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# Economic and Financial Statistics overhaul: have you spotted the opportunity

by Giovanni Butera and Chris Smith\*



Compliance and regulatory reporting requirements of banks and financial services firms have increased exponentially as a result of new regulations. 72% of respondents in an Ernst & Young study rated the changing regulatory environment as one of the top risk management challenges.

Recently, the Australian Prudential Regulation Authority (APRA) is overhauling its core regulatory reporting requirements for the first time in 15 years. All of Australia's Authorized Deposit-taking Institutions (ADIs) must meet these new reporting requirements.

\*Dr. Giovanni Butera is Managing Director, Head of Data Management, Analytics and Innovation at Nixora Group. M: +61 410 860 036 E: [giovanni.butera@nixoragroup.com.au](mailto:giovanni.butera@nixoragroup.com.au)

Chris Smith is Managing Director, Australia Country Head, at Moody's Analytics, M: +61 405 810 961 E: [chris.smith@Moody's.com](mailto:chris.smith@Moody's.com)

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## Introduction

The last ten years has seen explosive growth in the compliance and regulatory reporting requirements placed upon the banking and financial services industry. It is drawing on ever more resources on multiple fronts — be it headcount, investment in key system platforms, or in the deployment of IT experts from specialized firms. In a recent survey by Ernst & Young, nearly 72 per cent of respondents saw the rapidly changing regulatory environment as one of the top challenges in risk management. The required changes are as a result of Basel II, IFS9, SA-CCR, and the Economic and Financial Statistics (EFS) emphasises these challenges.

We hope to that an understanding of the current state of financial services regulations will provide you with a better view of the challenges and opportunities that lay on the horizon of the regulatory reporting landscape.

### The current state of affairs

In recent years, all over the globe, institutions such ESMA, ACPR, FED, PRA-UK, as well as APRA, have initiated a process of consultative papers<sup>1</sup> to gauge the reaction and acquire feedback from the industry before regulating or collecting information either to improve regulation or for economic policy reasons. Regulators are implementing a collaborative approach, calling on all market players for their contribution, emphasising the need for greater flexibility in adapting to changing circumstances, and to support progress towards more stable and well-functioning markets.

Here in Australia the process has been similar. APRA has commenced a multi-year work program to transform the way it collects, stores, accesses, and publishes data. One of the major components of this undertaking is the replacement of APRA's data submission tool Direct to APRA (D2A): "This system has functioned well for the past 16 years but is now ageing and no longer able to fully support the data collections required to service the financial services industry."<sup>2</sup>

In Australia, as in most Western countries, the volume of new regulations due in the near future (including the replacement of the submission tool), will have a huge impact on the infrastructure, resources, and budgets of local banks and financial institutions, presenting significant challenges to their operating models, analytics, and reporting capabilities.

As a consequence, in an already challenging environment that requires continually evolving efficiencies to meet the expectations of stockholders, regulators, and communities, compliance and regulatory reporting operations are destined to raise the bar significantly for banks. The EFS regulatory reporting overhaul is only the tip of the iceberg.<sup>3</sup>

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The scale of the changes is not surprising given the global events and regulatory developments that have transpired, particularly since the global financial crisis (GFC). Although the Australian economy was perceived to have weathered the GFC, the 2013 government-led Financial System Inquiry (FSI) sent a very clear message that the status of the Australian financial system must endeavour to remain “unquestionably strong”.

Over the following five years, Australia’s banks faced increasing headwinds in the pursuit of that goal; not only have Australia’s international banking peers improved their standards, but Australia continues to operate in an environment underscored by an overheated housing market and high debt levels.

## **Regulatory Data Collection overhaul:**

### **Economic and Financial Statistics (EFS)**

The EFS review is a refinement of APRA’s monitoring efforts by which the regulator can prudently manage the financial community. Essentially, it is a sharpening of surveillance tools that helps APRA play its role in ensuring stability, efficiency, and competition within the system. To that end, the benefits to community are largely recognised to outweigh the additional cost to the industry.

On 16 January 2017, APRA released its Economic and Financial Statistics (EFS) Form Review for public consultation. This package represented a major overhaul of many of the Financial and Statistical returns currently prepared by the Australian Authorised Deposit-taking Institutions (ADIs). It also introduced a new set of returns to be submitted.

