
IMPLEMENTATION OF THE BASLE CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

The Basle Committee on Banking Supervision released its *Core Principles for Effective Banking Supervision* in September 1997. These 25 principles have widespread acceptance as a basic reference tool for supervisory and other public authorities. The principles were designed to assist countries in developing adequate and robust prudential supervision of their financial sector and to strengthen existing arrangements.

The bulk of this material was taken from the Australian response to a Bank for International Settlements (BIS) survey, which was provided to the BIS in July 1998. The BIS released the broad outcomes of the survey at the October 1998 International Conference of Banking Supervisors in Sydney, although it did not reveal individual country details. Since an article on Australia's compliance with the Core Principles had already been published in the Reserve Bank of Australia (RBA) *Bulletin* in December 1997, we have had no reason to withhold our response. Similarly, the Australian Prudential Regulation Authority (APRA) has also supplied copies of our response to the Executives Meeting of East Asia-Pacific Central Banks (EMEAP) and the Asia Pacific Economic Cooperation (APEC) secretariats.

Principle 1 (1): An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks.

Implemented

The *Australian Prudential Regulation Authority Act 1998* (APRA Act) specifies that APRA's purpose is the prudential supervision of regulated entities, which includes banks and, later this year, building societies and credit unions. The *Banking Act 1959* (Banking Act) also states that APRA's functions include ensuring that banks carry out sound practices in relation to prudential matters and that APRA should exercise its powers and functions for the protection of the depositors of banks.

APRA's depositor protection responsibility does not confer any guarantee on bank deposits. In the event that a bank becomes unable to meet its obligations or suspending payment, the assets of the bank in Australia are to be available to meet that bank's deposit liabilities in Australia in *priority* to all other liabilities of the bank.

Principle 1 (2): Each such agency should possess operational independence and adequate resources.

Implemented

The APRA Act provides APRA with considerable operational autonomy, including an independent Board and the “power to do anything that is necessary or convenient to be done for or in connection with the performance of its functions”.

APRA is responsible for its own budget, which is funded by levies from the industry.

Principle 1 (3): A suitable legal framework for banking supervision is also necessary, including provisions relating to authorisation of banking establishments and their ongoing supervision.

Implemented

The APRA Act and Banking Act provide APRA with considerable powers in respect of the licensing and ongoing supervision of banks. A locally incorporated entity or a foreign bank wishing to operate as a bank in Australia must obtain an authority issued under the Banking Act. To be successful, an applicant for an authority must be able to meet minimum criteria established by APRA. These include criteria with regard to capital, ownership, board composition, management control, information systems and external audit arrangements. Banking authorities are granted on condition that the banks consult with APRA regarding prudential supervisory arrangements and conform with any prudential arrangements laid down by APRA. APRA may determine standards and regulations in relation to prudential matters to be complied with by banks and has powers to issue directions to a bank if it considers that the bank has contravened these standards/regulations or that the direction would be in the interests of depositors. APRA may appoint a statutory manager to take control of the bank's business if it is considered that the bank will become unable to meet its obligations.

Principle 1 (4): A suitable legal framework for banking supervision is also necessary, including powers to address compliance with laws as well as safety and soundness concerns.

Implemented

APRA has a wide range of powers in relation to carrying out its depositor protection and prudential supervision responsibilities. APRA may require a bank to supply information in relation to its activities and, if a bank fails to comply with this requirement, APRA may appoint a person to investigate the affairs of the bank. Where a bank becomes unable to meet its obligations or is about to suspend payment, APRA may assume control of and carry on the business of that bank or appoint a statutory manager to take control of the business of the bank and, if required, to wind up the bank's operations.

The Banking Act includes a range of provisions that may be applied to banks failing to meet prudential standards and regulations. These include monetary penalties; imprisonment; the removal of auditors, directors or management of a bank; powers to direct that certain activities are to cease; and any other directions that are considered to be necessary to ensure compliance with standards/regulations and safety of depositors. At the extreme, APRA may revoke the authority to carry on banking business.

