

Banking (prudential standard) determination No. 4 of 2019

EXPLANATORY STATEMENT

Prepared by the Australian Prudential Regulation Authority (APRA)

Banking Act 1959, section 11AF

Under subsection 11AF(1) of the *Banking Act 1959* (the Act), APRA has the power to determine standards (prudential standards), in writing, in relation to prudential matters to be complied with by authorised deposit-taking institutions (ADIs). Under subsection 11AF(3) of the Act, APRA may, in writing, vary or revoke a prudential standard.

On 29 November 2019, APRA made Banking (prudential standard) determination No. 4 of 2019 (the instrument) which revokes *Prudential Standard APS 221 Large Exposures* made under Banking (prudential standard) determination No. 4 of 2018 and determines a new *Prudential Standard APS 221 Large Exposures* (APS 221).

The instrument commences on 1 January 2020.

1. Background

APRA's mandate is to protect the Australian Community by establishing and enforcing prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by institutions we supervise are met within a stable, efficient and competitive financial system. A key component of this is requiring ADIs to have prudent processes and systems for identifying, measuring, evaluating, monitoring, reporting and controlling or mitigating material risks that may affect their ability to meet obligations to depositors.

APS 221 requires ADIs to implement prudent measures and to set prudent limits on their exposures (e.g. loans) to counterparties, to monitor and control their large exposures and risk concentrations. The previous revisions to APS 221 introduced more conservative prudential limits on exposures to counterparties and stronger requirements for measuring and aggregating exposures. Lower prudential limits are intended to limit large losses to the ADI when a counterparty defaults. Stronger requirements on exposure measurement and aggregation is intended to enhance the ability of ADIs to monitor and control systemic risks to which they are exposed.

The instrument makes minor amendments to APS 221 to remove transitional arrangements which are not effective after 31 December 2019, clarify the operation of limits in APS 221 where limits in *Prudential Standard APS 222 Associations with Related Entities* (APS 222) apply, and correct an omission in relation to the exclusion of a government-related entity from having to be treated as a connected counterparty with the related government, central bank or other government-related entities in the application of the large exposure requirements. These minor amendments are beneficial for ADIs and were foreshadowed with ADIs since late 2018.

2. Purpose and operation of the instrument

The purpose of the instrument is to revoke APS 221 and replace it with a new version of APS 221.

The previous version of APS 221, which commenced in January 2019, included transitional arrangements that had effect until 30 June 2019 or 31 December 2019. These transitional arrangements have been removed from the new version of APS 221, which commences on 1 January 2020.

The new version of APS 221 adjusts an exclusion from connecting counterparties involving government-related entities for the purpose of applying the large exposure requirements. Under the previous version, the exclusion only applied to the definition of a ‘control relationship’ in paragraph 22 of APS 221. The exclusion has been extended to apply to the definition of an ‘economic interdependence relationship’ in paragraph 24.

The new version of APS 221 clarifies the requirements on exposure limits where both APS 221 (which deals with large exposures) and APS 222 (which deals with exposures to related entities) apply. Paragraph 30 of APS 221 now explicitly states that the limits in that paragraph do not apply to an ADI’s exposures to its related entities. APRA has included this clarification in APS 221 in response to requests from ADIs; an equivalent statement was included in a draft copy of APS 222 released in August 2019 following public consultation on that standard.

The changes to APS 221 are not expected to have a significant impact on the management or measurement of large exposures by ADIs, and reflect policy positions that are beneficial to ADIs. The changes have been anticipated by ADIs since late 2018 and have been discussed with ADIs over a number of months.

Where APS 221 refers to an Act, Regulation or prudential standard, this is a reference to the document as it exists from time to time, and which is available on the Federal Register of Legislation at www.legislation.gov.au.

APS 221 provides for APRA to exercise various discretions. Decisions made by APRA exercising those discretions are not subject to merits review. This is because these decisions are preliminary decisions that may facilitate or lead to substantive decisions which are subject to merits review.

A breach of a prudential standard is a breach of the Act, as section 11AG of the Act provides that ADIs must comply with applicable prudential standards. However, there are no penalties prescribed for breach of a prudential standard. Instead, an ADI’s breach of a provision in the Act is grounds for APRA to make further, substantive decisions under the Act in relation to the ADI. Those decisions are:

- (a) to revoke an authority to carry on banking business (section 9A of the Act);
and
- (b) to issue a direction to the ADI, including a direction to comply with the whole or part of a prudential standard (section 11CA of the Act).

It is only at this stage that an ADI is exposed to a penalty: loss of its authority under section 9A or 50 penalty units if it breaches the direction (section 11CG of the Act).

The subsequent substantive decisions by APRA to impose a direction or revoke an authority are subject to merits review. In nearly all cases¹ the decision is preceded by a full consultation with the ADI to raise any concerns it may have in relation to the decision.

3. Consultation

In late 2018 to early 2019, APRA consulted with ADIs through the Australian Banking Association, the Customer Owned Banking Association, and the Australian Securitisation Forum on various queries relating to the implementation of the previous APS 221, including specifically on the minor amendments in this instrument. The feedback from this consultation was that ADIs welcome the changes to clarify the operation and intent of APS 221 and maintain the prudential standard as up-to-date.

4. Regulation Impact Statement

The Office of Best Practice Regulation has advised that a Regulation Impact Statement is not required for this legislative instrument.

5. Statement of compatibility prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

A Statement of compatibility prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* is provided at Attachment A to this Explanatory Statement.

¹ Subsection 9A(4) of the Act specifically provides that APRA does not need to consult where APRA is satisfied that doing so could result in a delay in revocation that would be:

- (a) contrary to the national interest; or
- (b) contrary to the interests of depositors with the ADI.

ATTACHMENT A

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

Banking (prudential standard) determination No. 4 of 2019

The legislative instrument is compatible with the human rights and freedoms recognised or declared in the international instrument listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* (HRPS Act).

Overview of the Legislative Instrument

The purpose of the instrument is to revoke *Prudential Standard APS 221 Large Exposures* determined by the Australian Prudential Regulation Authority (APRA) in 2018 and replace it with a new *Prudential Standard APS 221 Large Exposures* (APS 221).

APS 221 sets out requirements for authorised deposit-taking institutions (ADIs) to implement prudent measures to monitor and control their large exposures and risk concentrations, and to set prudent limits on their exposures to counterparties. ADIs are bodies corporate that have been granted the authority, under the *Banking Act 1959*, to carry on banking business in Australia.

The new APS 221 includes minor amendments to remove transitional arrangements which no longer have effect, clarify the operation of limits in APS 221 in circumstances where limits in *APS 222 Associations with Related Entities* apply, and correct an omission in relation to an exclusion from connecting a government-related entity with the related government, central bank or other government-related entities in order to determine the counterparties to which large exposure requirements apply. The purpose of the changes is to correct, clarify and ensure APS 221 remains clear and up-to-date.

Human rights implications

APRA has assessed the instrument and is of the view that it does not engage any of the applicable rights or freedoms recognised or declared in the international instruments listed in section 3 of the HRPS Act. Accordingly, in APRA's assessment, the instrument is compatible with human rights.

Conclusion

The instrument is compatible with human rights as it does not raise any human rights issues.