APS310: Regulators and the search for better quality & more timely data post GFC

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But before we begin. . .

- There's some important dates to mention here!
- The EFS is an overhaul to regulatory reporting that starts in about 4 months time
- Auditors are required to provide an opinion about a bank's "EFS readiness"
- APRA will respond to opinions that a bank is not EFS ready, and also track progress on fixing errors

Agenda

1. How we got here
2. APRA EFS: Modernised economic and financial statistics
3. The EFS Audit Activities
4. Standards and Guidance 702/701

The Agencies

RESERVE BANK
OF AUSTRALIA

AUSTRALIA
Australian
Bureau of
Statistics

AUSTRALIA

APRA

How we got here

A prudential response to the GFC

- The GFC that continues to impact us today.
- Response from not just APRA, but from RBA and ABS
- There was recognition that more data collection was required to provide insight into macroeconomic events.
- There's several motivations to the reform:
  - Modernization.
    - The last big change dated back 15+ years ago.
    - The changing and emerging issues led to a disconnect to the data retrieved.
    - Internationally, changes in other countries were also underway.
    - There was a growing lack of data available on interest rates.

How we got here

A prudential response to the GFC continued…

Other motivators include:

- Data quality
  - Growing rate of re-submissions
  - Feedback from the industry that the instructions are not clear
    - Instructions across forms aren't necessarily aligned
      - Different institutions can be given different instructions across time.

The APRA EFS Reform

January 2017 Consultation

On January 16, 2017, the Australian Prudential Regulatory Authority (APRA) released for public consultation its Economic and Financial Statistics (EFS) reform. This consultation package represents a major overhaul of many of the Financial and Statistical returns currently prepared by the Australian Authorised Deposit-taking Institutions (ADIs) as well as introducing a new set of returns to be submitted.

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The APRA EFS Reform

January 2017 Consultation

This major announcement represents a significant change to the current regulatory reporting framework and will have a dramatic impact on all Australian banks. The proposal included:

- A three phase approach with implementation beginning in 2018.
- Parallel reporting periods ranging from 6 to 12 months.
- New data quality guidelines.

The three phases included:

- Phase 1: Approximately 10 balance sheet related reports
- Phase 2: 9 finance related reports
- Phase 3: 3 other reports relating to derivatives, fees and margin lending

The APRA EFS Reform

August 2017 Response to Industry Submissions

Feedback from the industry through “Submissions” highlighted the challenges faced by banks due to the complicated implementation approach, challenging timelines, and confusing data quality guidelines.

APRA responded to the industry submissions in August 2017, which confirmed new “Report first submission dates”:
Phase 1: March 2019
Phase 2: July 2019
Phase 3: 3 reports on September 2019, and one report on June 2020.

These dates however came with a shortening of the parallel reporting periods which are now 3 to 6 months long, as well as a shorting of time between phases resulting in a faster transition from testing one phase to another. The delay of the phases was welcomed by the banking industry, however some of the larger banks would preferred greater “breathing space” between Phase 1 and 2 which are now only 3 to 4 months apart.

The audit requirements to the parallel runs has been heavily discussed amongst banks.

The APRA EFS Reform

Challenges faced by increased granular data

APRA's new reports presented challenges from banks not just in terms timelines but also due to the type of information.

- The balance sheet and finance reports have greater "slice and dice".
  - These are clearly visible on the forms, with columns and rows requesting further information on currency reporting, counterparty type reporting, and maturity banding.
- Additional finance related information required to allow agencies understand how policy decisions affect banks and customers.
  - Cost of funds and margin information.
    - Banks will have trouble sourcing this information on a regular basis.

The APRA EFS Reform

Challenges faced by increased granular data continued…

Alignment of requirements across all reporting collection other forms also one of APRA's goals.

- Concepts released in one set of reports should be the same in other set of reports where possible (definitions of counterparties, size, etc).
  - There has been alignments performed across 2019 within the EFS phases
  - However, this alignment is also across reports not being decommissioned by the EFS reform.
    - ARF 731 international exposures for example has provided new derivative netting approaches (specific maturity and product).
      - There have been questions as to whether alignment of such concepts should be applied across all reports.

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EFS Audit Activities

APS310 in relation to the EFS Data Collection

APS310 provides that APRA is able to seek independent advice from an ADI's auditor:
- This can be the ADI's appointed auditor, though separate auditors may be appointed.
- The ADI upon request by APRA will need to provide the appointed auditor's terms of engagement and scope of work undertaken.

APS 310 also provides that the ADI's internal auditor's scope includes a review of the policies, processes and controls put in place by management to ensure compliance with APRA's prudential requirements.
- This in particular has been under much discussion as to what APRA's expectations will be through the EFS implementation across the industry.

EFS Audit Activities

Audit requirements of the EFS data collection

So what do the agencies require?

- An audit report is expected to cover the reports for the entities end of financial year from the effective date onwards.
- An opinion as to the process and controls is also required, though for all reporting forms throughout the year, not just the most recent period.
- General and specific observations on the implementation process.
    - The challenges faced by banks should be importantly noted when providing this observation. From the inception of the EFS, the industry has constantly highlighted their concerns as to:
        1. The effective start dates
        2. The lack of time between each phase.

