RESPONSE TO SUBMISSIONS

Revisions to the related entities framework for ADIs

20 August 2019

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Executive summary

Banks' dealings with related entities can introduce the potential for material contagion risks. As demonstrated in the global financial crisis, deficiencies in controls to mitigate these risks can result in severe financial and reputational contagion within the financial system more broadly. Further, complex group structures may impact the ability of a bank to be resolved in a sound and timely manner, ultimately affecting its depositors. As a result, prudential requirements to monitor, manage and control contagion risk play an important role in ensuring that dealings with related entities are appropriately structured and managed.

In July 2018, APRA proposed changes to the current prudential requirements for related entity risk management by banks and other authorised deposit-taking institutions (ADIs).

Concessions in the existing framework have resulted in some ADIs establishing numerous operations in foreign jurisdictions, which are then managed and funded within the domestic bank. APRA has only limited visibility of these operations and they also fall outside the purview of foreign regulators. They complicate operating structures and there is no certainty their assets would be available to an ADI if it were to enter resolution. There are currently around 100 such operations within ADIs. In addition, if an ADI were to fully utilise some of the limits within the existing framework, they would be exposed to excessive levels of contagion risk.

The changes in this reform aim to update and streamline requirements, to account for lessons learnt from the global financial crisis on mitigating the flow of contagion risk to an ADI particularly from related entities, and to ensure general alignment with APRA's revised ADI large exposures framework which came into effect on 1 January 2019.

Submissions to APRA's consultation indicated that some respondents were concerned with the potential complexities of certain aspects of the proposed changes. These concerns related primarily to related entity exposure limits and changes to the treatment of certain overseas subsidiaries. Some submissions emphasised the need for transition periods. APRA's proposed broader definition of related entities, which would include substantial shareholders and other entities, was also highlighted as being potentially problematic to implement.

APRA has made a number of adjustments to the proposals to address many of these concerns, and has maintained other aspects of the original proposals where it has concluded these are warranted based on prudential considerations. Key aspects include:

- Related entity exposure limits: no changes have been made to the proposed related entity exposures limits. The limits align with APRA's large exposure limits, which are consistent with the Basel Committee on Banking Supervision's *Standards: Supervisory framework for measuring and controlling large exposures* (April 2014). APRA does not expect the revised limits to materially constrain existing levels of intra-group exposures for ADIs but will ensure these exposures do not become excessive in the future.

- Extended Licensed Entities (ELEs): no changes have been made to the proposal to remove the ability for overseas subsidiaries to be consolidated within the standalone ADI.

The revisions will address APRA's concerns around the potential complexity of group structures with ELEs, and the need for more transparency to support effective supervision. For some entities, the ELE revisions will have a substantial impact, with a need to restructure or reconsider the relative value of certain group operations. ADIs are encouraged to discuss transition needs with their APRA supervisor.

- Step-in risk: changes have been made to the way that step-in risk is addressed in the related entity framework. Step-in risk describes the possibility that an ADI may step in to support an unrelated entity due to reasons such as reputation or branding, beyond their legal obligation to do so. The changes require ADIs to appropriately address this step-in risk by having a risk appetite and strategy for managing step-in risk entities, identifying and assessing the risk arising from step-in risk entities regularly, and reporting on these entities. In response to submissions, APRA has removed step-in risk entities from the definition of related entities.

In finalising these reforms, APRA considered all elements of its mandate to reach an appropriate balance between stability, efficiency and competition. APRA recognises that the limits on related entity exposures may make it more difficult for potential new entrants that fund their related entities' business to meet ADI prudential requirements. In addition, the changes to the eligibility of offshore ELE subsidiaries may increase the costs of funding offshore subsidiaries and affect the ability of certain ADIs to compete for offshore business.

The changes to related entity limits, in conjunction with the Reserve Bank of New Zealand's proposed capital reforms, may also affect the ability of Australian ADIs to expand their operations in New Zealand without additional capital cost. Further to ensure capital resilience of domestic operations, APRA is also reviewing other relevant elements of its capital framework and will consult on these in the coming months. This includes the capital treatment of the parent ADI's equity exposures to subsidiary ADI and insurance companies.

