

Administered revenue arising from levies (including the Financial Assistance Levy) 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.

**Expenses**

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

Waivers of levies under the *Financial Institutions Supervisory Levies Collection Act 1998* are shown at Note 24, as required by the FMOs. 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.

**Contingent assets and liabilities**

There were no administered contingent assets or liabilities in 2011 or in 2010.

## Note 2: Events after the balance sheet date

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

# Notes to and forming part of the financial statements
## for the year ended 30 June 2011

## Note 3: 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*.

Details are as follows:

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| **Table 1: Summary** | | |
| Current year levies and penalties (see Note 17, Table 1) | **116,382** | 124,891 |
| Less: Waivers and doubtful debts (see Note 18) | **(615)** | (879) |
| Net current year levies and penalties (see Table 2 below) | **115,767** | 124,012 |
| Less: Amount retained in the CRF (see Table 3 below) | **(26,100)** | (25,800) |
| **Total** | **89,667** | 98,212 |
| **Table 2: Net current year levies and penalties by levy type** | | |
| Superannuation funds | **37,198** | 43,682 |
| Authorised deposit-taking institutions | **42,004** | 42,674 |
| Life insurers and friendly societies | **11,429** | 12,814 |
| General insurers | **25,136** | 24,842 |
| **Total** | **115,767** | 124,012 |
| **Table 3: Amounts retained in the CRF by levy type[1]** | | |
| Superannuation funds | **(16,700)** | (16,800) |
| Authorised deposit-taking institutions | **(3,800)** | (3,600) |
| Life insurers and friendly societies | **(2,300)** | (2,200) |
| General insurers | **(3,300)** | (3,200) |
| **Total** | **(26,100)** | (25,800) |
| **Table 4: Amounts of levy payable to APRA under the APRA Special Appropriation by levy type** | | |
| Superannuation funds | **20,498** | 26,882 |
| Authorised deposit-taking institutions | **38,204** | 39,074 |
| Life insurers and friendly societies | **9,129** | 10,614 |
| General insurers | **21,836** | 21,642 |
| **Total** | **89,667** | 98,212 |

1 As determined by the Minister in accordance with subsection 50 (1) of the *Australian Prudential Regulation Authority Act 1998*.

## Note 4: Expenses

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| **Note 4A: Employee benefits** | | |
| Salaries and wages | **67,241** | 64,573 |
| Superannuation | **7,044** | 7,206 |
| Leave and other entitlements | **7,586** | 9,326 |
| Separation and redundancies | **5** | 202 |
| Other employee benefits | **299** | 250 |
| **Total employee benefits** | **82,175** | 81,557 |
| **Note 4B: Supplier expenses** | | |
| **Goods and services** | | |
| Consultants | **4,816** | 2,023 |
| Contractors | **2,638** | 3,027 |
| Travel-related expenses | **3,737** | 4,068 |
| Operational expenses | **11,359** | 8,546 |
| Training and conference expenses | **2,044** | 2,262 |
| Other professional services | **67** | 2,660 |
| **Total goods and services** | **24,661** | 22,586 |
| **Goods and services are made up of:** | | |
| Provision of goods – external parties | **2,800** | 2,961 |
| Rendering of services – related entities | **2,340** | 447 |
| Rendering of services – external parties | **19,521** | 19,178 |
| **Total goods and services** | **24,661** | 22,586 |
| **Other supplier expenses** | | |
| Operating lease rentals – external parties: | | |
| – minimum lease payments | **6,911** | 7,302 |
| Workers' compensation premiums | **213** | 171 |
| **Total other supplier expenses** | **7,124** | 7,473 |
| **Total supplier expenses** | **31,785** | 30,059 |

# Notes to and forming part of the financial statements
for the year ended 30 June 2011

## Note 4: Expenses (Continued)

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| **Note 4C: Depreciation and amortisation** | | |
| **Depreciation:** | | |
| Computer hardware | **756** | 1,260 |
| Leasehold improvements | **1,301** | 1,642 |
| **Total depreciation** | **2,057** | 2,902 |
| **Amortisation:** | | |
| Intangibles – computer software | **2,136** | 1,640 |
| **Total amortisation** | **2,136** | 1,640 |
| **Total depreciation and amortisation** | **4,193** | 4,542 |
| **Note 4D: Finance costs** | | |
| Unwinding of discount | **103** | 99 |
| **Total finance costs** | **103** | 99 |
| **Note 4E: Write-down and impairment of assets** | | |
| **Asset write-downs and impairments from:** | | |
| Impairment of internally developed software | **53** | – |
| **Total write-down and impairment of assets** | **53** | – |
| **Note 4F: Losses from asset sales** | | |
| **Computer hardware:** | | |
| Proceeds from sale | **–** | (1) |
| Carrying value of assets disposed | **40** | 12 |
| **Total losses from asset disposals** | **40** | 11 |

## Note 5: Income

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| **Note 5A: Rendering of services** | | |
| Rendering of services – related entities | 1,512 | 1,192 |
| Rendering of services – external entities | 2,245 | 3,063 |
| **Total rendering of goods and services** | 3,757 | 4,255 |
| **Note 5B: Rental income** | | |
| Rental income | 9 | 38 |
| **Total rental income** | 9 | 38 |
| **Note 5C: Other revenue** | | |
| Licence fees from finance sector entities | 465 | 359 |
| Superannuation trustee applications | 20 | 71 |
| Fees from foreign bank representative offices | 75 | 70 |
| Recoveries from RBA for scholarship | 23 | 11 |
| Other | 144 | 143 |
| **Total other revenue** | 727 | 654 |
| **Note 5D: Other gains** | | |
| Resources received free of charge | 125 | 118 |
| **Total other gains** | 125 | 118 |
| **Note 5E: Revenue from Government*** | | |
| **Appropriations:** | | |
| Special Appropriations | 89,667 | 98,212 |
| Departmental outputs | 12,967 | 23,728 |
| **Total revenue from Government** | 102,634 | 121,940 |

*APRA received $5,700 (2009/10: Nil) under the Paid Parental Leave Scheme.

# Notes to and forming part of the financial statements
for the year ended 30 June 2011

## Note 6: Other comprehensive income

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| **Note 6A: Changes in asset revaluation reserve** | | |
| Net asset revaluation | 2,641 | – |
| Makegood revaluation | 187 | – |
| | 2,828 | – |

## Note 7: Financial assets

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| **Note 7A: Cash** | | |
| APRA Special Account | 41,756 | 49,530 |
| Cash on hand | 2 | 3 |
| **Total cash and cash equivalents** | 41,758 | 49,533 |
| **Note 7B: Trade and other receivables** | | |
| **Goods and services:** | | |
| Goods and services – related entities | 45 | 785 |
| Goods and services – external parties | 2,641 | 2,501 |
| **Total receivables for goods and services** | 2,686 | 3,286 |
| **Appropriations receivable:** | | |
| For existing outputs | 929 | 723 |
| Special Appropriations | 29 | 44 |
| **Total appropriations receivable** | 958 | 767 |
| **Other receivables:** | | |
| GST receivable from the Australian Taxation Office | 144 | 329 |
| Other | 47 | – |
| **Total other receivables** | 191 | 329 |
| **Total trade and other receivables (gross)** | 3,835 | 4,382 |
| Less: impairment allowance account | | |
| Other receivables | (4) | (6) |
| **Total impairment allowance account** | (4) | (6) |
| **Total trade and other receivables (net)** | 3,831 | 4,376 |

## Note 7: Financial assets (Continued)

### Note 7B: Trade and other receivables (Continued)

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| Receivables are expected to be recovered in: | | |
| Less than 12 months | **3,831** | 4,376 |
| **Total trade and other receivables (net)** | **3,831** | 4,376 |
| Receivables are aged as follows: | | |
| Not overdue | **3,762** | 4,299 |
| Overdue by: | | |
| – 0 to 30 days | **10** | 27 |
| – 31 to 60 days | **9** | 7 |
| – 61 to 90 days | **9** | 8 |
| – more than 90 days | **45** | 41 |
| **Total receivables (gross)** | **3,835** | 4,382 |
| The impairment allowance account is aged as follows: | | |
| – more than 90 days | **(4)** | (6) |
| **Total impairment allowance account** | **(4)** | (6) |

#### Reconciliation of the impairment allowance account

| Movements in relation to 2011 | Other receivables $'000 | Total $'000 |
|---|---|---|
| **Opening balance** | (6) | (6) |
| Amounts written off | 6 | 6 |
| Increase/decrease recognised in net surplus | (4) | (4) |
| **Closing balance** | **(4)** | **(4)** |

# Notes to and forming part of the financial statements
## for the year ended 30 June 2011

## Note 7: Financial assets (Continued)

### Note 7B: Trade and other receivables (Continued)

| Movements in relation to 2010 | Other receivables $'000 | Total $'000 |
|---|---|---|
| **Opening balance** | – | – |
| Increase/decrease recognised in net surplus | (6) | (6) |
| **Closing balance** | **(6)** | **(6)** |

## Note 8: Non-financial assets

| | **2011 $'000** | 2010 $'000 |
|---|---|---|
| **Note 8A: Property, plant and equipment** | | |
| **Computer hardware and office equipment** | | |
| – fair value | **1,060** | 4,727 |
| – accumulated depreciation | **–** | (3,027) |
| **Total computer hardware and office equipment** | **1,060** | 1,700 |
| **Leasehold improvements** | | |
| – fair value | **6,491** | 6,696 |
| – accumulated depreciation | **(1,387)** | (2,997) |
| **Total leasehold improvements** | **5,104** | 3,699 |
| **Total property, plant and equipment** | **6,164** | 5,399 |

No property, plant or equipment is expected to be sold or disposed of within the next 12 months.

**Revaluations of non-financial assets**

All revaluations were conducted in accordance with the revaluation policy stated in Note 1.15 and were undertaken by an independent valuer in May 2011.

A revaluation increment of $2,706,795 for leasehold improvements and a decrement of $65,585 for computer hardware and office equipment were taken to the asset revaluation reserve and included in the equity section of the balance sheet. No increments or decrements were expensed.

