

Financial Sector (Collection of Data) (reporting standard) determination Nos. 11 and 12 of 2020

EXPLANATORY STATEMENT

Prepared by the Australian Prudential Regulation Authority (APRA)

Financial Sector (Collection of Data) Act 2001, sections 13 and 15

Acts Interpretation Act 1901, section 33

Under subsection 13(1) of the *Financial Sector (Collection of Data) Act 2001* (the Act), APRA has the power to determine reporting standards, in writing, with which financial sector entities must comply. Such standards relate to reporting financial or accounting data and other information regarding the business or activities of the entities. Subsection 33(3) of the *Acts Interpretation Act 1901* provides that where an Act confers a power to issue an instrument the power shall, unless the contrary intention appears, be construed as including a power exercisable in the like manner and subject to the like conditions (if any) to revoke any such instrument.

On 8 December 2020, APRA made the following determinations (the instruments):

- (1) Financial Sector (Collection of Data) (reporting standard) determination No. 11 of 2020 which:
 - (a) revokes *Reporting Standard ARS 222.0 Exposures to Related Entities* made under Financial Sector (Collection of Data) (reporting standard) determination No. 12 of 2018; and
 - (b) determines *Reporting Standard ARS 222.0 Exposures to Related Entities* (ARS 222.0); and
- (2) Financial Sector (Collection of Data) (reporting standard) determination No. 12 of 2020 which determines *Reporting Standard ARS 222.2 Exposures to Related Entities – Step-in risk* (ARS 222.2).

The instruments commence on 1 January 2022.

1. Background

APRA's mandate is to ensure the safety and soundness of prudentially regulated financial institutions so that they can meet their financial promises to depositors, policyholders and fund members within a stable, efficient and competitive financial system. A key component of this is requiring ADIs to have prudent systems for identifying, measuring, evaluating, monitoring, reporting and controlling or mitigating material risks that may affect their ability to meet obligations to depositors.

Associations with related entities introduce the potential for material contagion risk within the banking sector. Deficiencies in prudential controls to mitigate the flow of this risk to related entities can result in severe financial and reputational contagion, ultimately affecting depositors. Financial contagion risk may arise when an ADI has a concentration of exposures to its related entities. This may be exacerbated by conflicts

of interest during the origination or ongoing management of an exposure to a related entity. Reputational contagion may arise where investors perceive that a related entity faces operational or financial difficulties or where an ADI could be seen to step in to support a group member beyond any legal obligation. ARS 222.0 collects information from ADIs on their exposures to related entities, which *Prudential Standard APS 222 Associations with Related Entities* (APS 222) defines as an entity which could give rise to risk to the ADI due to conflicts of interest and contagion, where the risk would not arise if the ADI were dealing with an unrelated entity.

ARS 222.2 collects information regarding step-in risk entities. A step-in risk entity is defined as an entity to which an ADI is likely to provide support beyond any legal or contractual obligation.

2. Purpose and operation of the instruments

The purpose of the instruments is to determine ARS 222.2, and to revoke ARS 222.0 and replace it with a new version of ARS 222.0.

APRA has revised its prudential standard on associations with related entities, APS 222, to strengthen the ability of ADIs to monitor, limit and control risks arising from transactions and other associations with related entities and those entities where an ADI is likely to provide support beyond any legal obligation (step-in risk entities). The changes incorporate lessons from the global financial crisis on mitigating contagion flowing from one group entity to another, align Australian requirements with international standards where appropriate, and also ensure broad alignment with requirements relating to an ADI's exposures to unrelated entities in APRA's revised large exposures framework, *Prudential Standard APS 221 Large Exposures*.

ARS 222.0 and ARS 222.2 (together, the reporting standards) set out requirements for the provision of information to APRA relating to an ADI's exposures to related entities and step-in risk entities. The amendments to ARS 222.0 and new ARS 222.2 require reporting by ADIs which is aligned with the amendments to APS 222 and capture more prudential information on related entities and step-in risk entities. The key changes to ARS 222.0 and the new ARS 222.2 which are needed to address the problems outlined above for reporting are:

- revised reporting on related entities, including comprehensive reporting on the largest related entity exposures, and on substantial shareholders;
- new reporting on step-in risk entities; and
- revised reporting on subsidiaries that are treated as part of an ADI's extended licensed entity (ELE) i.e. consolidated with the ADI for prudential purposes.

