



INFORMATION PAPER

APRA's policy priorities

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Chapter 1 – Introduction

1.1 Background

Through the prudential policy framework and its supervision activities, APRA establishes and enforces standards designed to ensure that, under all reasonable circumstances, financial promises made by financial institutions are met within a stable, efficient and competitive financial system.

APRA's prudential policy framework includes the legislation, prudential standards and guidance that, taken together, establish expectations for prudential conduct by regulated financial institutions. Regulated institutions are responsible for meeting the requirements relevant to their operations. APRA supervisors, in turn, rely on the prudential framework as a basis on which to assess prudent practice and, where necessary, enforce compliance with regulatory expectations.

This paper describes APRA's priorities for 2018 with respect to the prudential policy framework. These priorities include updating existing prudential requirements as well as introducing new components into the framework. In particular, APRA regularly updates and enhances prudential standards and guidance to ensure they remain fit for purpose, given changing industry conditions, and community and Australian Government expectations. As part of its role, APRA also provides advice to the government in areas where the legislative framework could be strengthened through changes to laws and regulations.

As set out in APRA's Corporate Plan, APRA's policy function is directed at:

- establishing a robust prudential framework that reflects all elements of APRA's mandate;
- maintaining a robust and flexible failure and crisis resolution framework; and
- ensuring policy development processes are effective.¹

In its policy development, APRA considers alternative options and assesses available data and other evidence on the likely impact of proposed policy changes. APRA undertakes a formal public consultation process and considers all submissions for each of its policy-making initiatives, and follows Office of Best Practice Regulation guidelines with respect to regulatory cost/benefit analysis and Regulation Impact Statements.

1.2 APRA's mandate

APRA's legislative mandate is set out in subsection 8(2) of the *Australian Prudential Regulation Authority Act 1998* (APRA Act):

¹ APRA, *2017-21 Corporate Plan*, 22 August 2017, available at: <http://www.apra.gov.au/AboutAPRA/Publications/Pages/index.html>.

In performing and exercising its functions and powers, APRA is to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and, in balancing these objectives, is to promote financial system stability in Australia.

These elements are summarised at a high level in Table 1, with illustrative examples of each in the context of the prudential framework.

Table 1: Elements of APRA's mandate

Objective	Policy is aimed at:	Examples
Financial safety	Financial soundness of individual regulated institutions	Minimum capital requirements for authorised deposit-taking institutions (ADIs) and insurers; risk management and governance expectations for all APRA-regulated entities
Efficiency	Least-cost regulatory option relative to delivery of prudential objective; avoiding distortion of resource allocation in the economy	Align regulatory requirements to industry sound practice; limit regulatory reporting to data that has most value in supervision or through publication
Competition	Institutions being able to compete with other regulated and unregulated providers through prices and features offered on their products and services	Focus on risk alignment rather than product-specific requirements; consideration of level playing field in policy options and simpler options for smaller entities
Contestability	Not hindering ease of entry and exit; new entities able to enter the market at reasonable cost	Regulatory requirements for new APRA-regulated institutions are flexibly applied in a manner proportionate to risk to the community
Competitive neutrality	Classes or types of institutions not favoured over others	Consistent regulatory requirements across classes of institutions; any differences in minimum financial soundness, governance or risk management expectations across regulated entities are necessary to align with scale, complexity and risk
Financial system stability	Resilience of credit, savings, insurance and investment markets and operations; maintenance of public confidence in financial sector	Minimum capital and liquidity requirements for ADIs and insurers; recovery planning expectations; the Financial Claims Scheme; expectations for assessment of outcomes provided to superannuation members

Most policy proposals involve potential impacts on regulated industries that involve multiple aspects of APRA's mandate. APRA considers how best to balance these objectives when it

consults on new or revised aspects of the prudential framework. To facilitate engagement with stakeholders, APRA's consultation on substantive changes to the prudential framework generally include a summary table explaining APRA's preliminary judgement of these considerations.

1.3 Drivers of policy priorities

Policy priorities are regularly reviewed by APRA within an overall framework of emerging risk analysis, strategic priorities for each regulated industry, related supervision activities, and relevant resource considerations both within APRA and industry.

