

**SENATE STANDING COMMITTEE ON ECONOMICS QUESTION**  
**(Supplementary Budget Estimates 20 October – 21 October)**

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Question: SBT 71

Topic: Supervision of Conglomerates

Senator Bushby asked:

How do APRA's proposals for supervision of conglomerates compare with other jurisdictions?

Does consideration (and implementation) of Basel III capital adequacy requirements affect the supervision of conglomerates initiative?

Has APRA consulted with ASIC on its conglomerate capital proposals?

Is APRA aware of ASIC's proposals (ASIC Consultation Paper 140 Responsible Entities: Financial Requirements) for additional capital requirements on Responsible Entities of Managed Investment Schemes?

APRA's and ASIC's methodologies are different – why is APRA basing its methodology on a proportion of funds under management while ASIC is basing its on a proportion of total revenue?

How will APRA's conglomerate capital proposals interact with the proposals in the Cooper review relating to increased capital requirements for all APRA regulated superannuation funds?

Do these proposals mean that superannuation funds which are part of conglomerate groups will be safer than those outside a conglomerate group (because the former's parent entity will be required to hold additional capital)?

Answer:

Background

Prudential supervision can be conducted at three levels:

- Level 1 supervision refers to the supervision of every entity authorised by APRA on stand-alone basis. These entities would be a single bank, insurance company or superannuation fund.
- Level 2 group supervision offers to specialist groups operating primarily in one industry. It essentially treats the group on a consolidated basis. The group could, for example, be a group comprising a number of general insurance companies, headed by an authorised non-operating holding company.
- The Proposed Level 3 supervision framework will apply to conglomerate groups that have material operations in more than one prudentially regulated industry and/or have one or more material unregulated entities across different industries (e.g. a group with banking and insurance entities).

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APRA has been supervising stand-alone entities (Level 1) since its inception. APRA has been supervising banking and general insurance entities on a group basis (Level 2) for a number of years. APRA is currently consulting on proposals to supervise conglomerate groups (Level 3).

Level 2 group supervision of a specialist group takes account of the fact that many prudentially regulated entities that sit within a corporate group do not operate as fully stand-alone entities and need to be considered in the context of their broader group.

The proposed Level 3 conglomerate group supervision aims to ensure that a conglomerate group holds adequate capital to protect the APRA-regulated entities from potential contagion and other risks within the group. The global financial crisis has shown that the failure of one entity (regulated or not) within a conglomerate group may damage or even cause the failure of related entities.

1. How do APRA's proposals for supervision of conglomerates compare with other jurisdictions?

The Joint Forum<sup>1</sup> is the key international group in this area and it has published principles on the supervision of financial conglomerates. APRA's proposals for the supervision of conglomerate groups align with these principles.

The Joint Forum principles on financial conglomerates will be updated in response to a review that was commissioned by the G-20 Leaders in March 2009. APRA is an active participant in the Working Group reviewing the Joint Forum principles.

At this time, the only jurisdiction with published policies covering conglomerate groups is the European Union (EU). These policies are contained in the EU's *Financial Conglomerates Directive* (FCD). The FCD, which is also currently under review, provides specific legislation for the prudential supervision of financial conglomerates and financial groups involved in cross-industry activities. Many jurisdictions are currently developing conglomerate group policies that address the risks to regulated entities that arise when they are part of a broader conglomerate group.

APRA's proposals for the supervision of conglomerate groups are more comprehensive than the FCD. Regulators in Europe and elsewhere have shown interest in APRA's work on conglomerate supervision.

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<sup>1</sup> The Joint Forum (previously known as The Joint Forum on Financial Conglomerates) is an international group bringing together financial regulatory representatives from [banking](#), [insurance](#) and [securities](#). It works under the international bodies for these sectors - the [Basel Committee on Banking Supervision](#) (BCBS), the [International Organization of Securities Commissions](#) (IOSCO) and the [International Association of Insurance Supervisors](#) (IAIS). The group develops guidance, principles and identifies best practices that are of common interest to all three sectors.

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2. Does consideration (and implementation) of Basel III capital adequacy requirements affect the supervision of conglomerates initiative?

Consideration (and implementation) of the new BCBS capital proposals (Basel III) capital adequacy requirements affect the framework for the proposed Level 3 supervision of conglomerates only indirectly.

APRA's proposed Level 3 capital adequacy requirements build on the existing stand-alone and industry group capital adequacy frameworks. Therefore, changes to these underlying frameworks flow through to the proposed conglomerate Level 3 requirements. For example, any changes to the definition of capital arising from Basel III will flow through to the proposed conglomerate framework.

The Basel III proposals will be finalised before APRA finalises its Level 3 framework.

3. Has APRA consulted with ASIC on its conglomerate capital proposals?

APRA has provided briefings to ASIC on its Level 3 conglomerate proposals.

4. Is APRA aware of ASIC's proposals (ASIC Consultation Paper 140 Responsible Entities: Financial Requirements) for additional capital requirements on Responsible Entities of Managed Investment Schemes?

ASIC has provided briefings to APRA on its proposed additional capital requirements on Responsible Entities of Managed Investment Schemes (*ASIC Consultation Paper 140 Responsible Entities: Financial Requirements*).

APRA's proposed capital requirement for conglomerate groups in respect of funds management activities (excluding life companies) is the greatest of:

- 0.25 per cent of funds under management; or
- any regulatory capital requirement of the entity (which would include the ASIC requirements); or
- the internal capital allocation of the entity.

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5. APRA's and ASIC's methodologies are different – why is APRA basing its methodology on a proportion of funds under management while ASIC is basing its on a proportion of total revenue?

APRA's proposed capital requirements are assessed against the risk to the conglomerate group of its funds management activities. APRA considered a range of possible methodologies, including those based on revenue, during the development of its proposals.

APRA's proposed methodology is based broadly on the current capital requirements for funds management type activities conducted in a life insurance company, which are based on a proportion of funds under management. The life insurance regime is risk-based and funds management is a major activity for many life companies.

6. How will APRA's conglomerate capital proposals interact with the proposals in the Cooper Review relating to increased capital requirements for all APRA regulated superannuation funds?

The Cooper Review has recommended that new capital requirements for trustees, on a risk-weighted basis, be phased in over time.

The Level 3 conglomerate proposals in respect of funds management activities will take into account any new capital requirements for superannuation entities if the Government accepts the relevant recommendation of the Cooper Review.

Question 2 explains how APRA's Level 3 conglomerate proposals inter-relate with any regulatory capital requirements applying to an entity within the group.

7. Do these proposals mean that superannuation funds which are part of conglomerate groups will be safer than those outside a conglomerate group (because the former's parent entity will be required to hold additional capital)?

The safety of a superannuation entity must be assessed broadly. Capital support is only one aspect of such an assessment.

It is also important to separate a 'capital requirement' from the 'capital held' by a superannuation entity, which may be higher. Further, APRA's conglomerate proposals require capital to be held by the Level 3 group and not specifically by the superannuation fund or its trustee.