## Note 8: Non-financial assets (Continued)

### Note 8B: Reconciliation of the opening and closing balances of property, plant and equipment – 2011

| | Computer hardware and office equipment $'000 | Leasehold improvements $'000 | Total $'000 |
|---|---|---|---|
| **As at 1 July 2010** | | | |
| Gross book value | **4,727** | **6,696** | **11,423** |
| Accumulated depreciation | (3,027) | (2,997) | (6,024) |
| **Net book value 1 July 2010** | **1,700** | **3,699** | **5,399** |
| **Additions**[1] | 191 | – | 191 |
| Revaluations and impairments recognised in other comprehensive income | (65) | 2,706 | 2,641 |
| Depreciation expense | (756) | (1,301) | (2,057) |
| Disposals: | | | |
| Write-off (at cost) | (311) | (19) | (330) |
| Write-off (accumulated depreciation) | 301 | 19 | 320 |
| **Net book value 30 June 2011** | **1,060** | **5,104** | **6,164** |
| **Net book value as of 30 June 2011 represented by:** | | | |
| Gross book value | **1,060** | **6,491** | **7,551** |
| Accumulated depreciation | **–** | **(1,387)** | **(1,387)** |
| | **1,060** | **5,104** | **6,164** |

1 Detailed information is provided in the *Schedule of Asset Additions*.

# Notes to and forming part of the financial statements
for the year ended 30 June 2011

## Note 8: Non-financial assets (Continued)

### Note 8B: Reconciliation of the opening and closing balances of property, plant and equipment – 2010

| | Computer hardware and office equipment $'000 | Leasehold improvements $'000 | Total $'000 |
|---|---|---|---|
| **As at 1 July 2009** | | | |
| Gross book value | **4,503** | **6,004** | **10,507** |
| Accumulated depreciation and impairment | (2,291) | (1,355) | (3,646) |
| **Net book value 1 July 2009** | **2,212** | **4,649** | **6,861** |
| **Additions**[1] | 756 | 692 | 1,448 |
| Depreciation expense | (1,260) | (1,642) | (2,902) |
| Disposals: | | | |
| Write-off (at cost) | (532) | – | (532) |
| Write-off (accumulated depreciation) | 524 | – | 524 |
| **Net book value 30 June 2010** | **1,700** | **3,699** | **5,399** |
| **Net book value as of 30 June 2010 represented by:** | | | |
| Gross book value | **4,727** | **6,696** | **11,423** |
| Accumulated depreciation | **(3,027)** | **(2,997)** | **(6,024)** |
| | **1,700** | **3,699** | **5,399** |

### Note 8C: Intangibles

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| **Computer software:** | | |
| – internally developed – in progress | **4,258** | 2,748 |
| – internally developed – in use | **13,950** | 11,464 |
| – purchased – in progress | **64** | 29 |
| – purchased – in use | **5,865** | 5,404 |
| – accumulated amortisation | **(12,515)** | (10,512) |
| **Total computer software** | **11,622** | 9,133 |
| **Total intangibles** | **11,622** | 9,133 |

No intangibles are expected to be sold or disposed of within the next 12 months.

1 Detailed information is provided in the *Schedule of Asset Additions*.

## Note 8: Non-financial assets (Continued)

### Note 8D: Reconciliation of the opening and closing balances of intangibles – 2011

| | Computer software internally developed $'000 | Computer software purchased $'000 | Total $'000 |
|---|---|---|---|
| **As at 1 July 2010** | | | |
| Gross book value | **14,213** | **5,432** | **19,645** |
| Accumulated amortisation | (7,016) | (3,496) | (10,512) |
| **Net book value 1 July 2010** | **7,197** | **1,936** | **9,133** |
| Additions[1] | 4,049 | 659 | 4,708 |
| Impairment of internally developed software | (53) | – | (53) |
| Amortisation | (1,410) | (726) | (2,136) |
| Disposals: | | | |
| Write-off (at cost) | – | (163) | (163) |
| Write-off (accumulated amortisation) | – | 133 | 133 |
| **Net book value 30 June 2011** | **9,783** | **1,839** | **11,622** |
| **Net book value as of 30 June 2011 represented by:** | | | |
| Gross book value | **18,208** | **5,929** | **24,137** |
| Accumulated amortisation | **(8,425)** | **(4,090)** | **(12,515)** |
| | **9,783** | **1,839** | **11,622** |

1 Detailed information is provided in the *Schedule of Asset Additions.*

# Notes to and forming part of the financial statements
for the year ended 30 June 2011

## Note 8: Non-financial assets (Continued)

### Note 8D: Reconciliation of the opening and closing balances of intangibles – 2010

| | Computer software internally developed $'000 | Computer software purchased $'000 | Total $'000 |
|---|---|---|---|
| **As at 1 July 2009** | | | |
| Gross book value | **11,073** | **4,286** | **15,359** |
| Accumulated amortisation and impairment | (6,853) | (2,850) | (9,703) |
| **Net book value 1 July 2009** | **4,220** | **1,436** | **5,656** |
| Additions[1] | 3,870 | 1,250 | 5,120 |
| Amortisation | (893) | (747) | (1,640) |
| Disposals: | | | |
| Write-off (at cost) | (730) | (104) | (834) |
| Write-off (accumulated amortisation) | 730 | 101 | 831 |
| **Net book value 30 June 2010** | **7,197** | **1,936** | **9,133** |
| **Net book value as of 30 June 2010 represented by:** | | | |
| Gross book value | **14,213** | **5,432** | **19,645** |
| Accumulated amortisation and impairment | **(7,016)** | **(3,496)** | **(10,512)** |
| | **7,197** | **1,936** | **9,133** |

## Note 8E: Other non-financial assets

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| Prepayments | **2,028** | 2,174 |
| **Total other non-financial assets** | **2,028** | 2,174 |
| **Total other non-financial assets are expected to be recovered in:** | | |
| Less than 12 months | **1,944** | 2,155 |
| More than 12 months | **84** | 19 |
| **Total other non-financial assets** | **2,028** | 2,174 |

1 Detailed information is provided in the *Schedule of Asset Additions*.

# Note 9: Payables

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| **Note 9A: Suppliers** | | |
| Operating lease rentals | 388 | 328 |
| **Total supplier payables** | 388 | 328 |

Operating lease rentals payable relate to external parties and are expected to be settled in less than 12 months.

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| **Note 9B: Unearned fees and charges** | | |
| Unearned revenue | 1,133 | 1,718 |
| **Total unearned fees and charges** | 1,133 | 1,718 |

Unearned fees and charges are expected to be settled in less than 12 months.

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| **Note 9C: Other payables** | | |
| Accrued expenses | 2,289 | 1,482 |
| Salaries and wages | 1,917 | 1,488 |
| Lease incentives | 188 | 114 |
| Other | – | 1 |
| **Total other payables** | 4,394 | 3,085 |
| Other payables are expected to be settled in: | | |
| – less than 12 months | 4,242 | 3,022 |
| – more than 12 months | 152 | 63 |
| **Total other payables** | 4,394 | 3,085 |

# Notes to and forming part of the financial statements
for the year ended 30 June 2011

## Note 10: Provisions

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| **Note 10A: Employee provisions** | | |
| Leave | **21,520** | 20,558 |
| Bonus | **4,534** | 4,492 |
| Other | **81** | 76 |
| **Total employee provisions** | **26,135** | 25,126 |
| | | |
| Employee provisions are expected to be settled in: | | |
| – less than 12 months | **21,334** | 20,361 |
| – more than 12 months | **4,801** | 4,765 |
| **Total employee provisions** | **26,135** | 25,126 |
| | | |
| **Note 10B: Other provisions** | | |
| Provisions for 'make good' | **2,025** | 2,218 |
| **Total other provisions** | **2,025** | 2,218 |
| | | |
| Other provisions are expected to be settled in: | | |
| – less than 12 months | **117** | – |
| – more than 12 months | **1,908** | 2,218 |
| **Total other provisions** | **2,025** | 2,218 |

| Reconciliation of other provisions | Provision for 'make good' $'000 | Total $'000 |
|---|---|---|
| **Carrying amount 1 July 2010** | 2,218 | 2,218 |
| Amounts reversed | (241) | (241) |
| Unwinding of discount or change in rate | 48 | 48 |
| **Closing balance 30 June 2011** | **2,025** | **2,025** |

APRA leases premises in Sydney, Melbourne, Canberra, Brisbane, Perth and Adelaide.

In the lease conditions of all locations except Canberra, there is a requirement for APRA, upon expiration of the lease, to restore the premises to the condition they were in at the commencement of the lease. The required level of 'make good' provision is being accumulated for each location over the terms of the various leases.

## Note 11: Statement of cash flows reconciliation

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| **Reconciliation of cash and cash equivalents as per *Balance Sheet* to *Statement of Cash Flows*** | | |
| **Cash as per** | | |
| *Statement of Cash Flows* | **41,758** | 49,533 |
| *Balance Sheet* | **41,758** | 49,533 |
| **Difference** | **–** | – |
| **Reconciliation of net cost of services to net cash from operating activities** | | |
| Net cost of services | **(113,731)** | (111,203) |
| Add: revenue from Government | **102,634** | 121,940 |
| **Adjustments for non-cash items** | | |
| Depreciation/amortisation | **4,193** | 4,542 |
| Loss on disposal of assets | **40** | 11 |
| Impairment of internally developed software | **53** | – |
| Makegood revaluation | **187** | – |
| **Change in assets/liabilities** | | |
| Decrease in net receivables | **545** | 2,123 |
| (Increase)/decrease in other non-financial assets | **146** | (199) |
| Increase in employee provisions | **1,010** | 3,662 |
| Increase in supplier payables | **60** | 328 |
| Increase/(decrease) in unearned fees and charges | **(585)** | 777 |
| Increase in other payables | **1,308** | 392 |
| Increase/(decrease) in other provisions | **(193)** | 468 |
| **Net cash from/(used by) operating activities** | **(4,333)** | 22,841 |

# Notes to and forming part of the financial statements
## for the year ended 30 June 2011

### Note 12: Contingent assets and liabilities

| | Claims for damages or costs | |
|---|---|---|
| | **2011** **$'000** | 2010 $'000 |
| **Contingent assets** | | |
| Balance from previous period | **–** | 200 |
| New | **–** | 38 |
| Assets recognised | **–** | (238) |
| **Total contingent assets** | **–** | – |
| **Contingent liabilities** | | |
| Balance from previous period | **–** | 500 |
| Obligations expired | **–** | (500) |
| **Total contingent liabilities** | **–** | – |
| **Net contingent assets/(liabilities)** | **–** | – |

**Quantifiable contingencies**

APRA has no quantifiable contingencies as at balance date.

**Unquantifiable contingencies**

APRA has no unquantifiable contingencies as at balance date.

**Significant remote contingencies**

APRA has no significant remote contingencies as at balance date.