In general, APRA's policy initiatives are motivated by one or more of the following underlying objectives:

- targeting improvements to prudential soundness, based on changing industry circumstances, risk management practices or emerging risks;
- a need to improve the clarity and efficiency of the existing framework to reduce burden or improve competition impacts or other outcomes, for example to update outdated concepts or remove requirements that are no longer needed; and
- external influences, including international regulatory measures and Government priorities.

Over the last decade, APRA's policy agenda was largely driven by reform of the prudential landscape for superannuation and a need to uplift APRA's governance and capital requirements across all industries. In more recent years, APRA's policy agenda has been significantly driven by external influences, most notably the finalisation of the internationally agreed banking regulatory reforms in response to the global financial crisis, and the need to respond to government initiatives. These have included structural regulatory changes such as shifting regulatory responsibility for private health insurers (PHIs) to APRA, and a broader focus on conduct and accountability in financial services. APRA has also focused on measures to ensure its policy requirements are proportionate, do not have adverse competitive impacts and give due consideration to the regulatory burden on institutions. Chapter 4 provides an overview of the 2018 priorities according to these key drivers.

Chapter 2 – 2017 in review

During 2017, APRA completed or progressed a number of enhancements to the prudential framework.

In the banking sector, these included:

- the calibration of benchmarks for ‘unquestionably strong’ capital ratios for authorised deposit-taking institutions (ADIs), addressing the first recommendation of the 2014 Financial System Inquiry (FSI);
- a policy framework for mutually owned ADIs to issue common equity capital instruments;
- updates to the prudential requirements for credit exposure concentrations (large exposures) consistent with international standards;
- updated guidance on residential mortgage lending, including sound lending standards; and
- completion of other elements of banking policy reforms underway for some time, including a prudential practice guide on securitisation.

APRA also issued a consultation paper on a phased approach to authorising new entrants to the banking industry. This proposal is intended to support increased competition by making it easier for applicants to navigate the ADI licensing process.

In the insurance sector, APRA:

- consulted on and finalised the application of APRA’s risk management prudential standard to private health insurers;
- consulted on a framework to strengthen the role of the appointed actuary in insurers; and
- initiated review of aspects of the life reinsurance framework.

Promoting improved governance and management in the superannuation sector is an ongoing priority for APRA, and one which has seen enhanced focus during the last year across APRA’s supervision and policy-making activities. During 2017, activities to enhance the superannuation policy framework included:

- updated guidance on successor fund transfers in superannuation funds;
- industry consultation on a key project to strengthen the focus on member outcomes by registrable superannuation entities (RSE) licensees; and
- advice to government on a variety of legislative reform proposals.

Other policy initiatives spanned multiple regulated industries. During 2017, APRA finalised its requirements for margining of derivatives exposures. APRA also conducted informal consultation with industry to obtain input into potential approaches for updating the cross-industry prudential standards on outsourcing and business continuity management, as well as developing new prudential requirements for information security, as discussed further in Chapter 3.

During 2017, APRA provided significant policy input into the drafting of the *Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017* (the Crisis Management Bill). The Crisis Management Bill, which was supported by a recommendation from the FSI, is the culmination of several years of policy development and public consultation since the global financial crisis on proposed enhancements to APRA's crisis management powers. This legislation, if passed, will strengthen APRA's powers to plan for, and respond to, the failure of an ADI or insurer.²

APRA also provided input to the Australian Government across a range of other legislative initiatives that would affect the prudential framework, including the new banking executive accountability regime (BEAR), governance reforms in superannuation, which would also see strengthened powers for APRA in some important areas, and limited rule-making power over non-ADI lenders.

In addition, over 2017, APRA made improvements to its policy processes in several areas. These included:

- greater use of informal industry consultation methods, such as workshops and roundtables, to solicit early feedback on policy proposals including from non-traditional industry participants; and
- early focus on implementation challenges, including more formalised implementation plans for supervisors and structured industry engagement.

² APRA, *Submission to the Senate Economics Legislation Committee's Inquiry into the Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017*, 18 December 2017, available at: <http://www.apra.gov.au/Submissions/Documents/APRA-Submission-17.03-Senate-Economics-Committee-Inquiry.pdf>.

Chapter 3 – Policy priorities for 2018

3.1 Banking

Capital

At the end of 2017, the Basel Committee on Banking Supervision published the final components of its revisions to the risk-based capital framework.³ These changes are aimed at reducing unwarranted variability in banks' reported risk-weighted assets. In early 2018, APRA will commence public consultation on associated changes to its prudential requirements for minimum ADI capital. This will include consultation on the broad set of proposed changes early in 2018, and subsequent individual consultations on specific prudential standards over the course of 2018 and 2019.