APRA expects it may be challenging for some entities to undertake assessments and provide details on identified step-in risk entities as step-in risk is a new concept for ADIs, however the reporting standards in conjunction with APS 222 provide details and instructions to facilitate the reporting process.

Where the reporting standards refer to an Act, Regulation, Prudential Standard, Reporting Standard, Australian Accounting or Auditing Standard, this is a reference

to the document as it exists from time to time, and which is available on the Federal Register of Legislation at www.legislation.gov.au.

The reporting standards refer to International Standards ISO 3166 and ISO 17442, which are issued by the International Organization for Standardization (ISO). These ISO standards are not intended to be incorporated in the reporting standards as the contents of the ISO standards are not relevant to understanding the terms of the reporting standards.

The reporting standards require ADIs to report the names of related entities, ELE subsidiaries and substantial shareholders alongside their respective ISO 17442 Legal Entity Identifier (LEI), if applicable. LEIs are issued by Local Operating Units (LOU) which provide registration services for entities that wish to be issued an LEI in accordance with ISO 17442. Each LEI comprises a 4-digit code for the issuing LOU, a 14-digit code for the specific legal entity, and a 2-digit verification code. LEIs are not contained in ISO 17442 and it would not be possible to determine an entity's LEI by referring to ISO 17442. LEIs can be searched online for free at <https://search.gleif.org/#/search/>.

ARS 222.0 requires ADIs to report the country where the ELE subsidiary is domiciled using the English name of the relevant country as assigned by the ISO 3166 Maintenance Agency to define country codes under ISO 3166. The ISO has stated that the Maintenance Agency assigns country names to member states of the United Nations and some dependencies of those member states based on information from United Nations sources.¹ Up-to-date information about country names and associated country codes is available for free on the online browsing platform at <https://www.iso.org/obp/ui/#search/code/>.

ADIs are expected to report the country names and LEIs as matters of fact, analogous to a requirement to include Australian or foreign addresses and telephone numbers. Information about how the country names and LEI codes can be accessed for free is included in the reporting standards to assist ADIs to understand and comply with the requirements. ADIs already report using country names and LEIs under other reporting standards made under the Act. Following extensive consultation undertaken on APS 222 and the reporting standards, ADIs are aware that they will also be required to report using country names and LEIs under the reporting standards.

ARS 222.2 requires ADIs to report the sector of a step-in risk entity from a list of sectors, such as 'banking institution', 'central banks' and 'registered financial corporations'. Registered financial corporations are corporations that are registered entities under the Act that are classified by APRA as category D (money market corporations) or Other (pastoral finance companies, finance companies and general financiers). ADIs are expected to report the relevant sector as a matter of fact. ARS 222.2 includes a link to the list of registered financial corporations on APRA's website. The list is not intended to be incorporated by reference.

There are a number of powers that may be exercised by APRA in reporting standards which involve an element of discretion and which may impact the interests of the

¹ <https://www.iso.org/iso-3166-country-codes.html>.

financial sector entity to which the reporting standard applies. These decisions include APRA refusing to change a reporting period or due date for an ADI to provide information required by ARS 222.0 and ARS 222.2. Decisions made by APRA exercising those powers are not subject to merits review.

APRA considers decisions made by APRA exercising discretions under its reporting standards should not be subject to merits review as they are financial decisions with a significant public interest element.

APRA's reporting standards collect financial data from regulated entities. This data contains critical indicators of a regulated entity's financial wellbeing, including data on an entity's assets, capital, liquidity, expenses and risk exposures. APRA relies heavily on this financial data to inform its supervisory actions towards its regulated entities. Without timely and complete data, APRA may miss indicators that an ADI is taking on imprudent risk or is in distress. APRA's supervisory decisions may be jeopardised if its receipt of data is unreliable due to entities seeking merits review under its reporting standards.