## Note 13: Remuneration of APRA Members

APRA Members are appointed by the Governor General under Part 3 of the *Australian Prudential Regulation Authority Act 1998* and remuneration is set by the Remuneration Tribunal under the *Remuneration Tribunal Act 1973*. Total remuneration as determined by the Tribunal for 2010/11 was Chairman $646,710 (2009/10: $621,230); Deputy Chairman $541,120 (2009/10: $519,800); and Member $514,750 (2009/10: $494,470). Any difference between the Tribunal determination and the cost to APRA is due to changes in unused annual and long service leave entitlements accumulated in the year and funding changes to defined benefit superannuation schemes where relevant.

| | 2011 | 2010 |
|---|---|---|
| The remuneration of APRA Members, measured in terms of the cost to APRA, is shown in the relevant remuneration bands: | | |
| $480,000 – $509,999 | – | 1 |
| $510,000 – $529,999 | 1 | – |
| $540,000 – $569,999 | 1 | 1 |
| $660,000 – $689,999 | 1 | 1 |
| **Total** | **3** | 3 |
| **Total remuneration of APRA Members** | **$1,745,596** | $1,721,235 |

# Notes to and forming part of the financial statements
for the year ended 30 June 2011

## Note 14: Remuneration of senior executives

### Note 14A: Remuneration expenses for senior executives

| | $ 2011 | $ 2010 |
|---|---|---|
| **Short-term employee benefits:** | | |
| Salary (including annual leave) | **6,548,279** | 5,767,732 |
| Movement in annual leave provision | **27,266** | 161,228 |
| Performance bonus | **392,907** | 355,138 |
| Allowances | **3,175** | 5,117 |
| **Total short-term employee benefits** | **6,971,627** | 6,289,215 |
| **Post-employment benefits:** | | |
| Superannuation | **800,745** | 676,326 |
| **Total post-employment benefits** | **800,745** | 676,326 |
| **Other long-term benefits:** | | |
| Long-service leave accrued | **235,489** | 303,972 |
| **Total other long-term benefits** | **235,489** | 303,972 |
| **Total** | **8,007,861** | 7,269,512 |

Note 14A was prepared on an accrual basis and excludes acting arrangements and part-year service where remuneration expensed was less than $150,000.

# Note 14: Remuneration of senior executives (Continued)

## Note 14B: Average annual remuneration packages and bonus paid for senior executives

| Fixed elements and bonus paid[1] | As at 30 June 2011 | | | As at 30 June 2010 | | |
|---|---|---|---|---|---|---|
| | **No.** | **TRP[2]** | **Bonus paid[3]** | No. | TRP[2] | Bonus paid[3] |
| | **Fixed elements** | | | Fixed elements | | |
| Total remuneration (including part-time arrangements): | | | | | | |
| $210,000 – $239,999 | **3** | **231,800** | **12,366** | 3 | 239,200 | 11,345 |
| $240,000 – $269,999 | **14** | **257,650** | **13,564** | 14 | 256,313 | 13,740 |
| $270,000 – $299,999 | **6** | **277,350** | **12,531** | 2 | 279,741 | 16,294 |
| $360,000 – $389,999 | **–** | | | 3 | 380,715 | 16,541 |
| $390,000 – $419,999 | **4** | **393,500** | **22,868** | 1 | 406,812 | 46,533 |
| **Total** | **27** | | | 23 | | |

## Note 14C: Other highly paid staff

During the reporting period, there were 82 employees (2009-10: 71) whose salary plus performance bonus was $150,000 or more. These employees did not have a role as a senior executive and are excluded from Notes 14A and 14B.

1. This table reports on senior executives employed by APRA as at the end of the reporting period. Fixed elements are based on the employment agreement of each individual. Each row represents an average annualised figure (based on headcount) for the individuals in that remuneration band.
2. APRA pays a fixed Total Remuneration Package (TRP) to each employee. This includes salary, employer superannuation payments, salary sacrifice payments, fringe benefits and any tax liability applying to fringe and other benefits. Various salary sacrifice arrangements are available to senior executives including superannuation, laptops, motor vehicles and expense payment fringe benefits.
3. Average bonuses paid during the reporting period are excluded for the purpose of determining remuneration bands. The bonus paid within a particular band may vary between financial years due to factors such as individuals joining or leaving APRA during the financial year and performance ratings.

   Senior executives have the following leave entitlements:
   - annual leave 20 days (2009-10: 20 days) each full year worked (pro-rata for part-time senior executives);
   - unlimited personal leave; and
   - long service leave (LSL) in accordance with *Long Service Leave (Commonwealth Employees) Act 1976*.

# Notes to and forming part of the financial statements
for the year ended 30 June 2011

## Note 15: Remuneration of auditors

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| Financial statement audit services were provided free of charge to APRA in 2010/11. | | |
| **Fair value of the services provided by:** | | |
| The Australian National Audit Office | **125** | 118 |

No other services are provided by the auditors of the financial statements.

## Note 16: Financial instruments

### Note 16A: Categories of financial instruments

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| **Financial assets** | | |
| Loans and receivables: | | |
| Cash | **41,758** | 49,533 |
| Trade receivables | **2,686** | 3,286 |
| **Carrying amount of financial assets** | **44,444** | 52,819 |
| **Financial liabilities** | | |
| At amortised cost: | | |
| Suppliers | **388** | 328 |
| Other payables | **4,206** | 2,971 |
| **Carrying amount of financial liabilities** | **4,594** | 3,299 |

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

# Note 16: Financial instruments (Continued)

## Note 16B: Credit risk

APRA's maximum exposure to credit risk at the reporting date is the carrying amount of the trade receivables reported in the *Balance Sheet*. APRA has no significant exposures to any other concentrations of credit risk.

### Credit quality of financial instruments not past due or individually determined as impaired

| | **$'000 Not past due nor impaired 2011** | $'000 Not past due nor impaired 2010 | **$'000 Past due or impaired 2011** | $'000 Past due or impaired 2010 |
|---|---|---|---|---|
| Cash | **41,758** | 49,533 | **–** | – |
| Trade and other receivables | **2,626** | 3,233 | **60** | 53 |
| **Total** | **44,384** | 52,766 | **60** | 53 |

### Ageing of financial assets that were past due but not impaired for 2011

| | $'000 0 to 30 days | $'000 31 to 60 days | $'000 61 to 90 days | $'000 90+ days | $'000 Total |
|---|---|---|---|---|---|
| Trade receivables | 2 | 8 | 9 | 41 | 60 |
| **Total** | **2** | **8** | **9** | **41** | **60** |

### Ageing of financial assets that were past due but not impaired for 2010

| | $'000 0 to 30 days | $'000 31 to 60 days | $'000 61 to 90 days | $'000 90+ days | $'000 Total |
|---|---|---|---|---|---|
| Trade receivables | 3 | 7 | 8 | 35 | 53 |
| **Total** | **3** | **7** | **8** | **35** | **53** |

# Notes to and forming part of the financial statements
for the year ended 30 June 2011

## Note 16 Financial instruments (Continued)

### Note 16C: Liquidity risk

APRA is funded annually by appropriations from Government based on the actual cost of regulation of the financial sector, fee for service activities and other activities that APRA may be required to perform from time to time. In addition, APRA maintains reserves and a Contingency Enforcement Fund. These arrangements, along with strictly controlled cash flow monitoring and forecasting, expose APRA to negligible liquidity risk.

### Note 16D: Market risk

APRA is not exposed to any form of currency risk, interest rate risk or other price risk.

## Note 17: Income administered on behalf of Government

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| **Revenue** | | |
| **Taxation revenue** | | |
| Note 17A: Financial Institutions Supervisory Levies | | |
| Current year levies and penalties (see Table 1) | **116,382** | 124,891 |
| **Total Financial Institutions Supervisory Levies** | **116,382** | 124,891 |
| **Table 1: Financial Institutions Supervisory Levies revenue by levy type** | | |
| Levy: | | |
| Superannuation funds | **37,658** | 44,228 |
| Authorised deposit-taking institutions | **42,006** | 42,679 |
| Life insurers and friendly societies | **11,429** | 12,815 |
| General insurers | **25,233** | 25,133 |
| **Total levies** | **116,326** | 124,855 |
| Late payment penalties: | | |
| Superannuation funds | **56** | 36 |
| **Total late payment penalties** | **56** | 36 |
| **Total current year levies and penalties** | **116,382** | 124,891 |

## Note 17: Income administered on behalf of Government (Continued)

| | 2011<br>$'000 | 2010<br>$'000 |
|---|---|---|
| **Note 17B: Financial Assistance Levy** | | |
| Current year levies | **54,925** | – |
| **Total Financial Assistance Levy** | **54,925** | – |

## Note 18: Expenses administered on behalf of Government

| | 2011<br>$'000 | 2010<br>$'000 |
|---|---|---|
| **Expenses** | | |
| **Note 18: Waivers** | | |
| Supervisory levy waivers (See Table 1) | **616** | 873 |
| Impairment allowance adjustment | **(1)** | 6 |
| **Total waivers** | **615** | 879 |
| **Table 1: Levies and late payment penalties waived by levy type** | | |
| Superannuation funds | **512** | 582 |
| General insurers | **102** | 286 |
| Other | **2** | 5 |
| **Total** | **616** | 873 |

# Notes to and forming part of the financial statements
for the year ended 30 June 2011

## Note 19: Assets administered on behalf of Government

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| **Financial assets** | | |
| **Receivables** | | |
| Financial Institutions Supervisory Levies | 29 | 44 |
| Financial Assistance Levy | 54,530 | – |
| **Total receivables (gross)** | 54,559 | 44 |
| Less: impairment allowance account | | |
| Supervisory Levies | (4) | (6) |
| **Total receivables (net)** | 54,555 | 38 |
| Receivables were aged as follows: | | |
| Not overdue | 54,546 | 14 |
| Overdue by: | | |
| – 0 to 30 days | 8 | 24 |
| – 31 to 60 days | 1 | – |
| – more than 90 days | 4 | 6 |
| **Total receivables (gross)** | 54,559 | 44 |
| The impairment allowance account is aged as follows: | | |
| – more than 90 days | (4) | (6) |
| **Total impairment allowance account** | (4) | (6) |

### Reconciliation of the Impairment Allowance Account

| | $'000 Receivables | $'000 Total |
|---|---|---|
| **Movements in relation to 2011** | | |
| **Opening balance** | (6) | (6) |
| Amounts written off | 6 | 6 |
| Increase/decrease recognised in net surplus | (4) | (4) |
| **Closing balance** | **(4)** | **(4)** |

| | $'000 Receivables | $'000 Total |
|---|---|---|
| **Movements in relation to 2010** | | |
| Opening balance | – | – |
| Increase/decrease recognised in net surplus | (6) | (6) |
| **Closing balance** | **(6)** | **(6)** |

## Note 20: Administered reconciliation table

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| **Opening administered assets less administered liabilities as at 1 July** | **38** | 85 |
| Plus: Administered income | **171,308** | 124,891 |
| Less: Administered expenses | **(615)** | (879) |
| Administered transfers to/from Australian Government: | | |
| Plus: Appropriation transfers from OPA for refunds | **75** | 11 |
| Less: Transfers to OPA | **(116,251)** | (124,070) |
| **Closing administered assets less administered liabilities as at 30 June** | **54,555** | 38 |

## Note 21: Administered financial instruments

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| **Note 21A: Categories of financial instruments** | | |
| **Financial assets** | | |
| Loans and receivables: | | |
| Receivables | **54,559** | 44 |
| **Carrying amount of financial assets** | **54,559** | 44 |

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

# Notes to and forming part of the financial statements
for the year ended 30 June 2011

## Note 21: Administered financial instruments (Continued)

### Note 21B: Credit risk

The maximum exposure to credit risk at the reporting date is the carrying amount of levy receivable as recognised in the *Schedule of Administered Items*. There is no significant exposure to any other concentrations of credit risk.