The announcement signalled a significant change in the regulatory reporting regime, and will have a dramatic impact on all Australian ADIs. The proposed changes represent a substantial extension of the existing reporting requirements, greatly increasing the breadth of data collected, as well as introducing a quality standard to enhance the accuracy of the provisioned data, significantly increasing audit requirements.

As a result, banks and financial institutions will need to broaden the range of information provided in areas such as lending, deposits, fees, counterparty information, and derivatives. The package focuses on residency, sector and industry classifications, which is one of the critical aspects of the new requirements.

This overhaul of reporting standards is consistent with international initiatives to enhance the breadth and quality of statistical and economic data gathered from the financial services sector.

APRA originally proposed a 'phase in' period beginning in July 2018 with the final forms going live by July 2019.

Following the consultation with the industry<sup>1</sup> APRA revised the submission dates as per the table below, while still maintains that reporting institutions will need to prepare to run the old and new forms in parallel for six months.

**Table 1: EFS New Reporting Timeline**

EDF Requirements New Submission dates		
Phases	New Dates	
Phase 1	Mar-19	
Phase 2	Jul-19	
Phase 3	ARF 722	Further consultation
	ARF 723	Sep-19
	ARF 730.1	Jun-20

The main EFS reporting changes are summarised as follows:

**New data dimensions and measures:** new forms will increase on balance sheet data availability (e.g., foreign currency, securitisation, derivatives), with a focus on financing and funding (e.g., interest rate/cost of funds, loan application/origination, deposit/security characteristics), and securities financing (e.g., collateral).

**Updated reporting concepts:** many definitions are updated or clarified to ensure fitness for use for the agencies (e.g., residency status, loan purpose). Although some of the new data required are already reported through other agencies or APRA's query process, the fundamental restructure of the forms will require a substantial change to the reporting process with regard to data mapping and submission.

**New data:** data not currently captured/stored (e.g., loan application, loan serviced with foreign income), misaligned with current collection (e.g., first home owner grant) or management reporting (e.g., cost of funds, offset accounts, excess repayments). This will require significant data sourcing effort as well as impacting processes upstream of report preparation. Changes to front office processes may also be required in order for existing data to comply with clarified reporting concepts (e.g., loan purpose).

**Increased data granularity:** income/expense and asset/liabilities will be more disaggregated; counterparties' details will be required on most forms (e.g., residency, related party).

The breakdown of counterparty by economic sector will be extended to include greater details on the financial sector in accordance with the SESCA 2008. Industry classification will also be updated in accordance with the ANZSIC 2006 (21 codes in use, up from 13 in the current forms), and a business size classification introduced.

**Data Accuracy and Assurance/Governance (ARS 702.0):** APRA Reporting Standard specifies the accuracy thresholds that information provided under all EFS reporting standards must achieve to comply with the requirements of specific standards. Banks must ensure that the scope of an internal audit includes a review of the policies, processes and controls put in place by management for compliance with the EFS reporting standards.

**Figure 1: Old and New EFS Reporting Requirements**

ARF		New/Replaced	New	New	
Code	Current Name	Discontinued	EFS Code	EFS Name	Phase
321.0	Statement of Financial Position (offshore)	Discontinued			
332.0	Statement of economic activity	Discontinued			
320.8	Housing loan reconciliation	Discontinued			
393.0	Lease finance	Discontinued			
320.0	Statement of Financial Position	Replaced	720.0	Statement of Financial Position	1
320.9	Intra-group receivables and payables	Replaced	720.3	Intra-group assets and liabilities	1
320.1	Debt securities held	Replaced	720.4	Debt securities held	1
320.2	Equity securities held	Replaced	720.5	Equity securities held	1
320.3	Securities on issue	Replaced	720.6	Securities on issue	1
320.4	Bill acceptances and endorsements	Replaced	720.7	Bill acceptances and endorsements	1
		New	720.1A	Loans and Finance Leases	1
		New	720.2A	Deposits	1
320.5	Securities subject to repurchase and resale and stock lending and borrowing	Replaced	721.0A/B	Repurchase agreements and securities lending	1
331.0	Selected revenues and expenses	Replaced	730.0	Statement of Financial Performance	2
391.0	Commercial finance	Replaced	741.0	Business finance	2
395.0	Business finance statistics	Replaced	742.0	Business credit stocks, flows and interest rates	2
392.0	Housing finance	Replaced	743.0	Housing finance	2
		New	744.0	Housing credit stocks, flows and interest rates	2
394.0	Personal finance	Replaced	745.0	Personal finance	2
		New	746.0	Personal credit stocks, flows and interest rates	2
		New	747.0	Deposit stocks, flows and interest rates	2
		New	748.0	Wholesale funding stocks, flows and interest rates	2
		New	722.0	Derivatives	3
		New	723.0	Margin lending	3
		New	730.1	Fees Charged	3

