



PRUDENTIAL PRACTICE GUIDE

Draft CPG 900 Resolution Planning

Integrated version

September 2022

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About this guide

Prudential practice guides (PPGs) provide guidance on APRA's view of sound practice in particular areas. PPGs frequently discuss legal requirements from legislation, regulations or APRA's prudential standards, but do not themselves create enforceable requirements.

Prudential Standard CPS 900 Resolution Planning (CPS 900) requires entities that are significant financial institutions (SFIs), or those that provide critical functions, to support APRA in the development and implementation of a resolution plan.

This PPG, *Prudential Practice Guide CPG 900 Resolution Planning (CPG 900)*, provides guidance to support the implementation of CPS 900. It sets out the outcomes that APRA is seeking to achieve at each stage of the resolution planning process, and the factors that APRA will have regard to in developing a resolution plan for a particular entity.

This integrated version of CPG 900 maps APRA's guidance to the relevant paragraphs in CPS 900. Paragraphs from CPS 900, which are enforceable requirements, have been set out in blue boxes like this; the accompanying guidance follows below, outside the blue boxes.

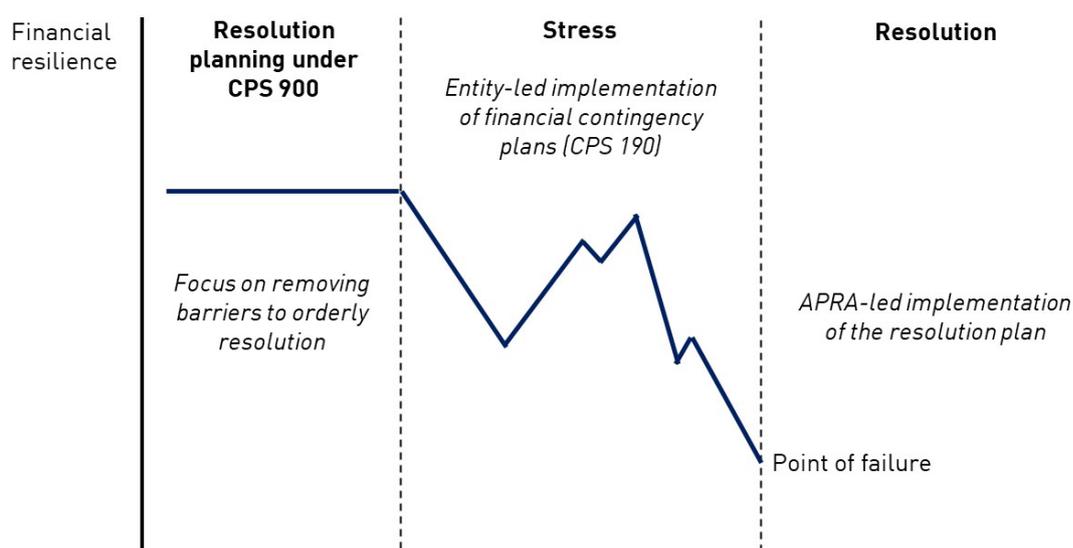
Glossary

| | |
|----------------------|---|
| ADI | Authorised deposit-taking institution |
| APRA | Australian Prudential Regulation Authority |
| Beneficiaries | Beneficiaries are collectively depositors, insurance policyholders and superannuation fund members of APRA-regulated entities |
| CPS 190 | <i>Prudential Standard CPS 190 Financial Contingency Planning</i> |
| CPS 900 | <i>Prudential Standard CPS 900 Resolution Planning</i> |
| FMI | Financial market infrastructure |
| Non-SFI | Non-significant financial institution |
| PPG | Prudential practice guide |
| RSE | Registrable superannuation entity |
| RSE licensee | Registrable superannuation entity licensee as defined in s10(1) of the <i>Superannuation Industry (Supervision) Act 1993</i> |
| SFI | Significant financial institution |

Resolution planning

Resolution is the process of dealing with a failed regulated entity, led by APRA as the resolution authority.¹ In the unlikely event that an APRA-regulated entity fails, APRA's objective is to minimise any adverse impact on depositors, insurance policyholders and superannuation fund members, while promoting financial stability (orderly failure). For large and complex entities, this requires planning in advance (see Figure 1).