**Credit quality of financial instruments not past due or individually determined as impaired**

| | **Not past due nor impaired 2011 $'000** | Not past due nor impaired 2010 $'000 | **Past due or impaired 2011 $'000** | Past due or impaired 2010 $'000 |
|---|---|---|---|---|
| Receivables: | **54,546** | 14 | **13** | 30 |
| **Total** | **54,546** | 14 | **13** | 30 |

**Ageing of financial assets that were past due but not impaired for 2011**

| | 0 to 30 days $'000 | 31 to 60 days $'000 | 61 to 90 days $'000 | 90+ days $'000 | Total $'000 |
|---|---|---|---|---|---|
| Receivables: | 8 | 1 | – | 4 | 13 |
| **Total** | **8** | **1** | **–** | **4** | **13** |

**Ageing of financial assets that were past due but not impaired for 2010**

| | 0 to 30 days $'000 | 31 to 60 days $'000 | 61 to 90 days $'000 | 90+ days $'000 | Total $'000 |
|---|---|---|---|---|---|
| Receivables: | 24 | – | – | 6 | 30 |
| **Total** | **24** | **–** | **–** | **6** | **30** |

### Note 21C: Liquidity risk

There are no administered financial liabilities and therefore there is no exposure to any liquidity risk.

### Note 21D: Market risk

There is no exposure to any form of currency risk, interest rate risk or other price risk.

## Note 22: Appropriations

### Table A: Annual appropriations ('recoverable GST exclusive')

| | 2011 Appropriations | | | | | |
|---|---|---|---|---|---|---|
| | *Appropriation Act* | | *FMA Act* | | | |
| | Annual Appropriation $'000 | Appropriations reduced[1] $'000 | Section 31 $'000 | Total appropriation $'000 | Appropriation applied in 2011 (current and prior years) $'000 | Variance[2] $'000 |
| **Departmental** | | | | | | |
| Ordinary annual services | **12,575** | **–** | **8,417** | **20,992** | **20,786** | **206** |
| Other services | | | | | | |
| Equity | **1,457** | **–** | **–** | **1,457** | **1,457** | **–** |
| **Total departmental** | **14,032** | **–** | **8,417** | **22,449** | **22,243** | **206** |
| **Administered** | | | | | | |
| Other services | | | | | | |
| New administered outcomes | **–** | **–** | **–** | **–** | **–** | **–** |
| **Total administered** | **–** | **–** | **–** | **–** | **–** | **–** |

| | 2010 Appropriations | | | | | |
|---|---|---|---|---|---|---|
| | *Appropriation Act* | | *FMA Act* | | | |
| | Annual Appropriation $'000 | Appropriations reduced[3] $'000 | Section 31 $'000 | Total appropriation $'000 | Appropriation applied in 2010 (current and prior years) $'000 | Variance[4] $'000 |
| **Departmental** | | | | | | |
| Ordinary annual services | 23,545 | – | 4,294 | 27,839 | 28,716 | (877) |
| Other services | | | | | | |
| Equity | 1,957 | – | – | 1,957 | 1,957 | – |
| Previous year's output | 773 | – | – | 773 | 773 | – |
| **Total departmental** | **26,275** | **–** | **4,294** | **30,569** | **31,446** | **(877)** |
| **Administered** | | | | | | |
| Other services | | | | | | |
| New administered outcomes | 1,524 | (1,524) | – | – | – | – |
| **Total administered** | **1,524** | **(1,524)** | **–** | **–** | **–** | **–** |

1. Appropriations reduced under Appropriation Acts (No.1,3) 2010-11, sections 10, 11, 12 and 15 and under Appropriation Acts (No.2,4) 2010-11, sections 12, 13, 14 and 17.
2. The variance between the total appropriation and the appropriation applied is made up of the prior year (2009-10) appropriation receivable applied in the current year less the current year appropriation receivable.
3. Appropriations reduced under Appropriation Acts (No.1,3) 2009-10, sections 10, 11 and 12 and under Appropriation Acts (No.2,4) 2009-10, sections 12, 13 and 14.
4. The variance between the total appropriation and the appropriation applied is made up of the prior year (2008-09) appropriation receivable applied in the current year less the current year appropriation receivable.

# Notes to and forming part of the financial statements
## for the year ended 30 June 2011

## Note 22: Appropriations (Continued)

### Table B: Unspent departmental annual appropriations ('recoverable GST exclusive')

| Authority | 2011 $'000 | 2010 $'000 |
|---|---|---|
| Appropriation Act (No. 1) 2010-11 | **929** | – |
| Appropriation Act (No. 1) 2009-10 | **–** | 20 |
| Appropriation Act (No. 2) 2009-10 | **30** | 1,870 |
| Appropriation Act (No. 2) 2010-11 | **1,457** | – |
| Appropriation Act (No. 3) 2009-10 | **60** | 1,156 |
| **Total** | **2,476** | 3,046 |

### Table C: Special appropriations ('recoverable GST exclusive')

| Authority | Type | Purpose | Appropriation applied 2011 $'000 | Appropriation applied 2010 $'000 |
|---|---|---|---|---|
| *Australian Prudential Regulation Authority Act 1998 – section 50*, Departmental | Unlimited Amount | 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*. | **89,667** | 98,212 |
| *Financial Management and Accountability Act 1997 – section 28*, Administered | Refund | To provide an appropriation for the repayment of overpaid levies and incorrect deposits received by APRA. | **75** | 11 |
| **Total** | | | **89,742** | 98,223 |

1. Administered items for 2009-10 were reduced to these amounts when the financial statements were tabled in Parliament as part of APRA's 2010 annual report. This reduction was effective in 2010-11, but the amounts were reflected in Table A in the 2010 financial statements in the column 'Appropriations reduced' as they were adjustments to 2009-10 appropriations.

## Note 22: Appropriations (Continued)

### Table D: Reduction in administered items ('recoverable GST exclusive')

There were no reductions of administered items in 2011.

| 2010 | Amount required[1] – by Appropriation Act | | Amount required[1] – as represented by: | | Total amount required[1] | Total amount appropriated[2] | Total reduction[3] |
|---|---|---|---|---|---|---|---|
| | Act (No.2) | Act (No.4) | Spent | Retention | | | |
| **Other Services** | | | | | | | |
| **New administered outcomes** | | | | | | | |
| Outcome 1 | – | 1,524,000.00 | – | – | – | 1,524,000.00 | (1,524,000.00) |
| **Total** | **–** | **1,524,000.00** | **–** | **–** | **–** | **1,524,000.00** | **(1,524,000.00)** |

## Note 23: Special Accounts

### APRA Special Account (Departmental)

Appropriation: *Financial Management and Accountability Act 1997*, section 21.

Establishing Instrument: *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.

| | **2011 $'000** | 2010 $'000 |
|---|---|---|
| **Balance brought forward from previous period** | **49,530** | 31,300 |
| Special Appropriation for reporting period | **89,682** | 98,259 |
| Appropriation Act No. 1 | **20,063** | 25,338 |
| Appropriation Act No. 2 | **1,457** | 3,630 |
| Appropriation Act No. 3 | **723** | 3,378 |
| **Total increase** | **111,925** | 130,605 |
| **Available for payments** | **161,455** | 161,905 |
| Payments made | **(119,699)** | (112,375) |
| **Total decrease** | **(119,699)** | (112,375) |
| **Total balance carried to the next period** | **41,756** | 49,530 |

1. Amount required as per Appropriation Act (Act 1 s. 11; Act 2 s. 12).
2. Total amount appropriated in 2009-10.
3. Total reduction effective in 2010-11.

# Notes to and forming part of the financial statements
## for the year ended 30 June 2011

## Note 23: Special Accounts (Continued)

### Financial Claims Scheme Special Account (Administered)

Appropriation: *Financial Management and Accountability Act 1997*, section 21.

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

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 Division 2 of the APRA Act.

| | 2011<br>$'000 | 2010<br>$'000 |
|---|---|---|
| **Balance brought forward from previous period** | **1,524** | – |
| Appropriation for reporting period | **–** | 1,524 |
| **Total increase** | **–** | 1,524 |
| **Available for payments** | **1,524** | 1,524 |
| Repayments made from the special account | **(73)** | – |
| **Total decrease** | **(73)** | – |
| **Total balance carried to the next period** | **1,451** | 1,524 |

## Note 23: Special accounts (Continued)

### Lloyd's Deposit Trust Special Account (Special Public Money)

Appropriation: *Financial Management and Accountability Act 1997*, section 20.

Establishing Instrument: *Financial Management and Accountability Determination 2006/26*.

Purpose: To disburse amounts in accordance with section 92Q of the *Insurance Act 1973*.

| | **2011 $'000** | 2010 $'000 |
|---|---|---|
| Balance carried from previous period | **2,000** | 2,000 |
| **Available for payments** | **2,000** | 2,000 |
| Payments made | **–** | – |
| **Total decrease** | **–** | – |
| **Total balance carried to the next period** | **2,000** | 2,000 |

Responsibility for the administration of the Lloyd's Deposit Trust Special Account was transferred from the Department of Treasury to APRA with effect from 26 May 2008.

The market valuation as at 30 June 2011 for Lloyd's inscribed stock is $2,078,740 (2010: $2,028,820).

# Notes to and forming part of the financial statements
for the year ended 30 June 2011

## Note 23: Special accounts (continued)

### Services for Other Entities and Trust Moneys (Special Public Money)

Appropriation: *Financial Management and Accountability Act 1997*, section 20.

Establishing Instrument: *Financial Management and Accountability Determination 2007/09*.