Principle 1 (5): A suitable legal framework for banking supervision is also necessary, including legal protection for supervisors.

Implemented

The APRA Act provides that the Board of APRA, staff members or their agents, are not subject to any liability in respect of anything done in good faith in the performance of their duties. The Banking Act has a similar provision for any person acting in good faith in the discharge of obligations imposed by the Act.

Principle 1 (6): Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.

Implemented

The APRA Act includes comprehensive provisions to facilitate the sharing of information about financial institutions with other

supervisory bodies. Protected information subject to secrecy provisions may be disclosed to another financial sector supervisory agencies to assist the latter to perform its functions. Information so disclosed must be kept confidential by the recipient agency.

Memoranda of Understanding covering exchange of information are in place (or arrangements in train) with other domestic regulators and some offshore supervisors.

Principle 2 (1): The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined.

Implemented

Only corporates in possession of an authority under the Banking Act can carry on banking business in Australia. The Banking Act has a broad definition of the activities considered to be banking business, including taking money on deposit and making advances. The Act also provides for banking business to be defined in regulations if this were considered necessary so as to cover types of business not easily captured in a general definition.

Principle 2 (2): The use of the word ‘bank’ in names should be controlled as far as possible.

Implemented

The Banking Act prohibits unauthorised institutions from using bank-related words (including foreign language equivalents) in relation to a financial business. There are penalties for breaches.

Principle 3 (1): The licensing authority must have the rights to set criteria and reject applications for establishments that do not meet the standards set.

Implemented

APRA has detailed Prudential Statements setting out minimum criteria for the issue of authorities for both locally incorporated banks and foreign bank branches. APRA has the power to reject unacceptable applications.

Principle 3 (2): The licensing process, at a minimum, should consist of an assessment of the banking organisation's ownership structure, directors and senior management, its operating plan and internal controls, and its projected financial condition, including its capital base.

Partially implemented

The application for an authority to carry on banking business must provide detailed information on the applicant's ownership, board and management; structure of business; management systems and procedures used to control and monitor risks; information and accounting systems; balance sheet and earnings projections out to three years; and capital ratio projections.

In deciding whether to grant an authority to carry on banking business, APRA will consider the quality of directors and senior management. In addition, a bank is required to notify APRA in advance of proposed changes in directors and provide details of the background, qualifications and associations of proposed new directors. Each bank provides APRA with a current list of directors' relevant associations on an annual basis. A prudential statement sets out guidelines for independence and prevention of conflict of interest.

APRA regards the above arrangements as satisfactory, but does not have a formal 'fit and proper' test for the appointment of directors and senior management of banks. While the legislation does not preclude the application of a fit and proper test, APRA has not sought to do this in respect of banks to date. This reflects the fact that all but one of Australia's fourteen local banks are large public companies listed on the Stock Exchange and subject to the scrutiny which comes from a broad range of shareholders (as required by the banking ownership rules; see Principle 4).

Principle 3 (3): Where the proposed owner or parent organisation is a foreign bank, the prior consent of its home country supervisor should be obtained.

Implemented

Each foreign bank applying for an authority to carry on banking business in Australia must provide in its application a statement from the home supervisor confirming the foreign bank's financial standing, and giving consent for the foreign bank to operate in Australia.

Principle 4: Banking supervisors must have the authority to review and reject any proposals to transfer significant ownership or controlling interests in existing banks to other parties.

Implemented

The *Financial Sector (Shareholdings) Act 1998* provides that the shareholding of any one entity (and associated entities) in an Australian bank may not exceed 15 per cent of the aggregate of the bank's voting shares. The Federal Treasurer may approve a higher percentage limit on national interest grounds (such exemptions have been granted in the case of foreign bank-owned subsidiaries). In addition, a person whose stake in a bank does not exceed 15 per cent may be declared by the Treasurer to have 'practical control' of the bank, in which case the person is required to take steps to relinquish practical control.

In the event of an unacceptable shareholding situation, the Federal Court may order the disposal of shares or restrain the exercise of rights attached to the shares.