EFS Audit Activities

Audit requirements across key dates

This leads to questions as to which reports are within an audit report's scope across the implementation period.

- As you might recall from previous slides, the EFS has 3 different phases with different effective dates, which are accompanied by parallel reporting periods.
  - Those dates month ends Mar, July and Sept 2019 with parallel periods ranging between 3 to 6 months depending on the report's submission frequency.
    - This will mean ADIs submit both current and new EFS reports for 3 to 6 months.

EFS Audit Activities

Audit requirements across key dates continued…

Agencies recognize the dual effort to have to audit both current and new sets of reports, and determined that for ADIs only the current reports are to be included in their audit report for the duration of the parallel period. Once the parallel period ends, then the new EFS reports are in scope.

- This determination for ADIs was based on the view that:
    - There would duplicate audit efforts for current and new collections at the same time.
    - Current report's data is the most crucial as they will be relied upon for publication purposes.

EFS Audit Activities

Audit requirements across key dates continued…

RFC's however have a slightly different treatment as the EFS forms are the ones required to be included in the audit report.

- Audit reports do not to cover data in the current report collection.
- RFC's audit requirements are within RRF710 which is applicable from July 2019. To that end, while the audit standard applies later to RFC's, the audit of the newer collection is essentially aligned to ADIs.

EFS Audit Activities

Some examples

There have been examples distributed by APRA to help understand the regulator's expectations throughout the EFS implementation period.

An ADI with a financial year end at 30 June 2019

- Audit is required on the existing set of reports as presently performed.
- This falls within the parallel run period, hence no audit required on the new EFS forms
    - However, Auditor's are to provide General and Specific Observation on Implementation Progress

EFS Audit Activities

Some examples continued

An ADI with a financial year end at 30 September 2019.

- This is after the phase 1 parallel run period, hence an audit is required on the new EFS forms. The current set of forms would be decommissioned at this point and don't require further submission to APRA

At this point however, phase 2 and phase 3 reports would be within it's parallel run period -> As with the previous example, these reports would not require audit as priority is given to the current reports.

As before, Auditor's are to provide General and Specific Observation on Implementation Progress

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Standards and Guidance 702/701

Reporting Practice Guide 702

APRA introduced data quality standards with the EFS collection – namely Practice Guide 702.

The purpose of 702 is to detail control obligations of financial institutions in relation to the EFS data collection.

- The practice guide also details the application of CPG 235, a practice guide for the management of data risk.

Standards and Guidance 702/701

Reporting Practice Guide 702 continued…

The initial draft of RPG 702 created a lot of confusion with it’s lack of clarity as to it’s interaction with audit standards.

- It proposed that processes and controls be in place that provide at least a 99% confidence that the data reported is within the data accuracy requirements as prescribed by reporting standard ARS 702.
  - Some auditing firms suggested this would mean a 100% sample rate.

The updated guidance removed the proposed 99% confidence requirement and instead included CPG 235 within it’s guidance.

Standards and Guidance 702/701

Reporting Practice Guide 702 Thresholds

702 introduces the concept of thresholds/benchmarks for error notification to APRA.

- It's intention is to allow institutions to understand at what point mis-reporting affects the agency's ability to use submitted data.
- It's also provided with the intention of allowing the institution to understand whether their controls and processes are sufficiently strong (ie. If the likelihood of a breach is high or low).
- 702 is intended for the institutions, however, auditors are expected to understand 702 and consider the priorities and limits set by 702 (more on this later).

So, how does 702 work?

Standards and Guidance 702/701

Reporting Practice Guide 702 - What is it based on?

Priority, Data Item Type, and Size of Institution.

Priority indicates the level of “relative importance” to the agencies, with three types being set:

- Standard
- High
- Very High

The priority determines which benchmark is applicable.

The rows within a report that are mapped to each priority type can be found within the report instructions themselves (or via an excel spreadsheet provided by APRA)

Standards and Guidance 702/701

Reporting Practice Guide 702 - A closer look.

Table 1a is taken from the 702 guide and applies to large institutions.

A “data item” is just a number you enter into a cell on a report.

A “reporting error” is the difference between the correct data item amount and the incorrect data item amount that is outside agency expectations.

“Stock” relates to balances, “Flow” relates to movement.

Table 1a: Benchmarks for identifying *reporting errors* for a *large institution*

Data item type	Priority	As percentage of series (%)	As absolute dollar value ($ million)
Stock	Very High	0.50	2,000
	High	5.00	
	Standard	Judgement	
Flow	Very High	5.00	250
	High	10.00	
	Standard	Judgement	

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Standards and Guidance 702/701

Reporting Practice Guide 702 - A closer look continued ...

Table 1b below applies to non-large institutions.
The quality/control burden is greater for larger institutions.