Purpose: To distribute amounts temporarily held on trust for the benefit of another person other than the Commonwealth; disburse amounts in connection with services performed on behalf of other Governments and bodies that are not FMA Act agencies; and repay amounts where an Act or other law requires or permits the repayment of an amount received.

| | **2011 $'000** | 2010 $'000 |
|---|---|---|
| Balance carried from previous period | **–** | – |
| **Available for payments** | **–** | – |
| Payments made | **–** | – |
| **Total decrease** | **–** | – |
| **Total balance carried to the next period** | **–** | – |

## Note 24: Compensation and debt relief

| | **2011 $** | 2010 $ |
|---|---|---|
| **Administered** | | |
| 144 waivers of amounts owing to the Australian Government were made pursuant to section 12 of the *Financial Institutions Supervisory Levies Collection Act 1998* (2010: 126 waivers). | **614,598** | 878,415 |

# Note 25: Reporting of outcomes

## Note 25A: Net cost of outcome delivery

APRA is structured to meet the following outcome:

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

| | 2011 $'000 | 2010 $'000 | 2011 $'000 | 2010 $'000 |
|---|---|---|---|---|
| | Outcome 1 | | Total | |
| **Expenses** | | | | |
| Administered | **615** | 879 | **615** | 879 |
| Departmental | **118,349** | 116,268 | **118,349** | 116,268 |
| **Total** | **118,964** | 117,147 | **118,964** | 117,147 |
| **Income from non-government sector** | | | | |
| **Departmental** | | | | |
| Activities subject to cost recovery | **2,245** | 3,063 | **2,245** | 3,063 |
| Other | **736** | 692 | **736** | 692 |
| **Total departmental** | **2,981** | 3,755 | **2,981** | 3,755 |
| **Other own-source income** | | | | |
| Administered | **171,307** | 124,891 | **171,307** | 124,891 |
| Departmental | **1,637** | 1,310 | **1,637** | 1,310 |
| **Total** | **172,944** | 126,201 | **172,944** | 126,201 |
| **Net (contribution) of outcome delivery** | **(56,961)** | (12,809) | **(56,961)** | (12,809) |

Australian National
Audit Office

INDEPENDENT AUDITOR'S REPORT

**To the Minister for Financial Services and Superannuation**

I have audited the accompanying financial statements of the Australian Prudential Regulation Authority (the Authority) for the year ended 30 June 2011, which comprise: a Statement by the Members and the Chief Financial Officer; Statement of Comprehensive Income; Balance Sheet; Statement of Changes in Equity; Statement of Cash Flows; Schedule of Commitments; Schedule of Contingencies; Schedule of Asset Additions; Schedule of Administered Items; and Notes to and forming part of the Financial Statements, including a Summary of significant accounting policies.

***Chairman's Responsibility for the Financial Statements***

The Chairman of the Authority is responsible for the preparation of financial statements that give a true and fair view in accordance with the Finance Minister's Orders made under the *Financial Management and Accountability Act 1997*, including the Australian Accounting Standards, and for such internal control as the Chairman determines is necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

***Auditor's Responsibility***

My responsibility is to express an opinion on the financial statements based on my audit. I have conducted my audit in accordance with the Australian National Audit Office Auditing Standards, which incorporate the Australian Auditing Standards. These auditing standards require that I comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Authority's preparation of the financial statements that give a true and fair view 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 Authority's internal control. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of accounting

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estimates made by the Chairman of the Authority, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

***Independence***

In conducting my audit, I have followed the independence requirements of the Australian National Audit Office, which incorporate the requirements of the Australian accounting profession.

***Opinion***

In my opinion, the financial statements of the Australian Prudential Regulation Authority:

(a) have been prepared in accordance with the Finance Minister's Orders made under the *Financial Management and Accountability Act 1997,* including the Australian Accounting Standards; and

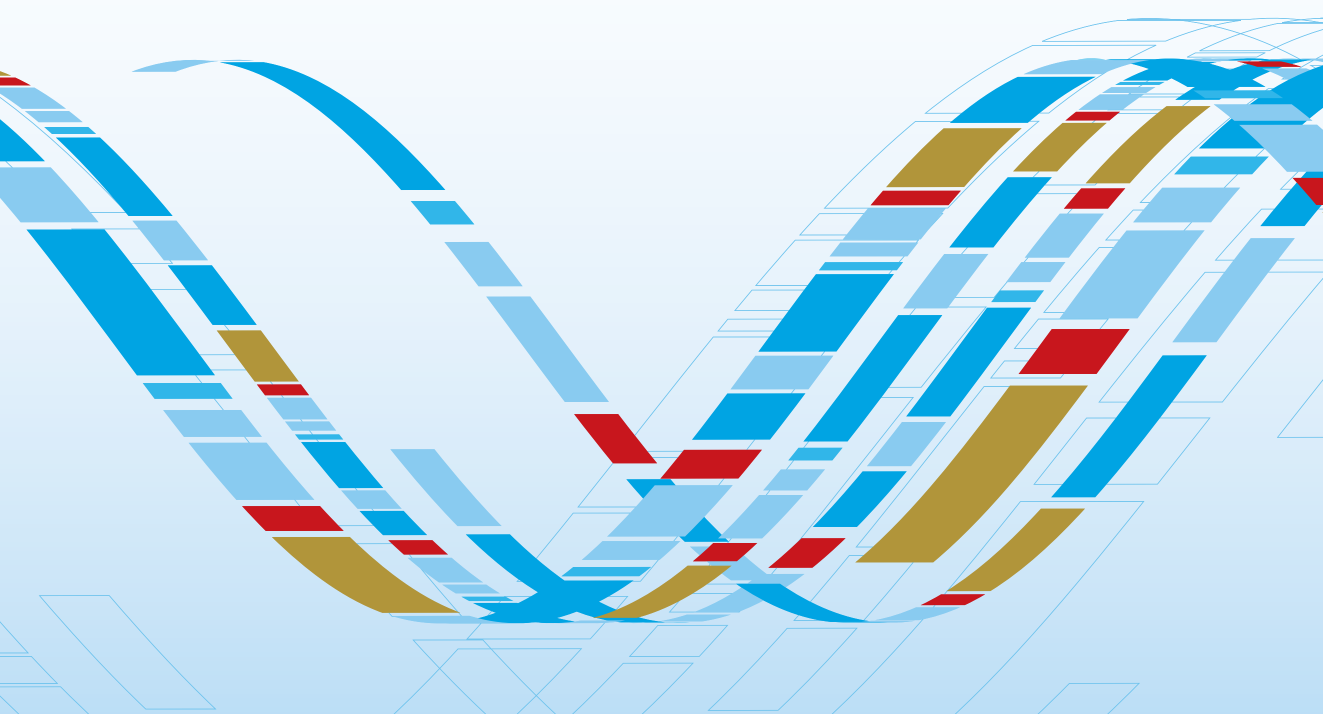
(b) give a true and fair view of the matters required by the Finance Minister's Orders including the Australian Prudential Regulation Authority's financial position as at 30 June 2011 and of its financial performance and cash flows for the year then ended.

Australian National Audit Office

Carla Jago
Executive Director
Delegate of the Auditor-General

Canberra

23 August 2011



Chapter nine

# Statutory report

## Statutory reporting requirements

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

- *Australian Prudential Regulation Authority Act 1998;*
- *Environment Protection and Biodiversity Conservation Act 1999;*
- *Equal Employment Opportunity (Commonwealth Authorities) Act 1987;*
- *Freedom of Information Act 1982;*
- *Occupational Health and Safety Act 1991;*
- *Commonwealth Fraud Control Guidelines;* and
- *Requirements for annual reports for departments, executive agencies and FMA Act bodies.*

APRA's financial arrangements are also subject to the *Financial Management and Accountability Act 1997*.

## *Australian Prudential Regulation Authority Act 1998* (APRA Act)

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

- the activities of ADI statutory managers within the meaning of the *Banking Act 1959* and persons conducting investigations under Division 2 of Part II and section 61 of that Act;
- the operation of Division 2AA (Financial Claims Scheme for account-holders with insolvent ADIs) of Part II of the *Banking Act 1959*;
- the operation of Part VC (Financial Claims Scheme for policyholders with insolvent general insurers) of the *Insurance Act 1973*; and
- the exercise during the year of APRA's powers under Part 15 of the Retirement Savings Accounts Act 1997 (RSA Act) and Part 29 of the *Superannuation Industry (Supervision) Act 1993* (SIS Act).

APRA did not appoint any ADI statutory managers or persons to conduct an investigation under Division 2 of Part II or section 61 of the *Banking Act 1959* during 2010/11. There were no continuing appointments during the year.

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

On 15 October 2009, the Minister made a declaration under section 62ZZC of the *Insurance Act 1973* that Division 3 of Part VC of that Act applied in relation to a general insurer[1]. Payments totaling $72,968 were made to claimants out of the Financial Claims Scheme Special Account in 2010/11.

APRA did not exercise its powers under Part 15 of the RSA Act in 2010/11.

1 Australian Family Assurance Limited (in liquidation)

APRA exercised its powers under Part 29 of the SIS Act as set out below:

| Exemption number | Date | Provision of SIS Act/regulations exempted |
|---|---|---|
| A19 of 2010 | 10/08/2010 | Regulation 13.17A |
| A20 of 2010 | 29/07/2010 | Regulations 9.29A and 9.30 |
| A21 of 2010 | 03/08/2010 | Regulation 7.04 |
| A22 of 2010 | 30/08/2010 | Regulations 9.29 and 9.30 |
| A23 of 2010 | 31/08/2010 | Regulation 9.04D(1) |
| A25 of 2010 | 21/09/2010 | Regulation 9.04D(1) |
| A26 of 2010 | 21/12/2010 | Regulation 9.04D(3) |
| A27 of 2010 | 11/11/2010 | Regulation 13.17A(1)(b) |
| A1 of 2011 | 25/02/2011 | Section 36 |
| A2 of 2011 | 09/02/2011 | Regulation 9.04D(1) |
| A3 of 2011 | 04/03/2011 | Regulations 9.29A and 9.30 |
| A5 of 2011 | 01/03/2011 | Regulation 9.04D |
| A6 of 2011 | 18/03/2011 | Regulations 9.29 and 9.30 |
| A7 of 2011 | 18/03/2011 | Regulation 9.04D |
| A8 of 2011 | 23/03/2011 | Regulation 7.04(1) |
| A10 of 2011 | 30/03/2011 | Regulation 6.34 |
| A11 of 2011 | 18/04/2011 | Regulation 6.34 |
| A12 of 2011 | 29/06/2011 | Regulation 9.30(2) |
| A14 of 2011 | 29/06/2011 | Regulations 9.08, 9.09, 9.17, 9.23, 9.24, 9.25 and 9.30 |

| Modification declaration number – particular entity | Date | Provision of SIS regulations modified |
|---|---|---|
| A3 of 2010 | 27/07/2010 | Section 332 and Regulations 8.02A, 8.03 and 8.04 |
| A4 of 2010 | 04/08/2010 | Section 29CC(1) |
| A5 of 2010 | 21/09/2010 | Regulation 6.17(2)(a)(i) |
| A6 of 2010 | 29/10/2010 | Section 29CC(1) |
| A1 of 2011 | 17/02/2011 | Regulation 6.17(2)(a)(i) |
| A2 of 2011 | 04/03/2011 | Regulation 1.03 |
| A3 of 2011 | 01/03/2011 | Regulation 1.03 |
| A4 of 2011 | 04/03/2011 | Regulation 7A.03H |
| A5 of 2011 | 15/04/2011 | Regulation 6.17 |
| A6 of 2011 | 03/05/2011 | Regulation 1.03 |
| A7 Of 2011 | 24/06/2011 | Regulation 1.03 |
| A8 of 2011 | 24/06/2011 | Regulation 1.03 |

## *Environment Protection and Biodiversity Conservation Act 1999*

### Ecologically sustainable development and environmental performance

APRA's Environmental Policy Statement reinforces its commitment to operating in an ecologically sustainable manner and APRA continues to take practical steps to reduce its environmental impact. Measures include zone-controlled lighting; energy-efficient power management settings on office equipment; recycling of paper, cardboard and printer cartridges; and staff awareness.