An authority granted to a foreign bank may be revoked in the event of any sale or disposal of its business by amalgamation; or the carrying on of business in partnership with another bank; or a reconstruction of the bank, unless approved by the Treasurer.

Principle 5 (1): Banking supervisors must have the authority to establish criteria for reviewing major acquisitions or investments by a bank.

Implemented

A prudential statement provides guidance to banks in respect of their equity associations. Banks' equity associations with other institutions should normally be in the field of finance. Such associations, whether direct or indirect, which would involve more than 10 per cent or more interest in an entity are required to be referred to APRA prior to the bank becoming committed in the investment.

Prior reference to APRA is required when a bank's aggregate investment in non-financial businesses would exceed 5 per cent of its Tier 1 capital. Individual investments are generally subject to a limit of 0.25 per cent of Tier 1 capital.

Banks must consult with APRA prior to entering into any firm commitment to merge or restructure. Any significant change in

ownership would trigger *the Financial Sector (Shareholdings) Act 1998* and require approval by the Federal Treasurer (see Principle 4).

Banks are required to obtain APRA's prior approval before setting up or acquiring banking operations in other countries.

Principle 5 (2): Banking supervisors must have the authority to establish criteria for ensuring that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.

Implemented

Banks are not permitted to provide general guarantees to cover the liabilities of subsidiaries and associates. Any support provided must be limited as to time and amount. Subsidiaries and associates are to be managed so as to be viable within their own resources and a bank should scrutinise its financial dealing with an associate as closely as it would dealings with unrelated customers (i.e. on an 'arms-length' basis). There are also restrictions on the size of a bank's non-bank associates relative to the size of the bank.

The new legislation, effective 1 July 1998, provides for bank holding companies which must be authorised. Policies regarding permissible exposures between a bank which is owned by a holding company and sister companies in the structure, will be elaborated by APRA in coming months.

APRA has guidelines covering banks' involvement in funds management and securitisation. These require clear separation of these activities from the banking group as well as prominent disclosure of the bank's role.

Principle 6 (1): Banking supervisors must set minimum capital requirements for banks that reflect the risks that the banks undertake, and must define the components of capital, bearing in mind its ability to absorb losses.

Implemented

APRA attaches great importance to ensuring that the capital resources of individual banks are adequate for the size, quality and type of their business. Each Australian bank is expected to maintain a minimum ratio of total capital to risk-weighted assets, on both a consolidated group and stand-alone basis, of 8 per cent (of which at least 4 per cent

should be Tier 1 capital). APRA may require a higher minimum ratio for new banks or where a bank is judged to have significant risk exposures.

Principle 6 (2): For internationally active banks, these requirements must not be less than those established in the Basle Capital Accord.

Implemented

APRA uses a risk based approach to the measurement of banks' capital adequacy. The definitions of risk weights and components of capital are detailed in a prudential statement and are consistent in all substantial respects with the Basle Capital Accord. APRA has also adopted Basle's Amendment to the Capital Accord to Incorporate Market Risks.

Principle 7 (1): An essential part of any supervisory system is the independent evaluation of a bank's policies, practices and procedures related to the granting of loans and making of investments.

Implemented

APRA conducts regular on-site reviews of authorised banks' credit management systems. The aim of the review is to assess whether banks' systems and controls for the management of risks are prudent, operating effectively, and consistent with good banking industry practice. Each applicant for an authority must provide details of its credit policies in its application. Prior to authorisation, an on-site team visits any existing Australian presence of the applicant to assess whether its systems and controls for the management of credit risks are adequate for the applicant's proposed business activities.

Principle 7 (2): An essential part of any supervisory system is the independent evaluation of a bank's policies, practices and procedures related to the ongoing management of the loan and investment portfolios.

Implemented

Banks are required to provide APRA with up-to-date versions of their credit systems descriptions and compliance is monitored through the regular on-site visits and off-site surveillance using information

provided from regular prudential returns from banks. External auditors are required to verify the banks' compliance with prudential requirements, integrity of the information provided to APRA, and compliance with any conditions on authorities to carry on banking business.