APRA recognises that these changes will impact some ADIs more than others, and for a small number of ADIs the impacts could be material. APRA has considered the alternative options raised in submissions and whether the desired prudential outcome could be achieved in other ways, and has adjusted the proposals where feasible to address relevant concerns. Overall, APRA expects that the changes to the related entity requirements will enhance prudential outcomes, improve financial safety and promote financial system stability by providing better management and control of contagion risks in the banking system.

This response paper sets out the material issues raised in submissions and APRA's response to those issues. The new APS 222 will become effective on 1 January 2021.

This paper, the prudential standard and reporting standards are available on APRA's website on www.apra.gov.au.

Chapter 1 - Introduction

Prudential Standard APS 222 Associations with Related Entities (APS 222) sets out APRA's requirements for the management of dealings with related entities by authorised deposit-taking institutions (ADIs). APS 222 complements the risk-based capital framework for ADIs and forms a key component of an ADI's risk management framework in line with *Prudential Standard CPS 220 Risk Management*. APS 222 was last materially updated in 2003.

On 2 July 2018, APRA released for consultation a discussion paper which outlined proposed revisions to the prudential framework for related entities. The proposals were designed to strengthen the ability of ADIs to monitor, limit and control risks arising from transactions and other associations with related entities including financial and reputational contagion risks. In particular, the changes update APS 222 to incorporate lessons from the global financial crisis on mitigating contagion flowing from one group entity to another, and to ensure broad alignment with the revised large exposures framework which became effective on 1 January 2019. The key proposals included:

- broadening the definition of related entities to capture all entities and individuals that may expose an ADI to conflicts of interest and contagion risk, such as substantial shareholders and individuals on the board of directors;
- revising the limits on exposures to related entities;
- introducing minimum requirements on contagion risk assessments;
- introducing stronger requirements to mitigate contagion flowing from one group entity to another, or to the ADI due to reputational reasons, particularly where these entities share common logos or brands with the ADI;
- aligning requirements for the measurement of exposures to related entities with those applying to exposures to unrelated entities in the revised large exposures framework;
- addressing risks arising from subsidiaries, which hold or invest in assets, that are treated as part of an ADI's extended licensed entity (ELE);
- updating requirements relating to an ADI's associations with a funds management vehicle that is a related entity of the ADI; and
- updating reporting requirements to align with the proposed amendments to APS 222 and capturing additional prudential information on substantial shareholders and subsidiaries that are treated as part of an ADI's ELE.

Feedback from consultation

APRA received submissions from a range of stakeholders including three ADI industry associations and seven APRA-regulated institutions. Six submissions were confidential.

Submissions generally supported revisions to the related entities framework and the need to reflect changes in the operating environment and contagion risks that ADIs are exposed to. However, submissions expressed concerns that certain proposals could result in complexities and challenges in implementing the prudential framework. APRA has considered the issues raised and made several amendments as a consequence.

Structure of this paper

This paper includes responses to issues raised in submissions.

Chapter 2 addresses the definition of related entities.

Chapter 3 addresses related entity limits, and the measurement of exposures to related entities.

Chapter 4 addresses the ELE framework.

Chapter 5 addresses step-in risk.

Chapter 6 addresses other matters raised in submissions on funds management, changes to reporting on exposures to related entities and other minor amendments.

In some circumstances, amendments have been made to APS 222 in response to issues raised in submissions. However, due to their minor and technical nature, APRA has not detailed its specific response to these issues in this response paper.

Chapter 2 - Definition of related entities

This chapter sets out issues raised in submissions relating to the definition of related entities and APRA's response to these issues.

2.1 Changes to the definition of a related entity

APRA proposed changing the definition of a related entity to align with the definition in the Basel Committee on Banking Supervision's *Core principles for effective banking supervision* (September 2012), and to enhance the ability of an ADI to identify entities which expose them to contagion risk or conflicts of interest, and bring such entities into the scope of APS 222.