During 2010/11, APRA's Environmental Issues Subgroup (EIS) investigated 'going green' issues in APRA's day-to-day operations referred by staff, as well as areas where APRA could reduce wastage and carbon emissions. The EIS has been active in encouraging recycling activities and in providing education about environmental alternatives.

APRA will continue to make improvements in its environmental management and, where possible, adopt environmentally friendly options.

EEO staff data – staff diversity as at 30 June 2011*

| Level | Female | Male | ATSI | NESB1 | NESB2 | PWD |
|---|---|---|---|---|---|---|
| Level 1 | 23 | 10 | 0 | 7 | 0 | 0 |
| Level 2 | 76 | 29 | 0 | 28 | 0 | 1 |
| Level 3 | 70 | 95 | 0 | 58 | 3 | 2 |
| Level 4 | 76 | 135 | 1 | 43 | 3 | 2 |
| Senior | 17 | 78 | 0 | 10 | 2 | 1 |
| Executive | 0 | 7 | 0 | 1 | 0 | 0 |
| **Total** | **262** | **354** | **1** | **147** | **8** | **6** |

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

**ATSI** Aboriginal and Torres Strait Islander
**NESB1** Non-English-speaking background, first generation
**NESB2** Non-English-speaking background, second generation
**PWD** People with disability

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

### Workplace diversity program report

APRA has taken a proactive and innovative approach to meeting its responsibilities under the EEO Act by establishing a comprehensive workplace diversity strategy. This includes flexible and inclusive employment that values and utilises the contribution of people of different backgrounds, experiences, perspectives and abilities. The strategy retains the essential EEO principles in relation to non-discrimination and equal employment opportunity, and also recognises the broader concept of diversity in ensuring a tolerant workplace free from all forms of harassment.

Each year, members of APRA's Staff Consultative Group and selected human resources staff receive detailed training by a specialist diversity provider, Diversity Council Australia, in order to perform the important role of Contact Officer. APRA's Contact Officers are available to provide confidential and impartial assistance to any staff with workplace diversity concerns at APRA.

APRA is committed to ensuring staff are given appropriate assistance in balancing their work, home, family and other personal commitments. In line with this, APRA offers a range of flexible work arrangements including coreless variable hours, a compressed work week and purchased additional leave, job-sharing, telecommuting, and leave options for the purpose of family responsibilities and career/personal development. APRA also provides a range of 'family friendly' benefits including 14 weeks paid maternity leave, two weeks paid partner's leave and a 'Keep-in-Touch' program for women on maternity leave. In recognising that staff with dependents may require further assistance, APRA has services available to assist such staff in making care arrangements. In addition, APRA is committed to retaining the skills, expertise and corporate knowledge of staff approaching retirement age through a 'Transition to Retirement' program and other measures.

## *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 exceptions needed to protect essential public interests or the privacy and business affairs of those who give information to APRA or the Commonwealth.

In 2010/11, APRA dealt with 18 applications for access to documents under the FOI Act and one application for internal review. Of the 18, two were on hand at the beginning of the period and the other 16 were new applications. One applicant disagreed with APRA's decision on access to documents and applied to the Information Commissioner for review under Part VII of the FOI Act. This application for review has not been determined by the Commissioner.

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

| | |
|---|---|
| Granted in full | 5 |
| Granted in part | 3 |
| Access refused | 6 |
| Withdrawn | 2 |
| Transferred to another agency | 0 |
| On hand at 30 June 2011 | 2 |
| **Total** | **18** |

Charges collected were $1,060 and the estimated cost of handling initial FOI requests and internal review requests in 2010/11 was approximately $28,727. The estimated cost of handling external review applications was $2,052.

## Section 8 statement for the period 1 July 2010 – 30 April 2011

As a result of recent reforms to FOI legislation, the Annual Report publication requirements in section 8 of the FOI Act ('section 8 statement') were amended with effect from 1 May 2011. The section 8 statement has been replaced by the publication requirements of the Information Publication Scheme.

The following section 8 statement covers the period 1 July 2010 to 30 April 2011:

### Initial contact for requests under FOI Act

Requests under the FOI Act should be made in writing, together with the prescribed fee, to:

The FOI Coordinator
Australian Prudential Regulation Authority
GPO Box 9836
Sydney NSW 2001
Phone: 02 9210 3000
Fax: 02 9210 3424
Email: foi@apra.gov.au

### Access to documents

APRA makes its publications available to the public on the APRA website, free of charge. The website contains application forms, regulatory information, prudential statements, circulars and guidelines covering the types of entities that APRA regulates.

Questions about publications should be made to:

Media and Communications
Australian Prudential Regulation Authority
GPO Box 9836
Sydney NSW 2001
Phone: 02 9210 3000
Fax: 02 9210 3170

### Categories of documents

APRA maintains the following categories of documents covered by section 8(1)(a)(iii) of the FOI Act available to the public free via APRA's website at www.apra.gov.au:

- lists of regulated entities and industry bodies;
- superannuation circulars, superannuation prudential practice guides and guidance notes relating to the *Superannuation Industry (Supervision) Act 1993* and the *Retirement Savings Accounts Act 1997*, and 'frequently asked questions' on superannuation industry issues;
- statutory instruments issued by APRA, including modification declarations, determinations and approvals;
- prudential standards and rules made under the *Banking Act 1959*, the *Insurance Act 1973* and the *Life Insurance Act 1995*, guidance notes and prudential practice guides;
- 'frequently asked questions' on the Financial Claims Schemes;
- transitional prudential standards made under the *Financial Sector Reform (Amendments and Transitional Provisions) Regulations 1999*;
- reporting standards made under the *Financial Sector (Collection of Data) Act 2001* together with reporting forms and instructions for the lodgement of returns;
- transfer rules made under the *Financial Sector (Transfers of Business) Act 1999*;
- class consents under section 66 of the *Banking Act 1959*;
- market statistics (including APRA's *Insight* and other various industry-based statistical performance publications) and other research material;
- policy discussion papers;
- media releases and other news updates;
- copies of Enforceable Undertakings issued by APRA and the APRA Disqualification Register;
- seminar papers and copies of speeches given by APRA Members and officers;
- APRA's ADI Points of Presence (concerning the availability of banking services in rural and regional areas);
- corporate information;
- procedural guidelines;
- enabling legislation; and
- indexed file list for the purposes of Senate Continuing Order No. 6.

### Information Publication Scheme

From 1 May 2011, APRA was required to publish on its website 10 categories of information, including information about its structure, functions and statutory appointments; 'operational information' that guides its decisions or recommendations that affect members of the public; and information about how the public can comment on its prudential policy proposals.

APRA's information publication plan shows the information APRA publishes in accordance with these Scheme requirements and is accessible from the APRA website.

## *Occupational Health and Safety Act 1991* (OHS Act)

### Details of investigations and other matters as prescribed

In compliance with reporting obligations under section 74 of the OHS Act, there were:

- no investigations conducted during the year that related to undertakings carried on 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.

## Measures taken to ensure health, safety and welfare of employees and contractors

Responsibilities imposed by the OHS Act were identified and allocated to individual staff members. They included the identification and training of two new health and safety staff representatives in Melbourne and Sydney.

Procedures for dealing with health and safety issues are published on APRA's intranet site and are included in staff induction programs.

During 2010/11, a new online ergonomic assessment tool was piloted across a small group of Sydney staff. This tool helps to identify any OHS risk with respect to desk-based work through the completion of a short online survey completed by staff. Following the successful pilot, the product was rolled-out to the Adelaide, Brisbane, Perth and Canberra Offices. The roll-out to Melbourne and Sydney offices will take place early in 2011/12.

First-aid services for the treatment of work-related injury or illness, including appropriately trained first-aid officers, are situated at all work locations. Rehabilitation services and support are provided to injured employees. Four new first-aid/deputy first-aid officers were trained in 2010/11.

Comprehensive health assessments continue to be provided to staff at senior levels as well as to those aged 50 and over. Shorter health checks are provided to staff aged 40-49 and a 15-minute 'cardiac risk assessment' check to all other staff. These assessments are not compulsory and APRA is provided with statistical data only (not personal details or results of the assessments). As in previous years, all staff are offered an annual influenza vaccination; in 2010/11, 45 per cent of staff accepted this offer compared with 53 per cent the previous year.

## OHS policies including establishment of staff committees and selection of health and safety representatives

APRA has arrangements for consultation on all occupational health and safety issues, including maintenance of the OHS Committee with four staff and four management representatives.

The OHS Committee satisfies legislative requirements, including meeting at least every three months and providing all staff with access to minutes of the meetings.

## Statistics requiring the giving of notice under section 68

During the year, two incidents on APRA's premises were notified to APRA, neither of which required a report to Comcare under section 68 of the OHS Act.

# Other reporting

## Advertising and market research

The *Commonwealth Electoral Act 1918* requires Commonwealth agencies to report annually on the amounts paid to advertising agencies, market research and media advertising organisations. In 2010/11, APRA paid $190,948 to Adcorp Australia Ltd for recruitment advertising and $51,647 to Australian Survey Research Pty Ltd for the Stakeholder Survey. APRA conducted no advertising campaigns during 2010/11.

## Auditor-General's activities

The Australian National Audit Office (ANAO) undertook the required statutory financial audits of APRA for 2010/11. APRA was not subject to any performance audits by the ANAO during the year.

## Certified Employment Agreements

On 1 July 2011, the *APRA Employment Agreement, 2008* was replaced by the *APRA Employment Agreement, 2011*. As at 30 June 2011, 526 staff were covered by the *APRA Employment Agreement, 2008*. One hundred and one senior staff were covered by common law agreements.

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

The TRP pay ranges for non-executive staff as at 30 June 2011 were:

| | |
|---|---|
| Level 4 | \$110,600 – \$184,300 |
| Level 3 | \$77,500 – \$129,100 |
| Level 2 | \$52,800 – \$88,000 |
| Level 1 | \$36,800 – \$61,300 |

## Commonwealth Disability Strategy

Since 1994, Commonwealth departments and agencies have reported on their performance as policy adviser, purchaser, employer, regulator and provider under the Commonwealth Disability Strategy. In 2007/08, reporting on the employer role was transferred to the Australian Public Service Commission's State of the Service Report and the APS Statistical Bulletin. These reports are available at www.apsc.gov.au. From 2010/11, APRA is no longer required to report on its performance under these various roles.

The Commonwealth Disability Strategy has been overtaken by a new National Disability Strategy that sets out a ten-year national policy framework for improving life for Australians with disability, their families and carers. A high level report to track progress of people with disability will be produced by the Standing Council on Community, Housing and Disability Services for the Council of Australian Governments and will be available at www.fahcsia.gov.au. The Social Inclusion Measurement and Reporting Strategy agreed by the Government in December 2009 will also include some reporting on disability matters in the regular *How Australia is Faring* report and, if appropriate, in strategic change indicators in APRA's Annual Reports. More detail on social inclusion matters can be found at www.socialinclusion.gov.au.