Principle 8 (1): Banking supervisors must be satisfied that banks establish and adhere to adequate policies, practices and procedures for evaluating the quality of assets.

Implemented

In addition to the arrangements outlined in respect of Principle 7, APRA has in place a Prudential Statement covering a number of aspects of banks' asset quality. Banks must have policies and procedures to ensure that they maintain sound asset quality, strong portfolio management, prudent risk controls, effective credit review and classification procedures, and an appropriate methodology for dealing with problem exposures. The Statement also recommends that banks implement risk grading systems which allow them to effectively monitor trends in asset quality. The policies and procedures are reviewed regularly through on-site reviews.

Principle 8 (2): Banking supervisors must be satisfied that banks establish and adhere to adequate policies, practices and procedures for the adequacy of loan loss provisions and reserves.

Implemented

APRA has a Prudential Statement which sets out a methodology for the identification and measurement of banks' impaired assets and establishes minimum standards for valuing security and broad principles for provisioning. Banks are required to submit quarterly returns of impaired assets, with details of security values and provisioning.

A bank whose provisioning appeared inadequate would be asked to explain its approach. Independent opinions may be sought from a bank's external auditor where this is considered appropriate. If considered necessary, a bank may be required to maintain a minimum capital ratio in excess of 8 percent.

Principle 9 (1): Banking supervisors must be satisfied that banks have management information systems that enable management to identify concentrations within the portfolio.

Implemented

Each bank must provide APRA with a statement of its policy in respect of large exposures to individual clients or groups of related clients. Banks are required to keep large exposures under review and to place a limit on their size relative to the capital base of the consolidated group.

Principle 9 (2): Supervisors must set prudential limits to restrict bank exposures to single borrowers or groups of related borrowers.

Implemented

APRA has a Prudential Statement regarding the supervision of banks' large credit exposures. Under this Statement banks must report quarterly all exposures (on- and off-balance sheet) of the consolidated group to individual clients, or groups of related clients, above 10 per cent of the group's capital base. Banks are required to receive approval from APRA before entering into any exposure to an individual client or group of related clients in excess of 30 per cent of the group's capital base.

Principle 10 (1): In order to prevent abuses arising from connected lending, banking supervisors must have in place requirements that banks lend to related companies and individuals on an arm's-length basis.

Implemented

Banks are required to provide APRA with details of their lending policy to shareholders, directors and associated interests. Definitions of related exposures are required to be clearly specified, as well as guidelines for determining when and how parties should be aggregated when determining risk. These details form part of the bank's credit systems descriptions as detailed in the response to Principle 7 (2).

Principle 10 (2): In order to prevent abuses arising from connected lending, banking supervisors must have in place requirements that such extensions of credit are effectively monitored.

Implemented

Lending policies to related parties are reviewed at the on-site visits, off-site surveillance and through the role of external auditors.

Principle 10 (3): In order to prevent abuses arising from connected lending, banking supervisors must have in place requirements that other appropriate steps are taken to control or mitigate the risks.

Implemented

A bank must separately report its exposures to subsidiaries and associates. The prior approval requirement in respect of large exposures noted in 9 (2) above applies to subsidiaries and associates measured against the bank's stand alone capital base.

Principle 11 (1): Banking supervisors must be satisfied that banks have adequate policies and procedures for identifying, monitoring and controlling country risk and transfer risk in their international lending and investment activities.

Implemented

Banks are required to establish limits on exposures to each country. Each bank must submit a quarterly country exposures return detailing its exposures by country.

Principle 11 (2): Banking supervisors must be satisfied that banks have adequate policies and procedures for maintaining adequate reserves against such risks.

Implemented

Provisions for country exposures are captured by APRA's policies in respect of credit risk as outlined in the response to Principle 8. Banks' provisioning levels are monitored by APRA against international practice.

Principle 12 (1): Banking supervisors must be satisfied that banks have in place systems that accurately measure, monitor and adequately control market risks.