Comments received

Submissions raised concerns on expanding the definition of a related entity to substantial shareholders and associates, and the inclusion of an entity to which an ADI is likely to provide support beyond legal or contractual obligation (step-in risk entity) in the related entity definition. Some submissions argued that the proposed meaning of associate based on section 50AAA of the *Corporations Act 2001* (Corporations Act) was too broad and complex to implement in practice, and that there would be difficulties in identifying associates accurately, such as in accessing information to determine the identity of individuals or legal entities without having direct control or influence over their actions. This concern was heightened with the extension to associates of other related entities such as a substantial shareholder's associates and a related individual's relatives and their associates.

Respondents expressed concerns that defining a substantial shareholder using the definition of a substantial holding in section 9 of the Corporations Act, which includes a threshold of five per cent of voting shares, may capture more entities than would typically be considered as large, major or principal shareholders of an ADI.

Submissions commented that step-in risk entities do not fit with the definition of related entity as the exposures are difficult to measure and are not limited or documented. Some submissions commented on the potential for conflicts between various requirements in APS 222 if step-in risk entities were treated as related entities.

APRA response

APRA considers that the scope of entities captured by APS 222 is critical to enhancing the ability of ADIs to identify entities which expose them to contagion risk or conflicts of interest. Recognising the matters raised, APRA has amended various parts of the definition of a related entity in APS 222.

APRA has introduced a broad principles-based definition of a related entity which outlines the principle underlying what is intended to form a related entity of an ADI. The principles-based definition highlights risk due to contagion and conflicts of interest which would not arise if the ADI were dealing with an unrelated entity.

On the inclusion of associates in the definition of a related entity, APRA considers that the elements of relations with associates which were intended to form part of the related entity definition are broadly captured in the definition through control, significant influence, and the inclusion of a principles-based definition of a related entity. Consequently, APRA has removed direct references to associates from the definition.

APRA has amended the definition of a substantial shareholder so that it is based on the definition of a substantial holding in the Corporations Act. This uses a threshold of ten per cent or more of the total number of votes attached to voting shares rather than five per cent or more. The revised threshold generally aligns with definitions of large or major shareholders and thresholds in relevant international jurisdictions.

Lastly, recognising the concerns raised, step-in risk has been removed from the definition of related entity. As there is still a need for step-in risk requirements within the prudential framework, APS 222 has been revised to include a new attachment which sets out details on the identification, measurement and management of step-in risk. Chapter 5 of this paper provides more detail on step-in risk.

Chapter 3 - Related entity exposures and limits

This chapter sets out issues raised in submissions relating to prudential limits for exposures to related entities, the measurement of exposures to related entities, and APRA's response to these issues.

3.1 Changes to related entity limits

APRA proposed to revise the capital base used in the related entity limits and the size of those limits. The existing APS 222 limits and those that were proposed in APRA's July 2018 discussion paper are set out in Table 1.

Table 1. Current and proposed limits on exposures to related entities

	Current APS 222	Proposed APS 222
Related ADIs (or overseas-based equivalents)		
Exposure to individual related ADI	50% of Total Capital	25% of Tier 1 Capital
Aggregate exposure to all related ADIs	150% of Total Capital	75% of Tier 1 Capital
Other related entities		
Exposure to other individual regulated related entities (other than related ADIs and related overseas-based equivalents)	25% of Total Capital	25% of Tier 1 Capital
Exposure to individual unregulated related entity (including related individuals)	15% of Total Capital	15% of Tier 1 Capital
Aggregate exposure to all related entities (other than related ADIs and related overseas-based equivalents, and including related individuals)	35% of Total Capital	35% of Tier 1 Capital

Comments received

Some respondents commented that the proposed limits were restrictive and did not reflect that relevant related entities are subject to the ADI's risk management framework. Submissions argued that since ADIs have oversight and the ability to control the activities of their related entities, contagion and reputational risks are mitigated, and that a higher limit would better reflect these arrangements. Respondents suggested that Total Capital would be a more appropriate capital base to use in the related entity limits, noting that consistency with *Prudential Standard APS 221 Large Exposures* (APS 221) should not be prioritised when considering related entity limits and the capital base.

Some submissions recommended that changes to prudential limits for exposures to related entities should be deferred until other considerations relevant to the capital framework are clarified, such as the Reserve Bank of New Zealand (RBNZ) review of its capital adequacy framework.