## *Commonwealth Fraud Control Guidelines*

The Chairman of APRA certifies that he is satisfied that:

- fraud risk assessments and fraud control plans have been prepared that meet APRA's needs and comply with the *Commonwealth Fraud Control Guidelines*;
- appropriate fraud prevention, detection, investigation and reporting procedures and processes are in place; and
- annual fraud data have been collected and reported in compliance with the *Commonwealth Fraud Control Guidelines.*

## Commonwealth Ombudsman

In 2010/11, the Commonwealth Ombudsman conducted investigations into 35 matters, 31 of which related to applications for early release of superannuation benefits. At 30 June 2011, three of these matters were still to be finalised. As a result of these investigations, the Commonwealth Ombudsman made no adverse findings regarding APRA's operations.

## *Commonwealth Procurement Guidelines*

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

As an FMA Act agency, APRA conducts its procurement processes within the CPGs, including but not limited to:

- conducting open tenders for procurement activities of more than \$80,000 (unless otherwise exempted under the CPGs);
- reporting all procurements over \$10,000 on AusTender; and
- reporting all purchases over \$100,000 on APRA's website.

In 2010/11, APRA had no AusTender-exempt contracts and all APRA competitively tendered contracts over $100,000 provided for the Auditor-General to have access to the contractor's premises.

## Consultancies

APRA's *Chairman's Finance Instructions and Financial Policies*, and associated operational procedures, include specific provisions on consultants. Considerations prior to engagement include whether in-house resources are available; the cost-effectiveness of the operation and whether the project is essential; availability of funds; a selection and evaluation process resulting in fair competition, effective services and value for money; project definition and outcomes; and superannuation implications.

The main purposes for which consultants were engaged in 2010/11 were financial and accounting services, IT consultancies, legal advice, litigation services and professional services.

During 2010/11, APRA entered into 24 new consultancy contracts each valued at over $10,000, involving total expenditure of $3.9 million. In addition, 25 other consultancy suppliers were active during the year, involving total expenditure of $1.64 million. Total expenditure on consultancies in 2010/11 was $5.54 million, including $0.66 million of capitalized expenses.

Annual Reports contain information about actual expenditure on contracts for consultancies. Information on the value of contracts and consultancies is available on the AusTender website www.tenders.gov.au.

## Consultative arrangements

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

APRA complies with the Government's policy on best practice regulation. During 2010/11, APRA fully met the requirements of the Office of Best Practice Regulation (OBPR) for Regulation Impact Statements on new legislative instruments (two in number). In addition, APRA completed 16 preliminary assessments for other regulations made or tabled during this period, for which the OBPR advised that no further regulation analysis was required.

## Courts and tribunals

Over 2010/11, there were no judicial decisions that had or may have a significant effect on APRA's operations.

*APRA's supervisory activities in 2010/11* section of this *Report* contains details of court and tribunal decisions relating to enforcement action taken by APRA during the year.

## Executive and consultative committees from 1 July 2010 to 30 June 2011

### Management Group

This Group comprises the APRA Members and the Executive General Managers and is responsible for high-level information-sharing and decisions on more routine supervisory and organisational matters. It meets weekly or more frequently as required.

### Leadership Team

The Leadership Team, which comprises APRA Members, Executive General Managers and General Managers, meets twice a year to develop APRA's strategic and business plans, to monitor performance against plans and to discuss major operational issues.

### Steering Groups

To strengthen its efficiency and effectiveness and to coordinate decision-making across its different divisions, APRA has three Steering Groups responsible for the prioritisation and implementation of a range of initiatives. These Groups comprise an APRA Member as Chair and relevant Executive General Managers and General Managers. The Groups are:

- Supervision Steering Group. This Group oversees the development and integration of APRA's supervisory systems, tools and processes.
- Infrastructure Steering Group. This Group oversees the development of APRA's physical and IT infrastructure and its business, financial and resource planning systems.
- People and Engagement Steering Group. This Group addresses initiatives on management and leadership, performance management, rewards and recognition, and APRA culture.

### Industry groups

There are four industry groups, comprising representatives of the various divisions of APRA. They cover APRA's four regulated industries:

- ADIs;
- superannuation;
- general insurance; and
- life insurance (including friendly societies).

These groups are important fora for identifying and seeking an APRA-wide assessment of emerging industry issues. Their main roles are to liaise with industry so as to identify emerging trends and to act as a sounding board for prudential policy issues in the different industries, prior to presentation of these issues to the Executive Group.

### Cross-Divisional Licensing Committee

This Committee, comprising representatives from across APRA, seeks to assist supervisors considering licence applications and ensure consistency in licensing practice and application across all APRA-regulated industries. It provides APRA-wide guidance on issues that need to be considered in licensing submissions and, after consideration of an application, recommends to the relevant Executive General Manager action to be taken.

### Enforcement Committee

This Committee comprises an APRA Member as Chair, an Executive General Manager and representatives of Supervision, Enforcement and Legal. It ensures that a whole-of-APRA perspective is brought to potential, and actual, investigation and enforcement actions. The Committee monitors ongoing enforcement actions and provides a forum to ensure a consistent approach is taken to any significant use of coercive powers by areas within APRA.

### International committees

APRA has two committees that coordinate its involvement with international bodies, one for banking and one for insurance. Their purpose is to prioritise resource allocation for APRA's involvement in international activities, coordinate consistent and timely responses to issues raised in the relevant international fora and ensure information from international sources is communicated effectively within APRA. Membership includes senior APRA staff involved in international committee work and also draws on other APRA staff with relevant expertise.

### Occupational Health and Safety Committee

This Committee, which includes both staff and management representatives, focuses on issues to do with the health, safety and wellbeing of staff and ensures that these are integrated into broader management systems and practices.

### Staff Consultative Group

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

### Security Group

This Group is the key forum for maintaining strategic and operational oversight of APRA's security policy, initiatives and their implementation. Its main priority is to develop an over-arching policy and governance strategy on all security matters affecting APRA and to take the measures necessary to implement the strategy.

## Grant programs

Grant programs, including discretionary grant programs, that APRA either jointly administers or participates in are the:

- Brian Gray Scholarship;
- University of New South Wales (UNSW) Coop Actuarial Scholarship;
- Australian Research Council Linkage Grants with UNSW and the Australian National University; and
- sponsorship of PhD research students through the Capital Markets Cooperative Research Centre.

Information on the Brian Gray Scholarship program and a list of previous winners is on APRA's website (www.apra.gov.au/AboutAPRA/WorkingAtAPRA/Pages/brian-gray-scholarship-program.aspx). Information on other grants awarded by APRA is available on APRA's website at: www.apra.gov.au/AboutAPRA/Pages/grants-and-scholarships.aspx.

## 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 is prohibited from disclosing the specific nature and limit of the liabilities covered and the amount of the premium.

## *Legal Services Directions 2005*

The *Legal Services Directions 2005* require Commonwealth agencies to make available publicly information on records of their legal services expenditure for the previous financial year.

During 2010/11, APRA's total expenditure on external legal advice and litigation services was $2.83 million (including 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 2010/11, APRA Members and officers made themselves available for public hearings before the:

- Senate Economics Legislation Committee (sitting as Senate Estimates) on 20 October 2010, 24 February 2011 and 31 May 2011;
- Senate Economics References Committee in its inquiry into Competition within the Australian Banking Sector on 14 December 2010; and
- Joint Committee on Corporations and Financial Services in its inquiry into Access for Small Business to Finance on 11 March 2011.

In November 2010, APRA made a submission to the Senate Economics References Committee's Inquiry into Competition into the Banking Sector.

In February 2011, APRA also made a submission to the Joint Committee on Corporations and Financial Services in its inquiry into Access for Small Business to Finance.

Transcripts of APRA's appearances before, and copies of its submissions to, parliamentary committees may be downloaded from its website www.apra.gov.au.

## Performance pay

APRA has a performance bonus system, designed in consultation with staff and management and covering all employees. For 2010/11, the aggregate bonus pool was $4.52 million. Under deferred bonus arrangements introduced in the APRA Employment Agreement, 2010/11 bonuses will be paid in December 2011 to eligible staff still in APRA's employ at that date.

## Privacy Commission

There were no investigations by the Privacy Commissioner under section 40 of the *Privacy Act 1988* during 2010/11. 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 should be addressed to:

The Privacy Officer
Legal Group
Australian Prudential Regulation Authority
GPO Box 9836
Sydney NSW 2001
Phone: 02 9210 3000
Fax: 02 9210 3424

## Responsible Ministers

The Hon Wayne Swan MP, Deputy Prime Minister and Treasurer of the Commonwealth of Australia, has portfolio responsibility for APRA.

He is assisted in this role by the Hon Bill Shorten MP, Assistant Treasurer and Minister for Financial Services and Superannuation.

## Staff statistics

### Staff by location and full-time/part-time as at 30 June 2011*

| Location | Full-time | Part-time | Total |
|---|---|---|---|
| Adelaide | 5 | 0 | 5 |
| Brisbane | 15 | 1 | 16 |
| Canberra | 3 | 0 | 3 |
| Melbourne | 65 | 5 | 70 |
| Perth | 3 | 2 | 5 |
| Sydney | 475 | 42 | 517 |
| **Total** | **566** | **50** | **616** |

### Staff by division and full-time/part-time as at 30 June 2011*

| Division | Full-time | Part-time | Total |
|---|---|---|---|
| Corporate | 112 | 15 | 127 |
| Diversified Institutions | 106 | 6 | 112 |
| Policy, Research and Statistics | 84 | 8 | 92 |
| Specialised Institutions | 132 | 12 | 144 |
| Supervisory Support | 132 | 9 | 141 |
| **Total** | **566** | **50** | **616** |

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

### Full-time equivalent (FTE) staff strength as at 30 June 2011

| | |
|---|---|
| Permanent | 591.8 |
| Fixed-term | 7.6 |
| Casual | 2.9 |
| **Total** | **602.3** |

## List of requirements

The following list of mandatory annual reporting requirements, as outlined in the *Requirements for annual reports for departments, executive agencies and FMA Act bodies* approved by the Joint Committee of Public Accounts and Audit, has been annotated with either 'not applicable' or the location of the information in this *Report*.