Figure 1. Indicative resolution lifecycle



CPS 900 sets out certain requirements for entities to cooperate with APRA in resolution planning. Under CPS 900, APRA will develop a resolution plan, which sets out APRA's strategy for resolving an entity in the event of its failure. This could include, for example, plans to recapitalise, wind-down or transfer operations. It is an important complement to a financial contingency plan, which sets out an entity's plan for managing risks to its financial viability.

Entities would only be subject to the requirements of CPS 900 when informed by APRA that it is commencing resolution planning. Prior to this, there are no requirements under CPS 900 that the entity would need to meet. There are six main stages to the resolution planning process; the outcomes from each are set out in Table 1 below. Shading has been used to differentiate the stages led by entities.

¹ APRA has powers to resolve failing banking and insurance entities through various Acts that it administers, including those introduced through the *Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Act 2018*. For superannuation, this includes powers introduced through the *Treasury Laws Amendment (Your Future, Your Super) Act 2021*.

Table 1. Stages of resolution planning

| Stage | Outcome |
|---|--|
| Critical functions assessment | APRA determines whether an entity has functions that could be important to financial system stability or the availability of essential financial services to a particular industry or community. |
| Identification of resolution options | APRA identifies options that could be used to support the orderly resolution of an entity and ensure the continuity of its critical functions. |
| Resolvability assessment | APRA may require an entity to assess the feasibility of resolution options, including potential barriers to implementation. |
| Determination of resolution plan | APRA determines which options may be used in resolution, and sets out its resolution plan. |
| Pre-positioning and capabilities | APRA may require an entity to remove barriers to the execution of the resolution plan, and develop and maintain necessary capabilities. |
| Review | Once the resolution plan has been established, an entity must undertake a regular review of its resolvability assessment. |

The resolution planning process would typically occur over several years. APRA expects that the initial stages would be mainly focused on information gathering and assessment, providing for a gradual implementation of requirements under the standard.

The resolution planning process would typically involve frequent engagement between APRA staff and the regulated entity. APRA expects that engagements would be open, cooperative and constructive, and that entities would provide the information needed for APRA to make informed assessments.

Where an entity has overseas operations, CPS 900 requires the entity to support the development and maintenance of cross-border components of a resolution plan. APRA may establish a working group to facilitate the consideration of cross-border resolution issues with overseas regulators.

Developing a resolution plan

Critical functions

13. An APRA-regulated entity must support APRA in the determination of whether it provides any critical function, if required by APRA. This may include the identification of all material business activities of the entity, and an assessment of whether any of these activities are critical functions based on their systemic impact, customer impact and the substitutability by other providers if they were to cease.

The first phase of the resolution planning process would typically involve an assessment of critical functions. Critical functions refer to any function that an individual entity provides that are important to financial system stability or the availability of essential financial services to a particular industry or community.²

The critical functions assessment is a foundational step in resolution planning; an orderly resolution would protect depositors, insurance policyholders and superannuation fund members (beneficiaries), and avoid significant disruption to the supply of critical functions.

Identifying critical functions is a complex judgement, which relies on a range of quantitative and qualitative information. To inform its judgement, APRA would typically provide entities with an information request and ask that entities complete a self-assessment against key criteria. Good practice would be to provide supporting information to explain any justifications against the criteria, where appropriate.

Table 2 below sets out APRA's key areas of focus in assessing critical functions, which would form the basis of information requests. Functions that do not have a material impact on financial stability, industries or communities, or those that can be substituted with a minimum of time and cost would be unlikely to be considered critical.