APRA response

APRA considers that limits within the related entity framework should reflect lessons learnt from the global financial crisis and act to limit the potential impacts, both financial and non-financial, that an ADI could bear as a consequence of associations with related entities, particularly in periods of stress. While related entities of an ADI may benefit from the ADI's risk management framework, contagion risk needs to be limited and the level of capital at risk in a crisis must be considered.

APRA views Tier 1 Capital as the appropriate capital base for the measurement of related entity exposures. A key principle underlying the level of capital used is that the capital base must be able to absorb unexpected losses on a 'going-concern' basis, rather than on a 'gone-concern' basis. The limits will impact some ADIs with large subsidiary banking operations, but APRA does not expect that the limits at current levels of exposures will be binding for the vast majority of entities. APRA is open to providing entity-specific transitional arrangements or flexibility on a case-by-case basis.

The RBNZ commenced a consultation on materially higher minimum capital requirements for New Zealand banks subsequent to the release of APRA's July 2018 discussion paper. These proposed changes, if implemented, have implications for exposures of Australian ADIs to their subsidiary operations in New Zealand.

APRA is not deferring its changes to related entity limits until the RBNZ finalises its proposals. The changes to APS 222 are important elements of APRA's ADI framework and apply to operations across jurisdictions and structures. APRA recognises that the limits being adopted in APS 222, and indeed the current APS 222 limits, could constrain the ability of some Australian banks to meet additional requirements to support their New Zealand subsidiaries.

3.2 Measurement of exposures to related entities

Comments received

Submissions requested further clarity regarding the methodology for measuring exposures to related entities. In particular, the 'look-through' approach, which requires an ADI to look through a structured vehicle to the underlying assets in considering the underlying risks of those exposures, raised a number of concerns.

Some respondents queried whether an exposure would be captured under APS 221 if the exposure is to a related entity and is already captured under APS 222. It was also suggested that the prudential standard makes explicit that only the exposure to a structured vehicle is required to be captured under the look-through approach where the exposure has also been assigned to the underlying assets in order to avoid double counting.

APRA response

Exposures to related entities captured under APS 222 are not captured by APS 221; as such APRA does not believe there is scope for double counting. The look-through approach for measuring exposures to structured vehicles is a robust method for identifying all exposures to a counterparty. It is appropriate to consider the exposures of both structured vehicles and the underlying assets in determining the exposure to a related party.

Chapter 4 - Extended Licensed Entity framework

This chapter sets out issues raised in submissions relating to the Extended Licensed Entity (ELE) framework and APRA's response to these issues.

4.1 Revisions to the ELE arrangements

The ELE framework is a longstanding feature of APRA's prudential framework which allows an ADI to consolidate certain approved subsidiaries (ELE subsidiaries) to meet prudential requirements that apply on a Level 1 ADI legal entity basis. The overall consolidation that includes the ADI and the ELE subsidiaries is termed the ELE. Exposures of the standalone ADI to its ELE subsidiaries are not subject to the limits in APS 222.

As outlined in APRA's July 2018 discussion paper, the ELE framework was established to enable efficiencies for legal, taxation and other regulatory compliance reasons. As a consequence of how the ELE framework has been used by ADIs, APRA has concerns that ELE arrangements have added complexity in ADI group structures, hindered supervision of ELE subsidiaries, and have the potential to complicate resolution in the wind-up of the ADI.

APRA proposed to amend the ELE framework to remove explicitly the eligibility of overseas subsidiaries from being included in an ELE, unless the subsidiaries were established with the sole purpose of borrowing on behalf of the ADI. Domestic ELE subsidiaries would continue to be eligible for inclusion in the ELE provided they do not fund offshore businesses. In APRA's view, this is consistent with current ELE eligibility requirements that there are no legal or regulatory barriers, or any other material risks, to the transfer of assets or funds back to the ADI from an ELE subsidiary. APRA requested alternative options to be put forward in submissions from ADIs in the July 2018 consultation in considering the amendments to the ELE framework.