APRA expects to commence the more detailed consultation phase with the credit risk capital prudential standards (*Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk* and *Prudential Standard APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk*) during 2018. Following this in 2019, APRA will consult on revisions to the prudential standards for operational risk, interest rate risk in the banking book and market risk, and associated changes to reporting and public disclosure requirements.

This stream of work will be a multi-year process and likely to involve multiple rounds of consultation. Given the need for extensive consultation, APRA does not expect to finalise the suite of prudential standards until 2019 or later. Where feasible and appropriate, APRA will consult on a proportionate approach including simplified requirements for smaller ADIs. Given the broad reach and complexity of the latest Basel reforms, APRA will give due consideration to appropriate adjustments to the implementation of these reforms to reflect Australian conditions.

As flagged in APRA's July 2017 information paper on unquestionably strong capital, APRA is considering changes to its overall approach to capital requirements in a number of areas where APRA's methodology is more conservative than minimum international requirements. If APRA proceeds in this direction, the outcome would be presentational changes to a number of capital prudential standards, although these would not affect the quantum of capital required.

APRA expects to introduce a minimum leverage ratio requirement for ADIs, consistent with the Basel III framework. APRA will commence consultation in early 2018, with a view to finalising the prudential standard *Prudential Standard APS 110 Capital Adequacy* in late 2018 or early 2019. This will also address one of the recommendations of the FSI.

Later in 2018, APRA also expects to commence consultation on proposals to implement the FSI's recommendation on a framework for minimum loss-absorbing and recapitalisation capacity. This will reflect considerations, in discussion with the Council of Financial

³ Basel Committee on Banking Supervision, *Basel III: Finalising post-crisis reforms*, December 2017, available at: <https://www.bis.org/bcbs/publ/d424.htm>.

Regulators, on an appropriate domestic approach for increasing the loss-absorbing capacity of the banking system.

APRA will finalise requirements for counterparty credit risk that were previously subject to consultation, for intended implementation in 2019. APRA also expects to issue for consultation various updates to *Prudential Standard APS 111 Capital Adequacy: Measurement of Capital* dealing with clarifications and refinements relating to the measurement of capital arising from Basel III as well as APRA's experience.

Executive accountability

The Australian Government has introduced legislation to enact a new banking executive accountability regime, known as BEAR.⁴ The proposed legislation builds on APRA's existing governance and 'fit and proper' regimes for ADIs by clarifying accountability for ADI executives and board members, and strengthening APRA's powers when expectations are breached. The legislation would provide APRA with the ability to pursue penalties against ADIs for unacceptable conduct that harms an ADI's prudential standing or reputation, while also enhancing existing disqualification powers over bank executives.

Given that the new requirements for accountability and remuneration are set out in the proposed BEAR legislation in some detail, APRA does not anticipate the need to incorporate BEAR expectations into the prudential standards or prudential practice guides in 2018. Through the implementation process, however, APRA will provide guidance where appropriate, potentially in the form of published Frequently Asked Questions (FAQs). In the medium term, APRA will consider whether changes to its existing fit and proper and remuneration requirements are needed to better align with the new legislative requirements as well as to reflect APRA's supervisory experience and industry developments.

Licensing and related matters

In the second quarter of 2018, APRA intends to finalise its approach to licensing certain new ADIs through a phased approach, as set out in its 2017 discussion paper on this topic.⁵ Although this may not include any changes to the prudential framework, APRA intends to publish a response package that will include an information paper setting out the phased licensing framework, which APRA expects will be available to an appropriate subset of potential ADI applicants. APRA will also update its *Guidelines on implementation of section 66 of the Banking Act 1959* should proposed changes to the *Banking Act 1959* to allow all ADIs to use the term 'bank' be passed.⁶

Other ADI matters

Other potential changes to the ADI policy framework are aimed at updating longstanding requirements to ensure the prudential framework remains fit for purpose. These initiatives,

⁴ Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Bill 2017, available at: https://www.aph.gov.au/Parliamentary_Business/Bills_LEGislation/Bills_Search_Results/Result?bld=r6000.

⁵ APRA, *Licensing: A phased approach to authorising new entrants to the banking industry*, 15 August 2017, available at: <http://www.apra.gov.au/AboutAPRA/Pages/0817-Consultation-Licensing.aspx>.

