



The Australian Approach to Conglomerate Supervision

The Level 3 framework

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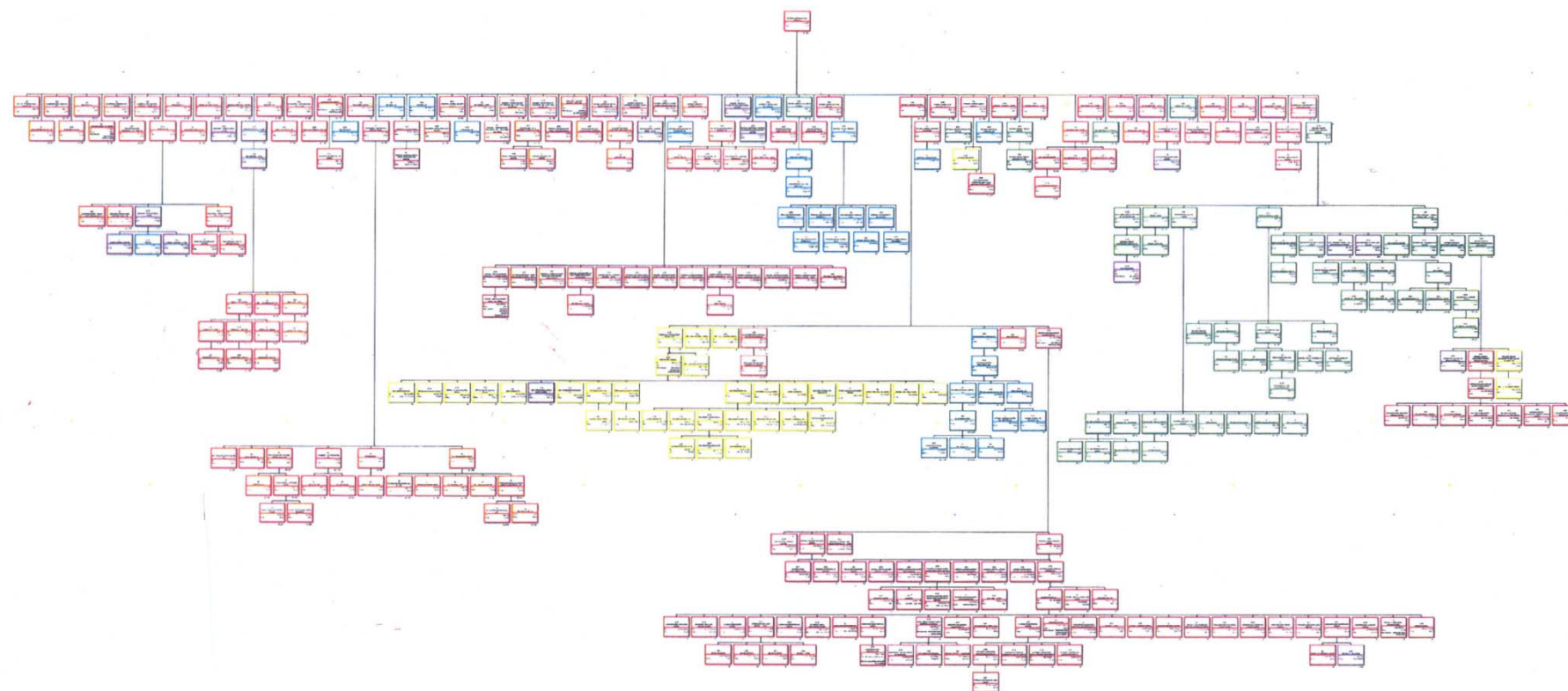
Brussels

Our founder...





Group Structure



January 2010

Why worry about conglomerates?