Comments received

Submissions requested that APRA review its decision to exclude Australian holding companies that have invested in overseas subsidiaries, for reasons which included that these holding companies were located in Australia and that the arrangement replicates the risk profile of the ADI holding the investment in the overseas subsidiaries directly. Respondents noted that the risks of overseas subsidiaries are mitigated through diversification across jurisdictions, counterparties and types of exposures. In particular, submissions suggested further weight should be given to jurisdictions with strong legal frameworks and robust regulatory and financial systems such that subsidiaries within these jurisdictions should be permitted to be included in the ELE. It was noted that no problems have been experienced with the transferability of assets by Australian ADIs in the past and that transferability is unlikely to be an issue in reasonably foreseeable situations. Some affected ADIs requested transition periods to meet the proposed ELE revisions.

APRA response

The information provided by submissions has not addressed APRA's concerns regarding the existing ELE framework, particularly in relation to overseas subsidiaries. The main concerns remain that the ELE framework has resulted in more complex group structures for ADIs, hindered transparency and supervision, and has the potential to complicate resolution activities in the event of the wind-up of an ADI. This has heightened concerns around contagion risks and the potential impacts on the standalone ADI in a crisis.

As detailed in APRA's July 2018 discussion paper, APRA is removing the eligibility of overseas subsidiaries to enhance the prudential supervision of an ADI's banking activities unless they have been established to borrow on behalf of the ADI. This is aligned with the current requirements that there are no legal or regulatory barriers, or any other material risks, to the transfer of any assets or funds (including assets of funds of underlying subsidiaries) back to the ADI. Any subsidiaries incorporated domestically, including any holding companies, which fund or hold offshore business or assets will not be eligible to be treated as part of an ELE.

The changes to ELE requirements will have material consequences for a limited number of ADIs and APRA is open to providing appropriate transitional arrangements to avoid unreasonable disruption to longstanding business operations. ADIs which require transition to meet the new requirements should contact their APRA supervisor.

Chapter 5 - Step-in risk

This chapter sets out issues raised in submissions relating to step-in risk and APRA's response to these issues.

5.1 Revisions to the treatment of step-in risk

Step-in risk is the risk that an ADI may step in to support an entity to which it is not related for reasons generally due to brand or reputational considerations. Step-in risk entities expose ADIs to similar risks to those arising from ownership or control of an entity. For both related entities and for entities for which an ADI might 'step-in', there is the potential for an ADI to act to manage contagion risks arising from its associations with these types of entities in a similar way. In APRA's July 2018 discussion paper, APRA sought information from ADIs regarding the number and size of entities that may be caught by the step-in risk requirements to understand the impact of this reform.

Comments received

Submissions commented that step-in risk entities do not fit within the definition of related entities as exposures to step-in risk entities are difficult to measure and are potentially not limited or documented. Submissions noted that treating the two types of entities in the same way under the related entities framework may create conflicts between various paragraphs in APS 222. Some respondents noted that the proposals on step-in risk may add complexity in terms of ongoing implementation, monitoring and governance. Submissions did not provide detailed data regarding the number and size of entities that may be caught by the step-in risk requirements.

APRA response

APRA acknowledges that while the contagion risk is similar, the approach for measuring and mitigating that contagion risk may be different between related entities and step-in risk entities.

In the revised standard, the definition of a related entity no longer includes a step-in risk entity. Instead, an ADI will need to assess contagion risks arising from step-in risk entities on a regular basis, and report on identified step-in risk entities annually. Furthermore, APRA has included requirements on step-in risk in Attachment A to APS 222, including the factors in the July 2018 consultation version of APS 222 which an ADI must consider in identifying step-in risk entities, with the addition of whether the entity carries the ADI's brand. An ADI will be required to determine the materiality of step-in risk by assessing the potential impact on its capital and liquidity positions arising from a step-in risk entity. ADIs must also maintain a risk appetite statement and strategy for managing its dealings with step-in risk entities and ensure that there are adequate systems and controls to identify, measure, monitor, manage and report exposures which arise from step-in risk entities.

To facilitate reporting of the exposures to step-in risk entities, APRA has added a new reporting standard, Reporting Standard ARS 222.2 Exposures to Related Entities – Step-in risk which requires high-level information on the step-in risk entities identified by ADIs.

Chapter 6 - Other matters

This chapter discusses other matters raised in submissions in relation to funds management, other amendments and changes to reporting of exposures to related entities.

6.1 Funds Management

Several submissions commented on the inclusion of, and changes to, funds management requirements in APS 222.