Implemented

Banks must provide APRA with details of the management systems and procedures in place to control market risks. An on-site market risk team reviews banks' systems and controls to ensure that they are appropriate for the type of activities undertaken. Banks must keep APRA informed of any changes to their systems.

Principle 12 (2): Supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposures, if warranted.

Implemented

APRA has a Prudential Statement setting out a framework for determining the level of capital to be held by a bank against its market risk. The approach is broadly consistent with that recommended by the Basle Committee on Banking Supervision.

Banks are permitted to adopt either a standard model or use their own internal model to measure market risk for capital adequacy purposes. The use of an internal model requires the explicit approval of APRA. Model validation visits are undertaken by the market risk team prior to granting approval to ensure that the internal models meet certain qualitative and quantitative standards.

Principle 13: Banking supervisors must be satisfied that banks have in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure, monitor and control all other material risks and, where appropriate, to hold capital against these risks.

Implemented

One of the requirements for an authority to carry on banking business is that the institution maintains appropriate management systems and procedures to monitor and limit risks. At the minimum, they must cover credit risks, market risks, liquidity risks and operational risks, including responsibilities for the identification, measurement, monitoring and control of the respective risks. Banks have an undertaking to provide APRA with updates of its management systems

descriptions, which are also covered by an annual attestation by banks' chief executives that “the board and management have identified the key risks facing the bank, have established systems to monitor and manage those risks including where appropriate, by setting and requiring adherence to a series of prudent limits, and by adequate and timely reporting processes; that these systems are operating effectively and are adequate having regard to the risks they are designed to control; and that the descriptions of systems held by APRA are accurate and current”.

Principle 14 (1): Banking supervisors must determine that banks have in place internal controls that are adequate for the nature and scale of their business.

Implemented

As part of the authorisation process, potential applicants must provide details of management systems and procedures used to control and monitor risks. APRA monitors these systems on an ongoing basis through its on-site visits and off-site surveillance of banks.

Principle 14 (2): These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding its assets; and appropriate independent internal or external audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.

Implemented

Banks must satisfy APRA as to the soundness of their operational arrangements. This entails provision of a description of the bank's organisational framework, including names and descriptions of the responsibilities of senior management, details of information and accounting systems and ‘back-up’ facilities. Compliance with these systems is assessed during on-site visits and by external auditors. Banks are also required to have appropriate internal audit arrangements. APRA may access the work of internal auditors, and hold discussions with them during on-site visits.

Principle 15: Banking supervisors must determine that banks have adequate policies, practices and procedures in place, including strict ‘know-your-customer’ rules, that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.

Implemented

Australia fully meets the objectives of the Financial Action Task Force recommendations. The Australian Transaction Reports and Analysis Centre (AUSTRAC) has prime responsibility for intelligence gathering to detect possible money laundering activities. AUSTRAC monitors compliance with the anti-money laundering requirements by financial institutions. Legislation requires banks to have in place processes to identify customers as well as reporting to AUSTRAC cash transactions above A\$10 000, all international telegraphic or wire transfers and any suspicious transactions. APRA has arrangements in place to share information with agencies responsible for prosecuting criminal activities.

Principle 16: An effective banking supervisory system should consist of some form of both on-site and off-site supervision.

Implemented

APRA's prudential supervision of banks involves both on-site and off-site supervision.

The financial conditions of banks are monitored through on-going analysis of data collected from banks and other sources. Banks are required to provide regular prudential returns on a number of areas of their operation, including on- and off-balance sheet information, large exposures, country exposures, impaired assets and liquidity mismatches. APRA also monitors banks' annual reports and other published information on banks. Analysis is done on an institutional, peer group as well as system basis.

APRA has asset quality and market risk review teams which visit all authorised banks on a regular basis; at least every two years but more frequently if this is considered necessary. These on-site visits assess whether banks' systems and controls for the management of risks are prudent given the nature and scope of the bank's operations.

Principle 17: Banking supervisors must have regular contact with bank management and thorough understanding of the institution's operations.