Table 2. Indicators of critical functions

| Factor | Key considerations for a function to be defined as "critical" |
|-----------------|--|
| Systemic impact | <ul style="list-style-type: none">• The function is highly interconnected with other participants.• There would be a significant impact on market confidence or operation if the function ceased.• There is potential for contagion to other market participants if the function ceased. |

² Critical functions are distinct from critical operations. Critical operations are defined in draft *Prudential Standard CPS 230 Operational Risk* (CPS 230) and relate to processes that would be important for a particular entity to ensure it could continue to provide its own business services through a disruption.

| | |
|-------------------------------------|---|
| Industry or community impact | <ul style="list-style-type: none"> • The entity provides highly concentrated services to a particular geographical region or community. • The entity provides specialised or unique services critical to a particular industry. |
| Substitutability | <ul style="list-style-type: none"> • The market is highly concentrated. • There are no clear substitutes, either alternative providers or different products. • The function cannot be quickly substituted with minimal disruption. • There are barriers to entry for new providers, such as contractual arrangements, infrastructure or expertise. |

APRA’s approach to assessing critical functions includes a focus on specific industry and community impacts. This is important since some industries or communities may be particularly reliant on the financial services of individual entities. For example, the failure of an insurer that provides builders warranty insurance could have significant impacts for the real economy, if new construction projects were unable to proceed due to lack of insurance cover.

Ahead of finalising its critical functions assessment, APRA would communicate its findings to an entity. This provides an opportunity for entities to clarify conclusions or provide further information, where appropriate.

Resolution options

14. APRA may determine a resolution plan for an APRA-regulated entity or a cohort of APRA-regulated entities, setting out the steps APRA would take to protect beneficiaries and maintain financial system stability in the event of entity non-viability. This may include resolution options such as a solvent wind-down, transfer, or recapitalisation of the entity or entities.

15. An APRA-regulated entity must support APRA in the development and implementation of a resolution plan.

Following an assessment of critical functions, APRA would then identify resolution options to support the orderly resolution of an entity. There are a range of potential options, depending on the industry an entity operates in and its particular risk characteristics. Some key examples are set out in Table 3 below.

Table 3. Potential resolution options

| Option | Likely application | Desired outcome |
|-------------------------|--|---|
| Recapitalisation | The largest and most complex entities, with significant critical functions | The conversion of hybrid capital instruments into equity, to restore viability using private, rather than public, funds |

| Option | Likely application | Desired outcome |
|----------------------|---|--|
| Transfer | Small to medium-sized entities, typically with limited critical functions | The transfer of all, or part, of an APRA-regulated entity to another party |
| Wind-down or run-off | Entities with no critical functions | Ceasing certain business activities with minimal adverse impact on customers, counterparties or the wider financial system |

16. An APRA-regulated entity with overseas operations must support the development and maintenance of cross-border components of the resolution plan.

Role of the Board

17. The Board of an APRA-regulated entity is ultimately responsible for ensuring the entity is resolvable. The Board must ensure that there are clear roles and responsibilities at a senior executive level for the purpose of meeting the requirements in this Prudential Standard.

18. The Board must provide oversight of and approve, where applicable:

- a) a resolvability assessment; and*
- b) a pre-positioning plan.*

A prudent Board would ensure that the resolvability assessment and pre-positioning plan have been subject to rigorous review and challenge. This could include an independent review, where considerations are complex or require specialist skills. Where APRA has concerns over the accuracy or completeness of an entity's resolvability assessment or pre-positioning plan, it may require an independent review at the APRA-regulated entity's expense.

Resolvability assessment

19. APRA may require an APRA-regulated entity to conduct a resolvability assessment to assess the feasibility of resolution options. The resolvability assessment must be conducted by personnel with appropriate skills and experience.

Once APRA has identified potential resolution options, APRA would typically request entities to assess their feasibility. This provides an opportunity for entities to provide feedback to APRA on the potential costs, risks and impacts of these options and associated pre-positioning measures.