Comments received

A few submissions queried the potential for duplication between funds management requirements in APS 222 and *Prudential Standard APS 120 Funds Management and Securitisation (May 2006)* (APS 120 (2006)) and requested clarification on the status of APS 120 (2006). One submission commented on the application of various requirements in APS 222, such as the interaction between requirements relating to ownership of a vehicle and participation in a vehicle through the purchase of securities, and whether funds management requirements apply to a fund manager or strictly to the funds management vehicle or fund. A few submissions commented on the time restriction of two months when an ADI underwrites the issue of securities by a funds management vehicle.

APRA response

APRA has incorporated all relevant requirements relating to an ADI's involvement in funds management from APS 120 (2006) into APS 222. The funds management requirements in APS 120 (2006) will no longer have any application.

While paragraph 4(a) of Attachment B to APS 222 applies to ownership or beneficial interest in a funds management vehicle, paragraph 6 of that Attachment applies to purchases of the funds management vehicle's securities; the two paragraphs are not contradictory. A footnote has been added for clarity. Attachment B to APS 222 applies to an ADI's associations with a funds management vehicle that is a related entity of the ADI; however, a fund manager may also be subject to the requirements in APS 222 if it is a related entity itself.

Under Attachment B to APS 222, when an ADI underwrites the issue of a fund's securities, the ADI is required to reduce its holding to below 20 per cent within two months of the underwriting agreement's commencement; this compares with the previous requirements which were set at three months. The two month period is to ensure that investors do not perceive that the ADI supports the fund, which could result from a prolonged association with the fund.

6.2 Reporting of exposures to related entities

A few submissions commented on the reporting dates in *Reporting Form ARF 222.0 Exposures to Related Entities* (ARF 222.0) and requested that the same number of days be used for reporting timeframes as required under *Reporting Form ARF 110.0 Capital Adequacy* to facilitate the alignment of reporting of Tier 1 Capital used in the related entity limits.

APRA response

APRA has aligned the reporting dates in ARF 222.0 with *Reporting Form ARF 221.0 Large Exposures* to 28 calendar days. ADIs will be able to continue reporting under current arrangements and, if concerned, can contact their supervisor.

6.3 Other amendments

In addition to the topics discussed in this response paper, APRA has made a number of minor changes to the draft APS 222 and draft *Reporting Standard ARS 222.0 Exposures to Related Entities* (ARS 222.0) from the July 2018 consultation, including:

- clarifying the requirements on the terms and conditions used in relation to dealings with an ADI's related entities;
- removing the requirement for an acknowledgement from an external counterparty that they have read and understood disclosures where there are financial transactions between an external counterparty and a member of the ADI's group that uses a common brand name with the ADI;
- removing the requirement for Board approval for participation in group operations, where management approval suffices;
- revising the requirements on the underwriting of issues by funds management vehicles to require an ADI that acts as an underwriter or committed dealer to deduct the value of the facility from the ADI's Common Equity Tier 1 Capital if the ADI underwrites a significant proportion of the issue of securities; and
- clarifying the deductions that must be made if an ADI that underwrites an issue of securities by a funds management vehicle holds more than 20 per cent of the outstanding value of a funds management vehicle's securities after two months of the underwriting agreement's commencement.

Attachment A - Regulatory costs

This Attachment sets out the steps taken in finalising the revised related entity requirements, including details of compliance cost estimates for implementation of the requirements.

The July 2018 discussion paper outlined three options for the future application and operation of the related entity requirements set out in APS 222, and the associated reporting requirements in ARS 222.0. The options were:

- option 1 — no changes: maintain APRA's existing prudential requirements for related entities;
- option 2 — comprehensive changes with complete removal of the ELE framework; and
- option 3 — comprehensive changes with adjustments to the ELE framework.

APRA's public consultation was open for around three months. APRA received ten submissions from a range of stakeholders including ADIs and industry bodies.

Assessment of regulatory costs

As part of its public consultation, APRA sought information from stakeholders on the compliance impacts of the proposed changes to the related entities framework, including associated substantive costs. Respondents were asked to use the Australian Government's Regulatory Burden Measurement Tool (RBMT) to assess regulatory costs.