Implemented

APRA has a formal meeting with senior management of every authorised bank on an annual basis (or more frequently if considered necessary) to discuss the bank's operations. In addition to specific concerns arising from on-site reviews and other sources, the agenda of these 'consultations' covers banks' strategies, performance, asset quality, and risk management issues. APRA will also meet with banks at any time to discuss/clarify significant developments and matters of prudential concern. APRA staff have an on-going dialogue with banks.

Principle 18 (1): Banking supervisors must have a means of collecting, reviewing and analysing prudential reports and statistical returns from banks on a solo and consolidated basis.

Implemented

APRA has power under the Banking Act to collect information from a bank relating to its banking business, and to specify the form and manner in which accounts and financial statements are to be submitted. APRA requires banks to provide a range of information on both a bank-only and consolidated group basis.

Principle 18 (2): Banking supervisors must have a means of collecting, reviewing and analysing prudential reports and statistical returns from banks on a consolidated basis.

Implemented

Prudential returns related to capital adequacy, large exposures, off-balance sheet business, impaired assets, foreign currency operations and maturity profiles cover banks' global operations, consolidated in accordance with Australian accounting standards. APRA's power to collect and publish information extends to authorised non-operating holding companies of banks and subsidiaries of the non-operating holding companies and banks.

Principle 19: Banking supervisors must have a means of independent validation of supervisory information either through on-site examinations or use of external auditors.

Implemented

APRA has in place arrangements with each bank's external auditor to provide independent confirmation of the reliability of data submitted to APRA and assurance that the bank is complying with prudential requirements. External auditors may also be requested to report on aspects of a bank's system descriptions under 'tripartite' arrangements between APRA, the bank and the bank's external auditors. The Banking Act requires external auditors to provide information about banks to APRA if APRA considers that the provision of information will assist it in performing its functions. Auditors also have a duty to inform APRA if there are reasonable grounds to believe that a bank is insolvent, or will become insolvent, or has failed to comply with any prudential standards or regulations.

Principle 20: An essential element of banking supervision is the ability of the supervisors to supervise the banking organisation on a consolidated basis.

Implemented

APRA undertakes globally consolidated supervision of locally incorporated banks, which includes all subsidiaries in Australia and offshore. Prudential guidelines are applicable to the global operations of a bank and its subsidiaries, consolidated in accordance with Australian accounting standards. Banks' management systems for controlling and limiting risks must cover both domestic and offshore operations.

Principle 21 (1): Banking supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with consistent accounting policies and practices that enable the supervisor to obtain a true and fair view of the financial condition of the bank and the profitability of its business.

Implemented

The Corporations Law requires Australian incorporated entities to maintain proper accounting records from which true and fair accounts of the entities can be prepared from time to time, and which can be

properly audited in accordance with the Law. In recognition of the importance of financial institutions, the Australian Accounting Standards Board issued a standard on disclosures in the financial report of a financial institution, to ensure that it provides relevant and reliable information about the financial institutions' activities. Arrangements are in place with the external auditor of each authorised bank to report to APRA annually the reliability of information supplied.

Principle 21 (2): Banking supervisors must be satisfied that the bank publishes on a regular basis financial statements that fairly reflect its condition.

Implemented

Refer response to 21 (1).

Principle 22: Banking supervisors must have at their disposal adequate supervisory measures to bring about corrective action when banks fail to meet prudential requirements (such as minimum capital adequacy ratios), when there are regulatory violations, or where depositors are threatened in any other way. In extreme circumstances, this should include the ability to revoke the banking licence or recommend its revocation.

Implemented

The Banking Act provides APRA with a range of powers to bring about corrective action. Where a bank fails to meet a prudential regulation or standard, a condition attached to its authority, or where it is felt necessary in the interests of depositors, APRA can issue directions to a bank. The types of direction that may be issued are wide-ranging and include directions as to the way in which the affairs of the bank are to be conducted or not conducted, removal of directors or management, and suspension of dividend payments. Non-compliance with these directions would invoke civil and criminal penalties.