Table 1a: Benchmarks for identifying *reporting errors* for a *large institution*

Data item type	Priority	As percentage of series (%)	As absolute dollar value ($ million)
ck	Very High	0.50	2,000
	High	5.00	
	Standard	Judgement	
w	Very High	5.00	250
	High	10.00	
	Standard	Judgement	

Table 1b: Benchmarks for identifying reporting errors for a reporting entity that is not a *large institution*

Data item type	Priority	As percentage of institutional series (%)	As absolute dollar value ($ million)
Stock	Very High	2.00	500
	High	10.00	
	Standard	Judgement	
Flow	Very High	10.00	100
	High	20.00	
	Standard	Judgement	

An ADI or RFC with greater than or equal to $200 billion in total assets measured on a domestic books basis.

Standards and Guidance 702/701

Reporting Practice Guide 702 - A closer look continued ...

A breach of the benchmarks occurs if a misreported data item expressed as a dollar value, count or proportion that exceeds the benchmarks in Tables 1a or 1b constitutes a reporting error.

"Very high" data items have lower benchmarks, meaning that the room for error is less.

Table 1a: Benchmarks for identifying *reporting errors* for a *large institution*

Data item type	Priority	As percentage of series (%)	As absolute dollar value ($ million)
Stock	Very High	0.50	2,000
	High	5.00	
	Standard	Judgement	
Flow	Very High	5.00	250
	High	10.00	
	Standard	Judgement	

Standards and Guidance 702/701

Reporting Practice Guide 702 - Let's go through some examples.

Table 1b: Benchmarks for identifying reporting errors for a reporting entity that is not a *large institution*

Data item type	Priority	As percentage of institutional series (%)	As absolute dollar value ($ million)
Stock	Very High	2.00	500
	High	10.00	
	Standard	Judgement	
Flow	Very High	10.00	100
	High	20.00	
	Standard	Judgement	

Example 1

A Non-large institution, applies benchmarks from Table 1b. Institution is analyzing high priority stock data items.

The difference between the reported amount and correct amount is $50 million and representing 8 per cent of the value of that *data item*.

$50m < $500m

8% < 10%

Does not breach the benchmarks Ie. No *"reporting error" as the "difference"* is within the agency expectations

Standards and Guidance 702/701

Reporting Practice Guide 702 - Let's go through some examples continued…

Table 1b: Benchmarks for identifying reporting errors for a reporting entity that is not a *large institution*

Data item type	Priority	As percentage of institutional series (%)	As absolute dollar value ($ million)
Stock	Very High	2.00	500
	High	10.00	
	Standard	Judgement	
Flow	Very High	10.00	100
	High	20.00	
	Standard	Judgement	

Example 2 – same as 1 though the amount being analyzed is $50m and representing 12% of the data item.

$50m < $500m
12% > 10%
Breach of the benchmarks Ie. "*reporting error"* is outside the agency expectations.

The institution must report this to APRA.

Standards and Guidance 702/701

Reporting Practice Guide 702 - Let's go through some examples continued…

Table 2a: Benchmarks for identifying *reporting errors* for a *large institution*

Priority	In basis points
Very high	5
Standard	15

Certain data items are expressed as interest rates.
As with 1a and 1b, 2a applies for larger institutions and 2b for non-large, with the heavier reporting burden on the larger institutions.

Table 2b: Benchmarks for identifying *reporting errors* for a reporting entity that is not a *large institution*

Priority	In basis points
Very high	10
Standard	20

Standards and Guidance 702/701

Reporting Practice Guide 702 - Let's go through some examples continued…

Table 2b: Benchmarks for identifying *reporting errors* for a reporting entity that is not a *large institution*

Priority	In basis points
Very high	10
Standard	20

Example 3

A non-large institution, with a standard priority data item relating to interest rate reporting. Reporting error investigated is 25 basis points.
(One basis point is 0.01%, or 0.0001.)

The acceptable error is 20bp. As 25 bp is above the acceptable level, there is a "reporting error" as the "difference" is outside the agency expectations.

This would require notification to APRA.

Standards and Guidance 702/701

Can Auditors Apply Reporting Practice Guide 702?

Reporting Practice Guide 702 outlines the thresholds which if are breached required the ADI to inform APRA of the details.

- APRA expects auditors to take into account of the guidance within RPG 702
- While RPG 702 provides actual numerical thresholds, auditors are not required to follow the prescribed thresholds.
- APRA acknowledges that auditors may refer to the guidance though their own judgement is expected to be used.

Standards and Guidance 702/701

Reporting Standard 701

ARS 701 outlines the definitions for the EFS collections (such as counterparty definitions, resident definitions etc).

- This is was an improvement over previous data collections which lacked detail at varying levels.
- Institutions at times would use a proxy where their data they source is unable to exactly meet the definition as outlined in 701.
- Auditors are expected to provide opinion in cases whereby proxies are used for any particular definition.

EFS Audit Activities

And Lastly . . . APRA's expectation on readiness

It is expected that auditors provide APRA with an opinion as to "EFS readiness".

APRA will respond to opinions that a bank is not EFS ready, and also track progress on fixing errors!