



THE TREASURY

SUBMISSION - INQUIRY INTO BANK PRUDENTIAL SUPERVISION – APRA: ANAO AUDIT REPORT NO. 42 2000-01

General Comments

Treasury provides advice to the government on policy processes and reforms that promote a secure financial system. Treasury assists the Treasury ministers in the administration of their responsibilities and implementation of government decisions. APRA is a statutory body with responsibility for developing prudential standards under its authority and for administering the system of prudential supervision. Further information about the different roles and responsibilities of APRA and Treasury, and how the agencies complement one another, are set out in the Memorandum of Understanding between Treasury and APRA (copy attached).

As noted in the ANAO Audit Report (page 10), Treasury was included within the scope of the audit and provided advice to the ANAO during its inquiries. This involved meetings with ANAO staff and providing written comments on the draft report.

Financial Governance

As noted in the ANAO Audit Report, we consider there is little evidence of cross-subsidisation in levy payments across sectors on an ongoing basis. APRA and Treasury will continue to work together, in consultation with industry, to ensure that as far as possible, advice to government on the setting of levies is consistent with government policy of avoiding cross-subsidisation of the costs of supervision between industries.

As noted in the report, Treasury considers it reasonable to expect some minor differences between the estimated costs of supervision (on which the levies are based) and the actual costs. This is because the levies are designed not only to avoid cross-subsidisation, but also to provide some certainty to the industry and to minimise volatility.

APRA could implement a system to more accurately measure its costs of supervision, but the system is likely to be resource intensive and the benefits are not likely to be significant. Overall, we consider that APRA's estimation methodology is relatively simple, low-cost, provides stability in levy parameters, is supported by industry and is consistent with government policy. APRA and Treasury will continue to maintain close consultation with industry in the levy setting process, including periodic reviews of the arrangements as a whole, and Treasury will assist APRA where appropriate in informing industry of the relative costs of supervision.

Supervisory Framework

Treasury notes that APRA's methodology is consistent with the legislative framework, government policy and with accepted international best-practice. Nevertheless, APRA is continually reviewing its policies and practices in order to respond appropriately to the constantly changing financial sector environment, and with a view to improving its effectiveness.

Implementation of the supervisory framework is a matter for APRA, but Treasury emphasises that assessing the effectiveness of such implementation by reference to individual events needs to have careful regard to the circumstances involved in each case.

Capital Adequacy

Treasury notes that Australia's capital adequacy framework is consistent with the Basel Capital Accord.

Supervision of Cross-Border Banking

Treasury agrees that the overseas operations of Australian financial institutions are relevant to assessing their overall financial soundness. The implications of this for supervisory practices will depend on a range of factors, including the relative significance of overseas as against domestic operations, the availability of relevant information from head office or domestic sources and the nature of cooperative arrangements between the Australian regulator and its overseas counterparts. Such matters are operational issues for APRA to consider.

Department of the Treasury
4 September 2001

MEMORANDUM OF UNDERSTANDING

Between

THE TREASURY

And

THE AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY (APRA)

Objective

1. This Memorandum sets out an agreed basis for policy and operational co-ordination between Treasury and APRA. The Memorandum is non-binding and each party reserves the right to vary its terms at any time, following consultation with the other party.
2. Treasury is a department of the Commonwealth which, through its Markets Group, is charged with advising the Government on policies and a framework of legislation and industry supervision that assist in increasing the efficiency, competitiveness and stability of Australia's financial system. The Treasury is also responsible for advising Government on retirement income policies, including in relation to superannuation.
3. APRA is a statutory body established for the purpose of regulating, subject to various laws, banks and other deposit-taking institutions, life and general insurance companies and superannuation entities, and for developing policies for the performance of that regulatory role.

