

Australian Prudential Regulation Authority instrument fixing charges No. 5 of 2013

Models-based capital adequacy requirements for ADIs for the financial year 2012-13

EXPLANATORY STATEMENT

Issued by the Australian Prudential Regulation Authority (*APRA*)

Australian Prudential Regulation Authority Act 1998, paragraphs 51(1) (a) and (b)

Instrument to which this explanatory statement relates

This explanatory statement relates to the instrument fixing charges which is made under paragraphs 51(1) (a) and (b) of the *Australian Prudential Regulation Authority Act 1998* (the *APRA Act*) and which is dated 6 June 2013 (the *instrument*).

Background

Legislative framework

The APRA Act is administered by APRA. APRA has statutory responsibility for the prudential supervision of most of the superannuation industry, the life insurance and general insurance industries, and authorised deposit-taking institutions (**ADIs**). ADIs include banks, building societies and credit unions.

Subsection 51(1) of the APRA Act provides that APRA may, by legislative instrument, fix charges to be paid to it by persons in respect of:

- (a) services and facilities which APRA provides to such persons; or
- (b) applications or requests made to APRA under laws of the Commonwealth.

Subsection 51(2) of the APRA Act provides that a charge fixed under subsection 51(1) must be reasonably related to the costs incurred or to be incurred by APRA in relation to the matters to which the charge relates and must not be such as to amount to taxation.

Purpose of the instrument

The instrument, made by the Chief Financial Officer as a delegate of APRA, imposes a charge for certain services provided by APRA relating to the on-going supervision of the capital adequacy of banks which have adopted the models-based approach under the New Basel Capital Framework (**Basel II**) for ADIs and to the accreditation of other ADIs which have applied to APRA to utilise that approach to determine their capital adequacy requirements.

Factual background

In June 2004, the Basel Committee on Banking Supervision (the **Committee**) released Basel II, reforming the 1988 Basel Capital Accord (the **1988 Accord**).

The objectives of Basel II are to provide capital adequacy guidelines that are more accurately aligned with the individual risk profile of institutions, lessen regulatory arbitrage opportunities and offer greater flexibility for supervisors to recognise or encourage the use of more sophisticated risk management techniques, where appropriate. Basel II provides a number of methods for calculating capital adequacy for each risk class, ranging from standardised (default) methods, which are in essence more risk-sensitive versions of the 1988 Accord, to more sophisticated methods which involve institutions adopting their own individualised internal risk assessment methodologies.

APRA implemented Basel II in Australia for all ADIs on 1 January 2008, through new prudential standards under section 11AF of the *Banking Act 1959*.

Under Basel II, ADIs are able to determine their capital adequacy requirements using one of two methods: a standardised (default) method (the ***standardised method***) or a models-based approach that more closely aligns with an ADI's individual risk profile (the ***models-based approach***). ADIs seeking to use the models-based approach must have APRA's approval to do so.

Basis of charging

APRA is principally funded by the annual supervisory levy imposed on regulated entities by the *Financial Institutions Supervisory Levies Collection Act 1998* and the related levy imposition Acts. However, section 51 of the APRA Act empowers APRA to impose charges in respect of services or facilities provided by it and in respect of applications made to it under Acts which it administers. Underlying section 51 is the principle of 'user pays' – that parties who receive special services or benefits from APRA should, where appropriate, have to pay the cost of providing them, rather than leaving them to be funded out of the supervisory levy which is paid by the general body of regulated entities.

APRA continues to charge fees that recover the assessment cost for, and ongoing supervision of, those ADIs seeking Basel II accreditation.

How the charges have been calculated

The charges set by the instrument are fixed on a cost recovery basis and in line with the *Australian Government Cost Recovery Guidelines July 2005*.

The charge is based on the need to recover APRA's costs of carrying out the on-going monitoring of the capital adequacy of ADIs using the models-based approach and assessing applications for model approval. Those costs are based on an estimation of APRA staff time involved with an addition of direct overhead costs. On this basis, APRA's total cost recovery in respect of the models-based approach for 2012-13 is \$2.3 million (2011-12: \$2.2 million).

The costs incurred in monitoring the capital adequacy of ADIs using the standardised method are recovered through the financial sector levies for those ADIs.

In 2012-13, the focus has been upon the on-going supervision of the capital adequacy of those ADIs approved to use the models-based approach (Australia and New Zealand Banking Group Limited (***ANZ***), Commonwealth Bank of Australia (***CBA***), National Australia Bank limited (***NAB***), Westpac Banking Corporation (***WBC***) and Macquarie Bank

Limited (**MBL**)) and the continued assessment of the accreditation application of ING Bank (Australia) Limited (**ING**).

As there is no material difference in APRA's approach to the monitoring of the models-based approach between ADIs who have received approval, each of these will be charged an equal amount of the relevant costs. ING's application for accreditation continued across 2012-13 and the charge determined reflects the cost recovery of APRA's associated effort.

Description of the charges

The charge imposed by the instrument is based on a two-tiered structure:

- (a) \$420,000 plus GST (which totals \$462,000) for ANZ, CBA, MBL, NAB and WBC; and
- (b) \$200,000 plus GST (which totals \$220,000) for ING.

These amounts (\$2.3 million plus GST, totalling \$2.53 million) have been set as a contribution to APRA's:

- Phase II work, being assessment of applications made by certain ADIs; and
- Phase III work, being on-going monitoring of the capital adequacy of ADIs using the models-based approach.

Charges must be reasonably related to the costs and expenses incurred

As indicated above, the charges set by the instrument are fixed on a cost recovery basis to defray the estimated effort involved in the discharge of APRA's responsibilities and in line with the *Australian Government Cost Recovery Guidelines July 2005*.

Cost Recovery Impact Statement

A Cost Recovery Impact Statement (CRIS) has been tabled in support of this Explanatory Statement.

Charges must not amount to taxation

As disclosed in the accompanying CRIS, the charges are reasonably related to the costs incurred by APRA in providing the services concerned and therefore do not constitute a tax.

Consultation

The *Legislative Instruments Act 2003* (LIA) requires that consultation be undertaken with those impacted by the instrument and section 17 of the LIA outlines the circumstances and processes underpinning consultation. However, section 18 of the LIA provides for relief from consultation where it may be determined to be unnecessary or inappropriate - for example, when appropriate consultation has already been undertaken.

The annual levies consultation process explicitly adopts the Wallis Inquiry recommendations that direct services be met by specific user charges, resulting in a compensating reduction of the total general levies to be collected from industry participants¹.

Before making the instrument, APRA informed the affected ADIs of the proposed charges.

Statement of Compatibility with Human Rights

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

A Statement of Compatibility with Human Rights is Appendix A to this Explanatory Statement.

¹ See the Consultation Paper *Proposed Financial Industry Levies for 2013-14* at The Treasury website.

Appendix 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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This Legislative Instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview of the Legislative Instrument

This Legislative Instrument will fix charges to be paid to APRA by ADIs for specific costs associated with the supervision of the capital adequacy of ADIs using a model-based approach and assessing applications by ADIs to utilise the models-based approach.

Human rights implications

APRA has assessed this Legislative Instrument against the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* (HRPS Act) and determined that this Legislative Instrument does not engage any of the applicable rights or freedoms, as the charges payable by the ADIs will not have any direct or indirect effect on the rights of individual persons.

Conclusion

This Legislative Instrument is compatible with human rights as it does not raise any human rights issues.