APRA may appoint a statutory manager to investigate the affairs of a bank, take control of the bank's business or appoint an administrator to take control of the bank's business if the bank is unable or likely to become unable to meet its obligations. The statutory manager has the powers and functions of the members of the board of directors of the bank.

APRA may revoke a bank's authority to carry on banking business if it is satisfied that the bank has failed to comply with prudential requirements or regulations, or that it would be contrary to the interests of depositors of the bank for the authority to remain in force, or that the bank is insolvent and is unlikely to return to solvency within a reasonable period of time. An authority to carry on banking business granted to a foreign bank can be revoked if it is contrary to the national interest for the bank to continue carrying on banking business in Australia.

Principle 23: Banking supervisors must practise global consolidated supervision, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by banking organisations worldwide, primarily at their foreign branches and subsidiaries.

Implemented

APRA practices globally consolidated supervision of locally incorporated banks, embracing all their subsidiaries and overseas branches. Prudential guidelines are applicable to the global operations of a bank and its subsidiaries, consolidated in accordance with Australian accounting standards. Banks' management systems for controlling and limiting risks must cover both domestic and offshore operations. Information is collected from banks on a global consolidated basis, and subject to verification by banks' external auditors.

A bank wishing to expand abroad is expected to provide a range of information in support of its proposal, including an outline of the nature and scale of the intended operation and an indication of the impact of the investment on the bank's capital position and management resources.

APRA may conduct on-site reviews of some of the more significant overseas operations of Australian banks and senior management of APRA may visit banks' foreign establishments for general discussions on strategy and performance with the local management.

Principle 24: A key component of consolidated supervision is establishing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities.

Implemented

APRA has well established contacts with supervisors in all the countries in which Australian banks operate — in some cases, Memoranda of Understanding are in place which specify the arrangements for sharing supervisory information.

APRA may object to a bank establishing a presence in a particular country where host supervision is considered inadequate, or where there would be restrictions either on the flow of information from the overseas operation or on APRA's ability to call on and consult with the local senior management of the operation.

Principle 25 (1): Banking supervisors must require the local operations of foreign banks to be conducted to the same high standards as are required of domestic institutions.

Partially implemented

Foreign banks operating as authorised banks in Australia are subject to broadly similar prudential requirements as Australian banks. While branches of foreign banks are not required to hold endowed capital in Australia and are not subject to any capital-based large exposure limits, APRA has to be satisfied that the foreign bank is subject to adequate standards of prudential supervision in its home country, including Basle minimum capital adequacy standards.

However, foreign banks can carry out wholesale banking type operations in Australia as 'merchant banks'. APRA is not in the position to provide home country supervisors with information on these institutions' activities in Australia as it neither authorises nor supervises them. However, in view of the nature of their operations in the wholesale market, they are subject to some requirements under the Corporations Law, which is administered by the Australian Securities and Investments Commission.

Principle 25 (2): Banking supervisors must have powers to share information needed by the home country supervisors of those banks for the purpose of carrying out consolidated supervision.

Partially implemented

As part of its application for an authority to carry on banking business in Australia, a foreign bank must provide a statement from the home supervisor confirming the bank's good standing, and consenting to the foreign bank setting up an operation in Australia. The home country supervisor must confirm that it practises consolidated supervision, and is willing to co-operate in the supervision of the branch or subsidiary in Australia, consistent with the principles of the Basle Concordat.

The APRA Act allows APRA to disclose information related to authorised institutions to another 'financial sector supervisory agency' when such information will assist the agency to perform its functions or exercise its powers. A financial sector supervisory agency includes a foreign supervisor.

Overseas supervisory authorities are permitted to conduct on-site examinations of their banks' subsidiaries or branches in Australia. APRA has entered into Memoranda of Understanding with some overseas supervisory authorities.

As outlined above, APRA is not in a position to provide information to home country supervisors on the activities of foreign bank owned merchant banks for the purposes of carrying out consolidated supervision.