Responsibilities

4. The Treasury has the primary responsibility for advising the Government on financial system laws. It is the principal adviser of the Treasury Ministers and is directly accountable to the Treasurer.
5. APRA is established by statute as an independent regulatory agency and so it too has a policy role, but one primarily related to the exercise of its powers conferred under the various laws for which it has administrative responsibility. The Board of APRA has policy making responsibility for the agency (subject to override by the Treasurer only in exceptional circumstances).
6. Financial system laws specify those areas where the Treasurer has decision-making authority and other areas where authority is vested in APRA:
 - the Treasurer has general responsibility for the laws themselves, for appointments of members of the APRA Board and the Chief Executive Officer, for the approval of shareholdings in financial institutions as prescribed in legislation, and for the exercise, in special circumstances, of a right to impose policies on the Board of APRA;
 - APRA has responsibility, subject to various laws, for the development of policies for the conduct of prudential regulation (or implementation of retirement income policy), and for the administration of those policies, including through granting and revocation of licences, the making of prudential standards and the issuance and enforcement of directions.
7. The Treasury will advise the Treasurer in relation to ministerial responsibilities but, subject to any restrictions imposed by Government, will consult with APRA in the development of its advice.

The Treasury, consulting with APRA, has responsibility for the development of laws relating to APRA (as for the Reserve Bank and ASIC). This may include laws, legislative amendments and regulations proposed by APRA. Where agreed, policies, drafting instructions and other materials may be developed by joint working parties involving Treasury and APRA staff.

8. APRA has responsibility for developing prudential standards (and informal policy guidelines) under its authority. APRA will consult Treasury in the substantive development of its policies (whether through standards or guidelines). In general, this consultation may take a form and timing equivalent to any industry or public consultation, and in respect of many of these, it is expected that Treasury will often not wish to comment. However, in areas of particular significance or sensitivity, prior consultation (or, if agreed, joint policy work) will be undertaken. This will include any proposal to alter the coverage of the classes of entities regulated by APRA, major changes to the approach to prudential regulation or which significantly change retirement income policy, and any regulations substantively affecting entry to financial service markets or the class of activities permitted for regulated financial entities.

9. An early priority for Treasury and APRA is the development of a co-ordinated policy in relation to the licensing of financial institutions and the regulation of ownership and control of financial institutions. Since the administrative responsibility for these is split between the Treasurer and APRA, and the Treasurer may delegate some of his powers in relation to shareholdings to APRA, these policies should be fully harmonised as soon as possible.

10. Treasury will keep APRA informed of issues and developments emerging from the Financial Sector Advisory Council, FSAC task forces or other financial sector fora. APRA will keep Treasury informed of developments in the financial system, and in domestic or international regulatory fora, that may have policy significance for Treasury or which may result in representations to the Treasurer.

Financial Distress and Instability

11. Where appropriate, in the event of financial distress in a regulated entity or financial instability generally, APRA and other regulatory agencies have responsibilities to keep the Treasurer informed. APRA will also advise the Treasury in these circumstances and keep it informed of other important developments in this area.

Operational Functions

12. APRA is an operationally independent statutory authority but is subject to the Commonwealth Authorities and Companies Act (CAC Act) and its funding is dependent on levies determined by the Treasurer. APRA will work with Treasury to ensure that appropriate estimates are prepared for annual budget purposes of the Commonwealth.

13. Treasury and APRA will consult in the exercise of these functions. This will include consultation on:

- general policies of the Government that APRA may be required to adopt under the CAC Act;
- conflict of interest provisions involving determinations by the Treasurer under s.21 of the CAC Act;
- the development of estimates for the Budget and advice to the Treasurer on the determination of industry levies; and

- the provision by Treasury of advice to the Treasurer or other Ministers in response to representations, parliamentary questions, or other information requests relating to matters dealt with by APRA. It is expected that APRA will provide any information required by Treasury that will assist the Department in responding to such requests.

Consultation and Co-ordination Processes

14. Senior executives of APRA and Treasury will meet regularly to co-ordinate and give effect to the consultation processes agreed by the Memorandum.

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