⁶ Treasury Laws Amendment (Banking Measures No. 1) Bill 2017, available at: https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bld=r5990.

together with those discussed above, are summarised in Table 2, including indicative timeframes for consultation, finalisation and implementation.

APRA's framework for management of ADIs' exposures to related parties (*Prudential Standard APS 222 Associations with Related Entities*) has not been substantively reviewed since 2003. APRA considers that aspects of the current framework warrant review, in particular the existing extended licensed entity (ELE) regime, which serves to exclude certain exposures from related party limits. APRA also intends to update the related party exposure framework to ensure that it remains consistent with the updated large exposure framework that was recently finalised. In addition, APRA intends to develop guidance or FAQs on the recently updated *Prudential Standard APS 221 Large Exposures* during 2018.

Prudential requirements for credit risk management in *Prudential Standard APS 220 Credit Quality* (APS 220) set expectations for ADI lending activity. APS 220 addresses risk management for loans and other credit exposures, including problem asset management and loan-loss provisions. APS 220 was last substantively updated for the adoption of relevant provisions in international financial reporting standards (IFRS) in 2006. Since then, there have been a number of developments in provisioning, notably the adoption of *IFRS 9 Financial Instruments*, which requires an expected loss approach to provisions.⁷

In addition, given developments in industry practices, APS 220 does not adequately address prudential expectations for loan underwriting standards. This includes expectations that APRA has incorporated recently in *Prudential Practice Guide APG 223 Residential Mortgage Lending*. As a result, APRA expects to commence consultation on revisions to APS 220 during 2018. APRA also expects to commence development of a prudential practice guide for commercial property lending.

⁷ International Financial Reporting Standards Foundation, *IFRS 9 Financial Instruments*, January 2018.

Table 2: ADI policy priorities

	1st half 2018	2nd half 2018	2019
Conceptual framework for Basel III capital and other changes	Consult		Finalise
Counterparty credit risk	Finalise		Implement
Leverage ratio	Consult		Finalise
Standardised approach to credit risk capital (APS 112)		Consult	Consult and finalise
Advanced approach to credit risk capital (APS 113)		Consult	Consult and finalise
Measurement of capital (APS 111)		Consult	Finalise
Credit risk management (APS 220)		Consult	
Related party exposures (APS 222)	Consult		Finalise

3.2 Insurance

APRA's policy agenda for the insurance sector remains stable. Key initiatives are summarised in Table 3, below.

The work underway on the role of the appointed actuary across life, general and private health insurance will be finalised in early 2018. A number of technical matters are also being addressed to modernise existing requirements. In particular, APRA intends to update aspects of the reinsurance framework for life insurers, including approval requirements for certain types of reinsurance arrangements under *Prudential Standard LPS 230 Reinsurance* and the treatment of exposures to offshore reinsurers under *Prudential Standard LPS 114 Capital Adequacy: Asset Risk Charge* and *Prudential Standard LPS 117 Capital Adequacy: Asset Concentration Risk Charge*.⁸ APRA will also consider whether any policy changes are needed to address the upcoming implementation of the Australian Accounting Standards Board's *AASB 17 Insurance Contracts*.⁹

In the private health insurance sector, APRA continues to proceed with initiatives outlined in its PHI policy roadmap released in 2016. The prudential framework for PHIs is being

⁸ Refer to APRA's letters to life insurers on its review of requirements for reinsurance arrangements <http://apra.gov.au/lifs/PrudentialFramework/Pages/LPS-230-Reinsurance-Consultation-November-2017.aspx> and offshore life reinsurers <http://apra.gov.au/lifs/Documents/Review-of-LPS-117-15-Dec-2017.pdf>.

⁹ Australian Accounting Standards Board, *AASB17 Insurance Contracts*, July 2017.

progressively reviewed in three phases, beginning with risk management proceeding to governance and finishing with capital requirements.

In 2017, APRA finalised the first phase, the application of APRA’s cross-industry *Prudential Standard CPS 220 Risk Management* to PHIs, with an implementation date of 1 April 2018. APRA has recently commenced work on phase two of the roadmap and expects to consult on proposals relating to governance, fit and proper and audit early in 2018. APRA anticipates that, as with CPS 220, the principles underpinning APRA’s cross industry *Prudential Standard CPS 510 Governance* and *Prudential Standard CPS 520 Fit and Proper* will be broadly appropriate for the private health insurance industry.