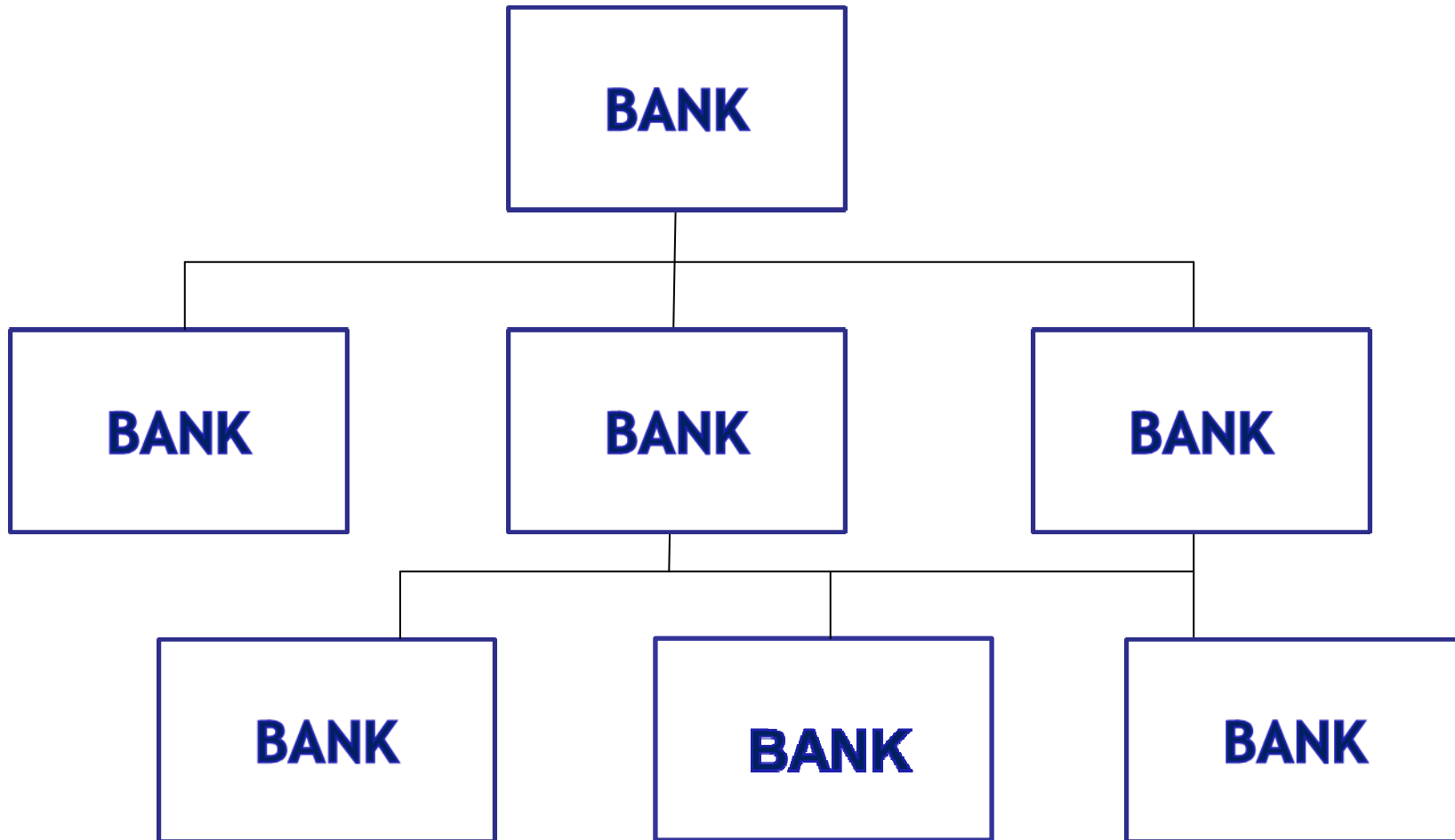
- Financial conglomerates dominate the Australian financial system
- Can fail for obscure reasons
- Management concentration
- Conglomerates are complicated

We know how to supervise this...

