10 minutes on....

APRA's proposed disclosure requirements for the composition of capital

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Highlights, Background & Scope

Highlights

- *On 9 April 2013 APRA released a consultation paper and draft prudential standard relating to Pillar 3 disclosures on the composition of capital and on remuneration by authorised deposit-taking institutions (ADIs) in Australia (APS 330)*
- *The draft standard addresses deficiencies identified by the Basel Committee during the global financial crisis in publicly available information and is intended to improve the transparency of regulatory capital and to enhance market discipline*
- *APRA is proposing that the requirements commence for the first reporting period on or after 30 June 2013*
- *The proposed disclosure requirements include*

❑ *a common disclosure template (page 3)*

❑ *a full reconciliation of the elements of the ADIs regulatory capital to its published financial statements (page 4)*

❑ *a summary of the main features of regulatory capital instruments (page 5)*

❑ *and other regulatory disclosures (page 5)*

Broader APS 330 context

On the 9 April 2013 the Australian Prudential Regulation Authority (APRA) released a consultation paper and draft prudential standard relating to Pillar 3 disclosures on the composition of capital and on remuneration by authorised deposit-taking institutions (ADIs) in Australia.

APRA is seeking feedback and comments on the draft prudential standard by 16 May 2013, with a proposed effective date of 30 June 2013.[1]

The Basel Committee on Banking Supervision released the Basel III capital reforms in December 2010, one component of this release requires the disclosure of additional information on an ADIs capital adequacy and capital instruments by ADIs. The intent is to provide a greater level of transparency over the composition of an ADIs' regulatory capital. In part this is accomplished by requiring the standardised reporting of the regulatory capital instruments held so that comparison between ADIs in different jurisdictions can be made.

ADIs will be required to:

- publish a reconciliation between their regulatory capital and financial statements
- disclose full details of the terms and conditions of each regulatory capital instrument
- disclose a summary of those instruments in a standard form

Scope of APS 330 and this publication

The extended APS 330 is applicable to all locally incorporated ADIs (*other than PPF providers*). For some requirements, this extends the current scope of APS 330 to include ADIs using the 'standardised' Basel II approaches to measuring credit and operational risk.

This publication covers only the composition of capital related elements of the APS 330 draft, for remuneration disclosures we refer you to our publication "10 minutes on APRA's proposed disclosure requirements for ADIs disclosure of remuneration".[2]

(1) www.apra.gov.au/adi/PrudentialFramework/Pages/April-2013-Consultation-Basel-III-Disclosure-Requirements.aspx

(2) www.pwc.com.au/industry/banking-capital-markets/index.htm

Cross jurisdictional capital transparency

Common disclosure template

The common disclosure template is designed to capture the capital positions of ADIs and is based on the Basel III implementation monitoring template.

ADIs will need to calculate all applicable elements in the disclosure template in order to be able to calculate their Basel III definition of capital, therefore the disclosure requirements should not result in a significant burden.

The Basel Committee proposes that ADIs should publish the completed disclosure template with the same frequency as the publication of their financial statements.

For the wider Basel community there are two common disclosure templates, there is a template for the period before 1 January 2018 and one for the period post 1 January 2018. This is due to the differences in the date that jurisdictions adopt Basel III.

As APRA has implemented the Basel III approach to regulatory adjustments in full from 1 January 2013, it is proposed that ADIs complete the post 1 January 2018 common disclosure template.

Until 1 January 2018, ADIs will be required to disclose that they are using the post 1 January 2018 common disclosure template.

The common disclosure template requires the disclosure of regulatory adjustments specific to national jurisdictions for each category of capital.

APRA has proposed additional disclosures to identify the regulatory adjustments that it requires. (*See table below*)

Additional disclosures
treasury shares (*if not included in share capital calculated under Basel III*)
holdings of capital instruments in group members by other group members on behalf of third parties
offsets to dividends declared due to dividend reinvestment plans, to the extent that the dividends are used to purchase new ordinary shares issued by the ADI
deferred fee income
the capital impact of common equity, Additional Tier 1 and Tier 2 investments in financial institutions that are outside the scope of regulatory consolidation, not already reported in the template
the capital impact of deferred tax assets (net of deferred tax liabilities) not already reported in the template
capitalised expenses
investments in commercial (*non-financial*) entities deducted under APRA's capital standards
covered bonds in excess of asset cover in pools
undercapitalisation of non-consolidated subsidiaries

APRA has proposed the inclusion of an addendum in which ADIs that wish, can disclose a comparison of the APRA requirements (*after applying national discretions*) and Basel III rule (*not applying national discretions*) for capital ratios.