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## How to comply with accuracy thresholds

To comply with accuracy thresholds, reporting institutions should examine the supporting control framework, from data capture to submission they should also consider data priority to ensure controls are appropriately designed, and provide the required level of granularity. Accuracy thresholds are primarily defined according to the importance of the data to the agencies and, as such, counterparty (residency, related party), lending and funding data (loan purpose, origination, offset account, deposit) are defined as very high priority. Other than data on securitisation and business size, most new data is classified as standard priority (including new industry and sector classification).

It is the responsibility of senior management to ensure that appropriate systems, processes and controls, and adequate resources are in place to guarantee data submitted to APRA meets these quality requirements. This includes data accuracy thresholds, as well as ensuring proper design and operating system effectiveness. Such processes and controls are expected to cover the end-to-end data lifecycle. Lastly, the standard requires internal audit functions to undertake the responsibility that these policies, processes and controls continue to comply with ongoing EFS requirements

## Some of the Challenges

The changes come on top of the earlier changes to the submissions for International Exposures (ARF 231/731) and Residential Mortgage Lending (ARF223), which were announced in 2016 and reported in Q4 2017.

In the medium-term, this is unlikely to be the last word from APRA, given that the capital adequacy reports were not part of the review, that Basel 3 continues to make ground, and that the widely speculated prospect of Basel 4 is driving a further wholesale reconstitution of regulatory imperatives.

These challenges centre primarily on data, which in many instances reside in silos all over the organisation, whether on legacy mainframes, hidden on the internal hard drives of employees, lost in a newly created private cloud, or even kept outside of the organisation.

In response to this challenge, an increasing number of reporting institutions are reinvesting in their data warehouse programs to streamline and rationalise data storage, management, archival and retrieval.

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Such programs are principally designed to ensure that reportable data are accessible, accurate, and up-to-date. While on face value this is a scornfully basic prerequisite for regulatory reporting, the sheer volume of resources currently assigned to this task at reporting institutions around Australia exhibits the acuteness of this issue.

Changes in reporting concepts are presenting other challenges from interpretation and comparability perspectives. As in the earlier example of agency needs versus accounting and management reporting needs (e.g., derivatives) versus supervisory needs (e.g., housing loan purpose), there may well also be misalignment in consolidation levels between accounting, supervisory and EFS collection.

The upside is that savvy institutions are recognising that the inevitable costs associated with complying with this current wave of regulatory requirements provide opportunities beyond binary compliance. Such initiatives, by virtue of the need to extract, interrogate and present data, can also be leveraged to drive business decisions for competitive advantage. Leading minds are, for example, considering how micro-concentration within sub-classifications of asset classes, geographies, or industries can be overlayed with other previously disconnected data, such as macro forecasts to create new intelligence on which to base market manoeuvres.

## Conclusion

Regulation and technology are two critical pillars upon which organisational success is founded. In banking, regulation is driving structural innovation vis-à-vis technology.

Many institutions have responded to this challenge and capitalised on its opportunities through a combination of internal initiatives and third-party partnerships. These organisations have recognised the merits of combining art with science, successfully blending the idiosyncrasies of the organisation with the confidence of vended solutions. A marriage that has proven successful in the arena of compliance and regulatory reporting.

As processes mature and become better defined, more units and departments of financial services firms will realize the cascading benefits of a unified multi-dimensioned regulatory-exploratory risk-finance ecosystem, including reduced ownership costs with increased transparency to both regulators and leaders.

Notes:

<sup>1</sup> [Response to Submissions](#): Modernised economic and financial statistics (EFS) data collection, August 2017

<sup>2</sup> [Letter from APRA](#) to all regulated banks and financial institutions in Australia, January 2018.

<sup>3</sup> [The full list](#) of reporting requirements for Australian ADIs.

Nixora Group is a data management and advisory firm that operates in partnership with world leading IT companies to provide banks and financial institutions with innovative solutions.

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Collins Square, Level 23, Tower Five  
727 Collins Street - Melbourne Vic 3008  
Ph: +61 3 9101 8038 Email: [Contact@nixoragroup.com.au](mailto:Contact@nixoragroup.com.au)