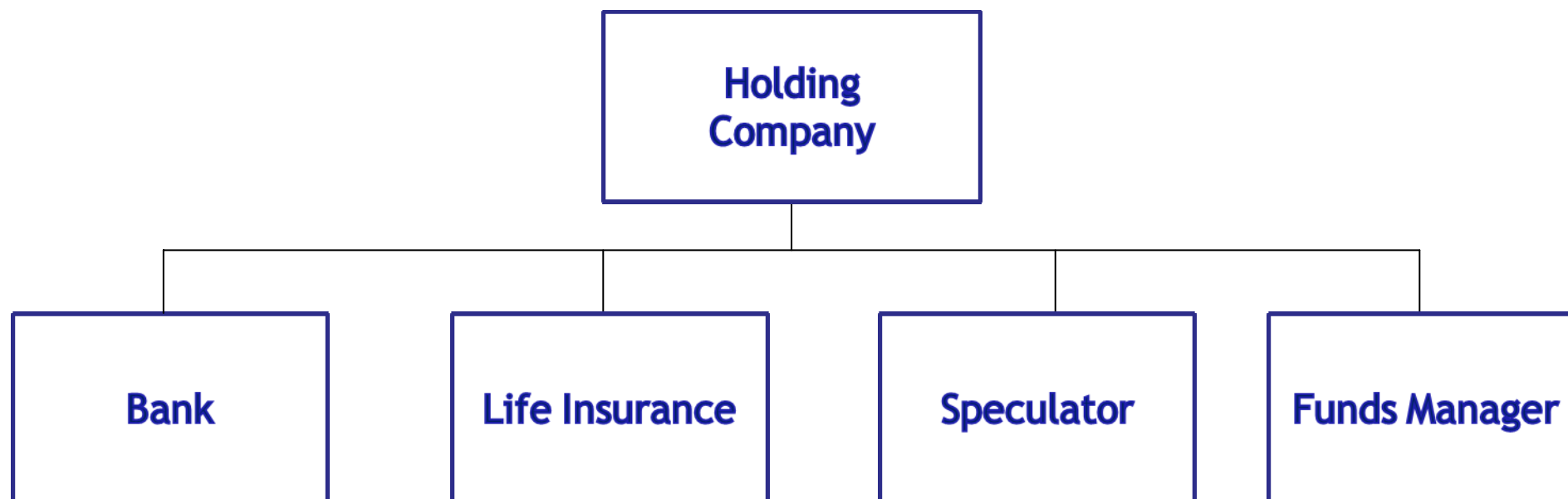


BANK

...And we can supervise these



But what about this?



APRA's conglomerate supervision aspirations



- **Any industry combination**
 - including unregulated
- **(Almost) any structural arrangement**
- **Focus upon large, Australian owned conglomerates**
 - but works for other groups

Some necessary vocabulary



- Level 1/L1 ⇒ stand alone entity
- Level 2/L2 ⇒ single industry conglomerates
- Level 3/L3 ⇒ multi industry conglomerates
- Regulation ⇒ standards and guidance
- Supervision ⇒ constraining entity behaviour

Three themes, three tactics



- Healthy information environment
- Healthy risk management environment
- Backstop capital regime

1. Empower the Board
2. Pragmatic simplicity
3. Flexible, proactive supervision



- **No “Dark Corners”**
 - for Board or Regulator
- **All material businesses covered**
 - regulated and unregulated
- **All material intra-group arrangements covered**



- **Current L1, L2 risk frameworks satisfactory**
- **Install same framework at L3**
- **Balanced approach**
 - Boards
 - Management
 - Auditors, Actuaries
 - Supervisor
- **Includes unregulated entities, where material**
- **Focus upon aggregate group risk**

Backstop capital regime



- **Aspiration: group possesses sufficient equity**
- **Does not relieve L1, L2 requirements**

Only binds when

- **Group has large, undercapitalised, unregulated entities**
- **Material, artificial, intra-group dealings**

- **Australian Boards generally useful**
- **APRA strategy: make ally of the Board**
- **Board signs off at L3 on**
 - group capital management plan
 - group risk management plan
 - management incentives and pay
- **Supervisory communication is critical**



- Identifying L3 groups: APRA decision
- Capital regime: equity focus
- L3 vs. L2, L1 equity requirements
- Cutting through diversification

Capital: more or less than sum of parts?



Less: diversification across industries

Less: spread cost of risk management

More: concentrated management risk

More: contagion, intra-group artificiality

More: complexity

- **Net effect APRA assumption: a balance**
 - use sum of parts without adjustment

Flexible, proactive supervision



- Same as L1, L2
- Aspiration: healthy, transparent practice
- Above all: constant, mild intervention
- Compliance necessary but not sufficient
- Pillar 2 approach
- Conflict of opinion
- At L3: group focus
- Not seeking to supervise unregulated subsidiaries



- **Common owner for L3 group**
 - may or may not be holding company
 - may or may not be ultimate parent
- **Equity requirement: building block approach**
 - removing intra-group artificiality
 - prudential filters (intangibles, etc) applied across group
- **Unregulated entities**
 - focus upon economic reality

Required L3 equity: bank



- **\$100 net Tier 1, 10% Tier 1 ratio**
- **Regulatory minimum @ L1: 6%**
- **Group target: 8% (and APRA agrees)**
 - required L3 equity: \$8
 - actual L3 equity: \$10

Required L3 equity: gravel quarry



- **\$100 in assets, \$30 in equity, \$20 intangibles**
- **Group policy: unregulated entities must have >20% equity/assets**
- **APRA analysis**
 - ⇒ **publicly listed proxies have ~\$ >70% tangible equity/assets**
 - ⇒ **required equity = \$70**
 - ⇒ **actual equity = \$30 - \$20 = \$10**
 - ⇒ **group equity shortfall = \$60**



- **APRA L3 proposals out for consultation**
- **Prudential standards determined in 2011**
- **New regime commences 2012**
 - transition as necessary

- **Complex rules are not the right response to complex structures**
- **Can firewall insurance companies - banks much harder**
- **Must be able to regulate holding companies**
- **Boards should be empowered**
- **Healthy information and risk management at least as important as capital**
- **Proactive supervision is critical**



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