While none of the submissions provided regulatory cost estimates using the RBMT, APRA has sought cost impacts directly from ADIs.

Option 1: No changes

Under this option, ADIs and other stakeholders would not incur any additional compliance costs as the current related entities framework would be retained without change. However, APRA expects there may be future indirect costs and inefficiencies for ADIs arising from inconsistent exposure measurement requirements across APRA's prudential framework.

Table 1. Average annual regulatory cost of Option 1

Sector	Business	Community organisations	Individuals	Total change in costs
Total change in cost by sector ($ million)	0	0	0	0

Option 2: Comprehensive changes with complete removal of ELE framework

This option involves comprehensive changes to the related entities framework, with complete removal of the ELE framework. This would improve financial system stability through the simplification of ADI group structures, though it would require ADIs to substantially restructure the funding of subsidiaries that are part of their ELEs.

APRA expects this option would involve extensive resources and time, depending on the size of entities and their current ELE arrangements. APRA expects larger ADIs would require a lengthy transition period in order to completely restructure the funding of subsidiaries that are currently part of their ELEs.

Table 2. Average annual regulatory cost of Option 2

Sector	Business	Community organisations	Individuals	Total change in costs
Total change in cost by sector ($ million)	3.92	0	0	3.92

Option 3: Comprehensive changes with specific *adjustments to ELE framework*

This option involves comprehensive changes to the related entities framework with adjustments to the ELE framework that would allow domestic ELE subsidiaries to remain eligible.

APRA expects costs to vary depending on the size of entities and their current ELE arrangements, and envisages the need for transition periods to allow larger ADIs to reassess and restructure overseas subsidiaries that are currently part of the ELE framework.

Table 3. Average annual regulatory cost of Option 3

Sector	Business	Community organisations	Individuals	Total change in costs
Total change in cost by sector ($ million)	3.09	0	0	3.09

Conclusion

Option 1 results in no additional compliance costs, as it involves maintaining the current related entities framework without change. Options 2 and 3 result in compliance costs for industry.

Option 2 results in complete removal of the ELEs framework and would require extensive resources and a lengthy transition period. ADIs would be required to completely restructure domestic and offshore subsidiaries that would no longer be eligible under the revised prudential standard.

Option 3 involves maintaining the ELE framework with specific adjustments, such as the removal of eligibility of overseas subsidiaries, while addressing the prudential concerns regarding the current ELE arrangements. APRA expects adjustments to the ELE framework would involve lower costs compared to complete removal of the ELE framework.

The costs outlined in the tables above are only reflective of the estimated compliance and regulatory costs associated with the implementation of the changes to APS 222. In considering the direct impacts of these changes to ADIs, APRA expects that Option 2 will result in a higher material cost to ADIs than Option 3, as select ADIs will have to restructure domestic and offshore subsidiaries in order to completely remove usage of the ELE framework. Option 3 leads to the removal of overseas subsidiaries only, resulting in a lower impact to ADIs overall as domestic subsidiaries that form part of the ELE will still be eligible.

Table 4. Summary of net benefits of each option

	Option 1	Option 2	Option 3
Compliance cost	No change	High cost	Moderate cost
Reduce system-wide financial and reputational contagion risk	No change	Meets this criteria	Meets this criteria
Reflect local conditions	No change	Does not meet this criteria	Meets this criteria
Align with exposure measurement requirements across APRA's prudential framework	Does not meet this criteria	Meets this criteria	Meets this criteria
Overall	Low net cost	Moderate net cost	Moderate net cost

Implementation and review

On release of APS 222, ARS 222.0 and ARS 222.2, ADIs will have until 1 January 2021 to comply with the requirements under the new prudential standard and reporting standards. Where an entity requires a transition period for complying with the revised ELE requirements, the transition will be determined by APRA on a case-by-case basis.

Under APRA's policy development process, reviews of new prudential measures are typically scheduled for two to three years from implementation date or as otherwise considered appropriate. Such a review would consider whether the requirements continue to reflect good practice, remain consistent with international standards and remain relevant and effective in facilitating sound risk management practices. APRA would also take action within a shorter timeframe where there is a demonstrable need to amend a prudential requirement.