The data collected by APRA's reporting standards is also often used to compile key macroeconomic indicators for Australia. The Reserve Bank of Australia uses the data to compile and publish its monetary and credit aggregates. The Australian Bureau of Statistics uses the data to compile the national accounts. The data is also used to meet Australia's international reporting obligations.

Delays caused by an entity seeking merits review of APRA's decisions under one or more reporting standards could significantly compromise these publications. As the publications are done at an aggregate level, any lack of data from one entity caused by a merits review claim prevents the release of the entire publication.

3. Consultation

APRA has consulted extensively on proposed changes in APS 222 and the reporting standards. APRA undertook a public consultation from July to September 2018, and has met with and discussed the proposed changes with a number of interested parties. APRA received a total of ten submissions from ADIs and industry bodies. Based on submissions, APRA made changes to the definition of a related entity, such as by excluding step-in risk entities from being related entities, and has added a new reporting standard, ARS 222.2, to include high-level information on the step-in risk entities identified by ADIs. There were other minor comments on reporting of exposures to related entities which have been addressed through the consultation and response process.

4. Regulation Impact Statement

APRA prepared a Regulation Impact Statement which has been lodged as supporting material.

5. Statement of compatibility prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

A Statement of compatibility prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* is provided at Attachment A to this Explanatory Statement.

ATTACHMENT A

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

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The legislative instruments are compatible with the human rights and freedoms recognised or declared in the international instrument listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* (HRPS Act).

Overview of the Legislative Instruments

The purpose of the instruments is to make a revised *Reporting Standard ARS 222.0 Exposures to Related Entities* (ARS 222.0) and a new *Reporting Standard ARS 222.2 Exposures to Related Entities – Step-in risk* (ARS 222.2).

ARS 222.0 and ARS 222.2 set out requirements for the provision of information to APRA relating to an authorised deposit-taking institution's (ADI) exposures to related entities, and entities where an ADI is likely to provide support beyond any legal obligation (step-in risk entities). The information collected under these reporting standards are used by APRA for the purpose of the prudential supervision of the ADIs in connection with *Prudential Standard APS 222 Associations with Related Entities* (APS 222). APS 222 sets out requirements for ADIs to identify, monitor and control contagion risks arising from their associations and dealings with related entities and step-in risk entities.

Human rights implications

APRA has assessed the instruments against the international instruments listed in section 3 of the HRPS Act and determined that only Article 17 of the International Covenant on Civil and Political Rights (ICCPR) is conceivably of relevance to the instruments.

Article 17 of the ICCPR prohibits the arbitrary or unlawful interference with a person's privacy, family, home and correspondence, and attacks on reputation. Article 17 is exclusively concerned with prohibiting interference with the privacy and/or reputation of individual persons. It does not extend to the privacy and/or reputation of corporate entities.

The instruments facilitate the collection of specific information provided to APRA by ADIs in accordance with ARS 222.0 and ARS 222.2. They do not facilitate the public disclosure of information directly relating to individual persons. The information that ADIs are required to report to APRA under ARS 222.0 and ARS 222.2 include information about the exposures that an ADI has to individuals who fall within the definition of a 'related entity', such as a director, senior manager or substantial shareholder of the ADI, or a 'step-in risk entity'. This information ultimately supports APRA achieving its mission of ensuring that, under all reasonable circumstances,

financial promises made by the institutions that APRA supervises are met within a stable, efficient and competitive financial system.

APRA does not publish any personal information which it collects. Information provided to APRA under reporting standards is protected information for the purposes of section 56 of the *Australian Prudential Regulation Authority Act 1998* and cannot be disclosed except under a limited range of circumstances provided for under that section. While APRA does publish some protected information collected under reporting standards, APRA reviews all releases of data received under reporting standards to ensure that no information pertaining to an individual person can be deduced from the data.

Conclusion

The instruments are compatible with human rights because to the extent that ARS 222.0 and ARS 222.2 limit human rights, those limitations are reasonable, necessary and proportionate.