Over the medium term, APRA expects that changes to the prudential framework for insurance may be needed to address issues with the provision of life insurance in superannuation, as well as potential innovative post-retirement products. APRA does not anticipate consulting on these issues in 2018, unless Australian Government priorities necessitate.

Table 3: Insurance policy priorities

	1st half 2018	2nd half 2018	2019
Risk management for PHIs (CPS 220)	Implement		
Reinsurance (LPS 230)	Finalise and implement		
Role of the appointed actuary	Finalise		Implement
Offshore reinsurers (LPS 114/117)	Consult		Finalise
Governance, fit and proper and audit for PHIs	Consult	Finalise	Implement

3.3 Superannuation

As the prudential framework is now well-embedded across the APRA-regulated superannuation industry, APRA is taking the opportunity to review whether the prudential standards, guidance and reporting obligations continue to support effective prudential supervision of the sector. Table 4 summarises the current set of initiatives.

During 2017, APRA foreshadowed a package of prudential reforms to address an identified gap relating to the adequacy of strategic and business planning practices within RSE licensees’ business operations. A consultation package outlining APRA’s proposals for strengthening superannuation member outcomes was issued in December 2017.¹⁰ The consultation package is designed to address the identified gaps in practices and also includes new *Prudential Standard SPS 225 Outcomes Assessment*, which would require RSE

¹⁰ APRA *Strengthening superannuation member outcomes*, 13 December 2017, available at: <http://www.apra.gov.au/Super/Pages/Strengthening-Member-Outcomes-Consultation-Dec17.aspx>.

licensees to undertake regular assessments of outcomes being delivered to members. Over the first half of 2018, APRA will meet with stakeholders and consider submissions in response to the package, with a view to releasing final requirements mid-2018. Implementation is expected to commence from January 2019. APRA has been engaged in the progress of legislation relating to the Government’s accountability and governance measures. Should this legislation proceed, APRA will consider what changes may be needed to align the prudential framework with the final legislative amendments.¹¹

APRA will also undertake a comprehensive post-implementation review of the remainder of the superannuation prudential and reporting frameworks; the prudential and reporting standards and associated guidance have been in place for five years and such a review is timely, given the pace of change in the industry. This process will involve public consultation on the effectiveness of the framework, including costs and benefits, whether the framework is meeting its objectives and whether any changes could enhance the framework. APRA hopes to report the findings of this review in late 2018 or early 2019. APRA will then consider how best to make any necessary changes to the prudential or reporting frameworks.

Table 4: Superannuation policy priorities

	1st half 2018	2nd half 2018	2019
Strengthening superannuation member outcomes	Consult	Finalise	Implement
Post-implementation review	Consult	Consult and finalise	

3.4 Cross-industry initiatives

In addition to industry-specific prudential requirements, APRA has issued prudential standards and guidance that apply to regulated entities across multiple regulated industries. These cross-industry standards and guidance are also subject to regular review and are updated as needed to incorporate prudential expectations and evolving industry sound practice. Where possible and appropriate, APRA takes opportunities to harmonise requirements across industries. Cross-industry initiatives and expected timeframes are shown in Table 5.

APRA has commenced an important project to update its existing prudential standards and guidance on outsourcing, business continuity and information security, which apply to entities in the banking, insurance and superannuation industries. The objective of this initiative is to align prudential requirements with industry better practice and community expectations for a high degree of resilience to material operational risk incidents. APRA’s intention is to also issue broad-based expectations for operational risk and resilience that align to the overarching risk management framework. APRA will take the opportunity to streamline existing requirements where appropriate.

¹¹ Refer to Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017, available at: https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bld=s1089.

As noted above, APRA undertook initial informal industry consultation during 2017, which was very useful in generating input for the policy development process. Formal consultation will commence with proposed prudential requirements for information security risk management, given that APRA does not have existing requirements in this area. Subsequently, requirements for operational risk management and revised standards for business continuity and outsourcing (updated to cover service provision more broadly) will be issued for consultation.

APRA will continue to work with Treasury to assist with the progression of the Crisis Management Bill through Parliament. This will provide the basis for APRA to formalise its prudential framework for recovery and resolution planning in the coming years, reflecting the lessons learnt from ongoing planning work with relevant banks and insurers. Consequential amendments may also need to be made to relevant subordinate instruments and regulations, although the nature and timing of any changes will not be determined until such time as the legislation has passed.