Reconciliation with audited statements

Full reconciliation of the elements of the ADIs regulatory capital to its published financial statements

APRA has proposed to adopt the Basel Committee's common approach for banks, to disclose 'a full reconciliation of all regulatory capital elements back to the balance sheet in the audited financial statements'

APRA see this as a 3 step process

Step 1: Disclose the reported balance sheet under the regulatory scope of consolidation	• To identify and disclose differences between the numbers used in the calculation of regulatory capital and the numbers used in the financial statement • To identify and disclose differences between the sets of legal entities included within the accounting scope and the regulatory scope of consolidation • To disclose total balance sheet assets and liabilities and the principal activities of these entities
Step 2: Expand the balance sheet to display components of the capital disclosures	• Include the components used in the disclosure requirements for the composition of capital in the balance sheet
Step 3: Reconcile components from step 2 with the common disclosure template	• Illustrate how components have been used to calculate items in the common disclosure template

Capital Adequacy is a prudential, not an IFRS concept, so it is not in accordance with accounting standards

For advanced accredited ADIs bring the capital ratios within the financial statements will require a clarification of the scope of their audits. While currently the risk weighted asset (RWA) information is subject to audit under APS 310, with the exception of advanced accredited ADIs, whose internal models are only subject to limited assurance. It is our opinion that the APRA proposal is ambiguous as to whether or how the bringing of capital ratios within the financial statement will extend the scope of advanced accredited ADIs audit reports of their financial statement.

More details for capital & other requirements

Main features template

To ensure that the main features of regulatory capital instruments are disclosed in a consistent and comparable way, the Basel Committee has introduced a 'main features template'.

APRA has proposed to adopt the 'main features template' which represents the minimum level of summary disclosure that banks are required to report in respect of each regulatory capital instrument. It is designed to be completed by ADIs from 1 January 2013.

Additionally APRA has proposed that the full terms and conditions of the ADIs regulatory capital instruments are available on the ADIs website.

APRA has proposed that whenever a new capital instruments is issued and included in regulatory capital, whenever an instrument is redeemed, converted or written off, or where these is a material change in it's nature, the full terms and conditions of the capital instruments and the main features template will need to be updated within seven calendar days of the event.

Other disclosure requirements

APRA has proposed that non-Basel III terminology to describe regulatory capital ratios be accompanied with a comprehensive explanations of how these ratios are calculated.

APRA has proposed that all locally incorporated ADIs have a formal policy relating to its prudential disclosures approved by the Board of directors that addresses the ADIs approach to determining the content of its prudential disclosures and the internal controls over the disclosure process.

APRA is updating the Market risk – disclosure for ADIs using the IMA for trading portfolios

- For internally modelled incremental risk capital charge and the comprehensive risk capital charge the disclosure of descriptions of methodology including, the approach used by the ADI to determine liquidity horizons, the methodologies used to achieve a capital assessment that is consistent with the required soundness standard and the approaches used in the validation of the models
- For trading portfolios under the IMA: the high, mean and low stressed VaR values over the reporting period and period-end, the high, mean and low incremental and comprehensive risk capital charges over the reporting period and the period-end

What companies need to do

In preparation for the proposed prudential standards, ADIs may wish to consider

- Where and when should APS330 disclosures be made? With part of the APS330 requirements involving extensions to the balance sheet and the disclosure timing coinciding with the reporting period is the proposal dividing disclosures across reports?
- Is it feasible to audit disclosures within the time frames proposed by APRA? Considering that no framework for the audit of capital ratios has been developed are audited disclosures practical for the first reporting period on or after 30 June 2013?
- Has the proposal done enough to facilitate the transparent comparison of capital ratios across different jurisdictions? APRA has proposed an addendum to address the comparison of Australian ADI's to Basel capital ratio disparity. Is this remedy sufficient to level the playing field with international peers?

How PwC can help

We can help you to prepare for and review your APS330 disclosures.

Within our Australian practice we have deep knowledge in the areas of financial risk, regulatory change and capital, we also have experience of working for financial services firms nationally and internationally, including Australia's largest ADIs.

For a deeper discussion about these issues, please contact:

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