APRA would typically provide entities with 3-6 months to complete the resolvability assessment; APRA may hold several engagements with entities throughout this period to assess progress.

20. For each resolution option, the resolvability assessment must assess:

a) any legal, structural, operational or regulatory barriers to implementation;

Impediments could arise from a range of sources, including:

- contracts that do not allow for transferability of functions or prevent recapitalisation objectives;
- organisational structures that may not facilitate partial transfers;
- reliance on shared services and key staff;
- dependence on financial market infrastructure (FMI) service providers;
- insufficient financial resources; or
- a need for regulatory approvals or exemptions to execute the option.

b) timelines for implementation;

It is important that the resolution option can be implemented in a timely manner. A prudent entity would assess all relevant steps needed to implement the option, clearly indicating where timeframes may be dependent on external parties.

c) any execution risks; and

Execution risks could arise from a range of sources, including:

- reliance on external parties;
- weaknesses in systems for producing valuations; or
- potential barriers to the effective conversion or write-down of capital instruments.

d) pre-positioning measures required to effectively execute the option.

Where barriers to implementation and execution risks have been assessed as low, and timelines for implementation are within acceptable ranges, APRA expects that pre-positioning measures would be fairly limited.

An example may be where the resolvability assessment identifies certain clauses in contracts with third-party service providers that would inhibit access to these services in resolution. A prudent entity would clearly demonstrate how their pre-positioning measures would mitigate this risk.

In addition to pre-positioning measures, an entity would identify the capabilities required to execute the resolution options. This might include systems and expertise needed to ensure operational continuity during resolution.

21. APRA may require an independent review of the resolvability assessment.

Resolution plan

Using the findings from an entity's resolvability assessment, APRA would then determine an entity's resolution plan. The resolution plan sets out APRA's strategy for resolving the APRA-regulated entity, to protect beneficiaries and maintain the continuity of identified critical functions.

In determining the resolution plan, APRA will weigh up a range of considerations. APRA will seek to achieve its objectives – the financial safety of institutions and the stability of the Australian financial system – in a manner that balances efficiency, competition, contestability and competitive neutrality. APRA will also seek to leverage any work that has already be done to improve resolvability under an entity's financial contingency plan.

Pre-positioning

Pre-positioning plan

22. APRA may require an APRA-regulated entity to develop and implement a pre-positioning plan to remove barriers to the execution of resolution options and mitigate execution risks.

23. The pre-positioning plan must include, where applicable:

- a) changes to organisational or legal structure, including the location of any shared support services within a group;*
- b) renegotiation of contracts, including with third-party service providers;*
- c) development of wind-down or run-off plans for particular businesses or assets;*
- d) measures to ensure the operational continuity of key functions and services during resolution; and*
- e) any other actions required to remove barriers to the execution of resolution options or mitigate execution risks.*

24. APRA may require an APRA-regulated entity to implement additional pre-positioning actions if necessary to support a resolution plan.

Once a resolution plan has been determined, APRA-regulated entities will typically be required to develop and implement a pre-positioning plan for the measures identified in the resolvability assessment. APRA expects that these plans would set out clear timeframes and accountabilities for the completion of pre-positioning actions. Prudent entities would also set out the risks to effective implementation, making sure that appropriate mitigants are in place.

APRA will engage with entities regularly to assess progress against the plan. A prudent entity would make sure that there is appropriate oversight of the plan. Where APRA is not satisfied with the actions planned or taken, APRA may require additional pre-positioning actions to be taken.

Capabilities

25. An APRA-regulated entity must develop and maintain the capabilities required to execute a resolution plan. This includes, but is not limited to:
- a) crisis governance arrangements;
 - b) operational capabilities;
 - c) data and systems; and
 - d) a post-crisis stabilisation plan.
26. APRA may require an APRA-regulated entity to establish and maintain capabilities that APRA considers are reasonably necessary to support a resolution plan.
27. An APRA-regulated entity must maintain the financial resources required to operationally execute resolution actions.