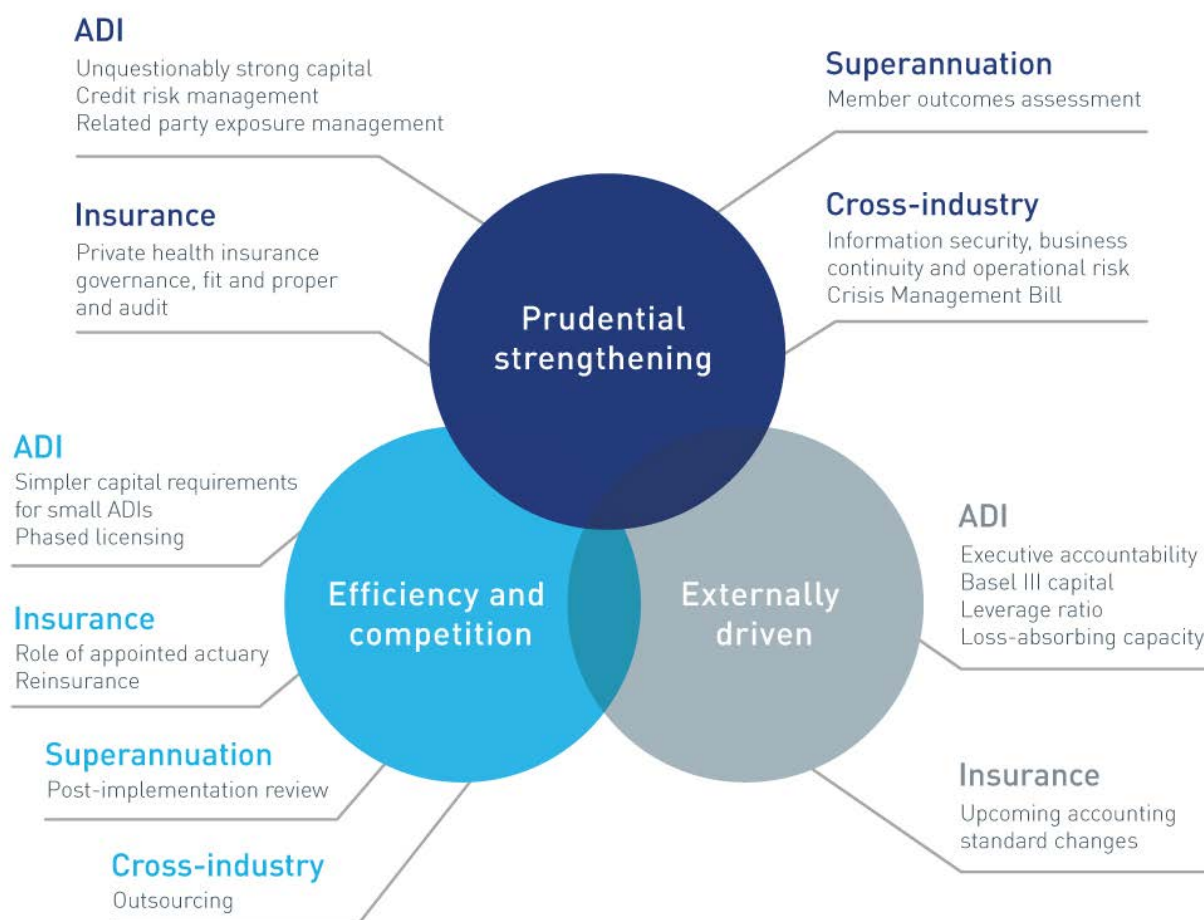
Table 5: Cross-industry policy initiatives

	1st half 2018	2nd half 2018	2019
Information security	Consult	Finalise	
Business continuity, outsourcing/service provision, operational risk		Consult	Finalise
Crisis Management Bill-related amendments			Consult

Chapter 4 – Summary

APRA’s policy activities encompass all aspects of APRA’s legislative mandate. As summarised in the diagram below, APRA’s current policy priorities are substantially weighted toward strengthening APRA’s prudential framework, but also reflect important measures to enhance its impact on efficiency and competition, taking account of Australian Government priorities and international banking regulatory developments.

Figure 1: Policy priorities for 2018, by primary driver





 **APRA**