| Part of *Report* | Description | Location or applicability |
|---|---|---|
| | Letter of transmittal | Page 2 |
| | Table of contents | Page 3 |
| | Index | Pages 164-165 |
| | Glossary | Pages 162-163 |
| | Contact officer(s) | Page 150 |
| | Internet home page address and internet address for report | Page 166 |
| Review by Chairman | | Chapter 1 |
| Overview of Authority | Overview | Chapter 7 |
| | Role and functions | Chapter 7 |
| | Organisational structure | Pages 160-161 |
| | Outcome and program structure | Chapter 6 |
| Report on performance | Review of performance in relation to programs and contribution to outcomes | Chapter 6 |
| | Actual performance in relation to deliverables and KPIs | Chapter 6 |
| | Narrative discussion and analysis of performance | Chapter 2 – Chapter 5 |
| | Trend information | Chapter 2 – Chapter 5 |
| | Performance against service charter customer service standards | Not applicable |
| | Discussion and analysis of the Authority's financial performance | Chapter 6 |
| | Authority's resource statement and summary resource tables by outcomes | Chapter 6 |
| | Developments since the end of the financial year that have affected or may significantly affect the Authority's operations or financial results in future | Not applicable |

| Part of *Report* | Description | Location or applicability |
|---|---|---|
| Corporate governance | Statement of the main corporate governance practices in place | Chapter 7 |
| | Compliance with the *Commonwealth Fraud Control Guidelines* | Chapter 9 |
| External scrutiny | Significant developments in external scrutiny | Chapter 9 |
| | Judicial decisions and decisions of administrative tribunals | Chapter 2 and Chapter 9 |
| | Reports by the Auditor-General, a Parliamentary Committee or the Commonwealth Ombudsman | Chapter 9 |
| Management of human resources | Assessment of effectiveness in managing and developing human resources to achieve the Authority's objectives | Chapter 4 |
| | Statistics on staffing | Chapter 4 and Chapter 9 |
| | Enterprise or collective agreements, determinations, common law contracts and AWAs | Chapter 9 |
| | Performance pay | Chapter 9 |
| Assets management | Assessment of effectiveness of assets management | Not applicable |
| Purchasing | Assessment of purchasing against core policies and principles | Chapter 9 |
| Consultants | Summary statement detailing consultancy arrangements and confirming that information on contracts and consultancies is available through the AusTender website | Chapter 9 |
| Australian National Audit Office access clauses | Absence of provisions in contracts allowing access by the Auditor-General | Chapter 9 |
| Exempt contracts | Contracts exempt from the AusTender process | Chapter 9 |
| Financial statements | | Chapter 8 |
| Other information | Occupational health and safety (section 74 of the *Occupational Health and Safety Act 1991*) | Chapter 9 |
| | Freedom of Information (subsection 8(1) of the *Freedom of Information Act 1982*) | Chapter 9 |
| | Advertising and market research (Section 311A of the *Commonwealth Electoral Act 1918*) and statement on advertising campaigns | Chapter 9 |
| | Ecologically sustainable development and environmental performance (Section 516A of the *Environment Protection and Biodiversity Conservation Act 1999*) | Chapter 9 |
| | Grant programs | Chapter 9 |
| | Correction of material errors in previous annual report | Not applicable |

**Executive Group**

**Dr John Laker (Chairman)**
**Mr Ross Jones (Deputy Chairman)**
**Mr Ian Laughlin (Member)**

Executive General Manager
Diversified Institutions
**Wayne Byres**

- General Manager
  Branch 1
  **Neil Grummitt**
- General Manager
  Branch 2
  **Heidi Richards**
- General Manager
  Branch 3
  **Denis Wilkinson**
- General Manager
  Branch 4
  **Harvey Crapp**

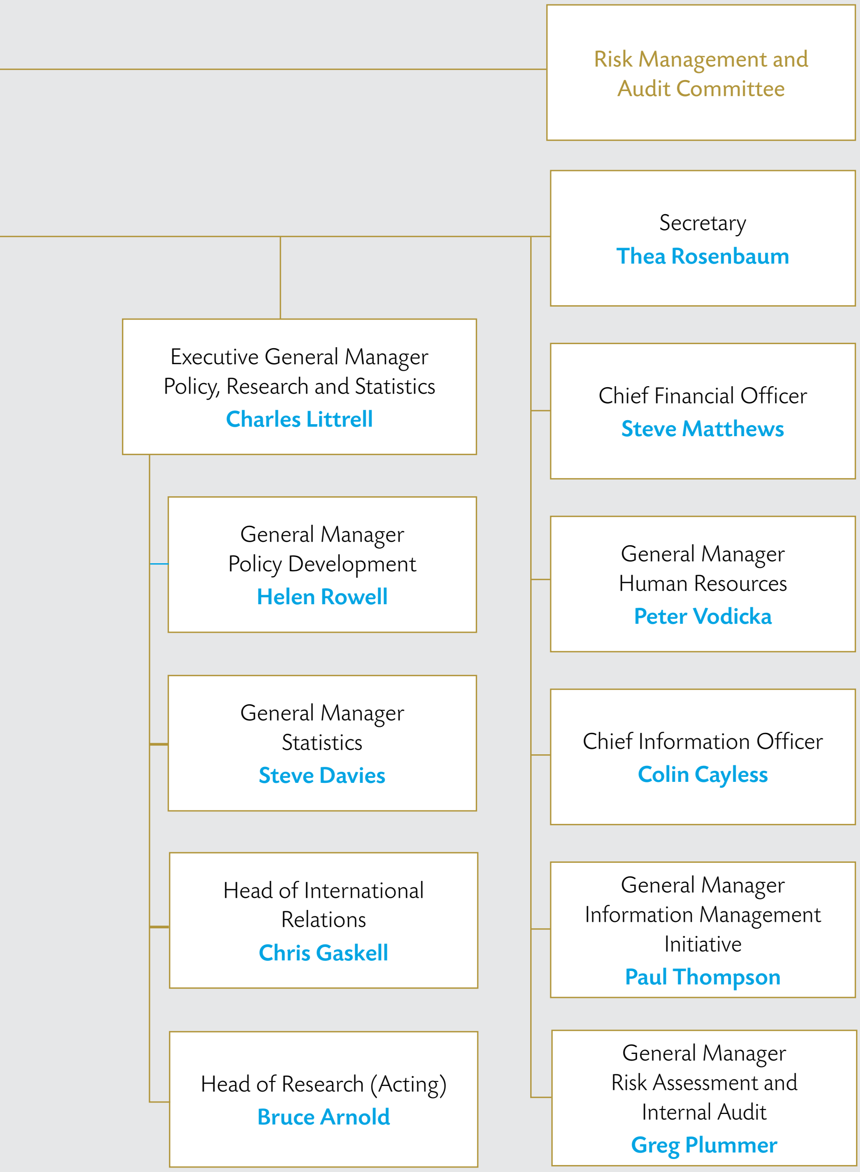
Executive General Manager
Specialised Institutions
**Brandon Khoo**

- General Manager
  Central Region
  **Nigel Boik**
- General Manager
  South West Region
  **Stephen Glenfield**
- Head of Northern Region
  **Clayton Osborne**

General Manager
Supervision Framework Team
**David Lewis**

Executive General Manager
Supervisory Support
**Keith Chapman**

- General Manager
  Industry Technical Services
  **Puay Sim**
- General Manager
  AMIRS[1]
  **Greg Brunner**
- General Manager
  CORS[2]
  **Pat Brennan**
- General Manager
  Legal
  **Warren Scott**
- General Manager
  Enforcement
  **Louis Serret**




[1] AMIRS – Actuarial Market and Insurance Risk Services
[2] CORS – Credit and Operational Risk Services

| | |
|---|---|
| AASB | Australian Accounting Standards Board |
| ACCC | Australian Competition and Consumer Commission |
| ADI | Authorised deposit-taking institution |
| ANAO | Australian National Audit Office |
| APEC | Asia-Pacific Economic Cooperation |
| APRA | Australian Prudential Regulation Authority |
| APRA Act | *Australian Prudential Regulation Authority Act 1998* |
| ASIC | Australian Securities and Investments Commission |
| ATO | Australian Taxation Office |
| AUSTRAC | Australian Transaction Reports and Analysis Centre |
| CoFR | Council of Financial Regulators |
| CRF | Consolidated Revenue Fund |
| D2A | Direct to APRA |
| EAFD | Early Access Facility for Depositors |
| EEO | Equal Employment Opportunity |
| EMEAP | Executives' Meeting of East Asia – Pacific Central Banks |
| FCS | Financial Claims Scheme |
| FMA Act | *Financial Management and Accountability Act 1997* |
| FMO | Finance Minister's Order |
| FOI Act | *Freedom of Information Act 1982* |
| FSAP | Financial Sector Assessment Program (of the IMF) |
| FSB | Financial Stability Board |
| IAAust | Institute of Actuaries of Australia |

| | |
|---|---|
| IAIS | International Association of Insurance Supervisors |
| IASB | International Accounting Standards Board |
| IMF | International Monetary Fund |
| IOPS | International Organisation of Pension Supervisors |
| IOSCO | International Organisation of Securities Commissions |
| MoU | Memorandum of Understanding |
| OECD | Organisation for Economic Co-operation and Development |
| OHS | Occupational Health and Safety |
| OPA | Official Public Account |
| OBPR | Office of Best Practice Regulation |
| PAIRS | Probability and Impact Rating System |
| PER | Performing Entity Ratio |
| PHIAC | Private Health Insurance Administration Council |
| RBA | Reserve Bank of Australia |
| RBNZ | Reserve Bank of New Zealand |
| RSA Act | *Retirement Savings Accounts Act 1997* |
| RSE | Registrable Superannuation Entity |
| SCCI | Specialist credit card institution |
| SEANZA | South-East Asia New Zealand and Australia (Forum of Banking Supervisors) |
| SIS Act | *Superannuation Industry (Supervision) Act 1993* |
| SOARS | Supervisory Oversight and Response System |
| UFI | Unauthorised foreign insurer |

## Head office

### New South Wales

**Delivery address:**
APRA
Level 26, 400 George Street
SYDNEY NSW 2000

**Mailing address:**
GPO Box 9836
SYDNEY NSW 2001

T: 02 9210 3000
F: 02 9210 3411

## Other offices

### Australian Capital Territory

**Delivery address:**
APRA
Level 2, 243–251 Northbourne Avenue
LYNEHAM ACT 2602

**Mailing address:**
GPO Box 9836
CANBERRA ACT 2601

T: 1300 55 88 49
F: 02 6213 5307

### Queensland

**Delivery address:**
APRA
Level 23, 300 Queen Street
BRISBANE QLD 4000

**Mailing address:**
GPO Box 9836
BRISBANE QLD 4001

T: 07 3001 8500
F: 07 3001 8501

### South Australia

**Delivery address:**
APRA
Level 5, 100 Pirie Street
ADELAIDE SA 5000

**Mailing address:**
GPO Box 9836
ADELAIDE SA 5001

T: 08 8235 3200
F: 08 8232 5180

### Victoria

**Delivery address:**
APRA
Level 21, Casselden Place
2 Lonsdale Street
MELBOURNE VIC 3000

**Mailing address:**
GPO Box 9836
MELBOURNE VIC 3001

T: 03 9246 7500
F: 03 9663 5085

### Western Australia

**Delivery address:**
APRA
Level 15, QV.1 Building
250 St Georges Terrace
PERTH WA 6000

**Mailing address:**
GPO Box 9836
PERTH WA 6001

T: 08 9481 8266
F: 08 9481 8142