Table 4 below sets out some example considerations for resolution capabilities.

Table 4. Key resolution capabilities

| Capabilities | Example considerations |
|---------------------------------------|---|
| Crisis governance arrangements | It is important that appropriate governance arrangements can be put in place to support an orderly resolution, and maintain effective oversight of risks. A prudent entity would consider the need for engagement with key stakeholders, including regulators, and key risk indicators that would need to be monitored. |
| Operational | Good practice would be to consider how to retain staff in key roles that are necessary for operational continuity, taking into account incentives or transferability of roles. A prudent entity would also consider their reliance on third-party service providers and FMI, where appropriate. |
| Data and systems | It is important that management information systems can produce timely and accurate information, including accounting, position keeping and risk systems. |
| Post-crisis stabilisation plan | Where the resolution plan involves an entity continuing to operate following resolution, a prudent entity would have an established plan for returning to a sustainable and resilient long-term financial position. These plans would be underpinned by prudent assumptions. |
| Financial resources | It is important that entities are able to maintain the financial resources required to operationally execute resolution actions, including sufficient capital to absorb losses and liquidity to continue meeting financial obligations. |

Loss-absorbing capacity

28. APRA may require an APRA-regulated entity that is not an RSE licensee to maintain an amount of loss-absorbing capacity to support the resolution plan:
- a) for an ADI, APRA may adjust its Total Capital prudential capital requirement under Prudential Standard APS 110 Capital Adequacy; and
 - b) for an insurer, APRA may adjust its prudential capital requirement under Prudential Standard GPS 110 Capital Adequacy or Prudential Standard LPS 110 Capital Adequacy, or a capital adequacy supervisory adjustment under Prudential Standard HPS 110 Capital Adequacy.
29. For an APRA-regulated entity that is not an RSE licensee, APRA may adjust prudential requirements for capital where material barriers to resolution are not addressed or where capabilities to support a resolution plan are insufficient.

In determining a resolution plan, APRA may require an entity that is not an RSE licensee to hold an amount of loss-absorbing capacity to support the execution of a resolution option. This is more likely to occur under a recapitalisation strategy, and could be necessary for the execution of other resolution options. In requiring entities to maintain loss-absorbing capacity, APRA's objective is to ensure that, in the event of failure, an entity could be resolved using private rather than public funds.

External advisors

30. APRA may require an APRA-regulated entity to:
- a) engage, at the expense of the APRA-regulated entity, expert external advisors as may be prescribed by APRA, to support with any aspect of this Prudential Standard; or
 - b) pay the costs of external advisors engaged by APRA to support in the exercise of APRA's powers and functions under this Prudential Standard.

Review and notification

Review

- 31. An APRA-regulated entity must review the resolvability assessment at least every three years, or as otherwise determined by APRA. The review must be conducted by operationally independent, appropriately experienced and competent persons, and be submitted to APRA.*
- 32. The review must recommend any updates to the pre-positioning plan to reflect any changes in organisational structure, strategy or risk profile that could affect the APRA-regulated entity's resolvability. The review must also recommend any updates to capabilities and resources necessary to support a resolution plan.*

Once the resolution plan has been developed, it is important that it remains effective and is updated, where appropriate. Strategic decisions can have significant impacts on the effectiveness of resolution planning. Decisions to enter new contracts, expand into new markets or restructure business lines may introduce new risks to the resolution plan, and prompt the need for additional pre-positioning actions.

Notification and disclosure

- 33. An APRA-regulated entity must notify APRA if it intends to make changes to its business or operations, if it becomes aware that such changes would create a material barrier to the resolution plan.*
- 34. An APRA-regulated entity must not make any disclosures on resolution planning without the approval of APRA.*



 **APRA**