

**Banking, Insurance, Life Insurance and Superannuation (prudential standard)
determination No. 1 of 2020**

EXPLANATORY STATEMENT

Prepared by the Australian Prudential Regulation Authority (APRA)

Banking Act 1959, section 11AF

Insurance Act 1973, section 32

Life Insurance Act 1995, section 230A

Superannuation Industry (Supervision) Act 1993, section 34C

APRA may, in writing, determine a prudential standard that applies to an APRA-regulated institution under:

- (1) subsection 11AF(1) of the *Banking Act 1959* (Banking Act), in relation to authorised deposit-taking institutions (ADIs) and authorised non-operating holding companies (authorised NOHCs);
- (2) subsection 32(1) of the *Insurance Act 1973* (Insurance Act), in relation to general insurers and authorised non-operating holding companies (authorised insurance NOHCs);
- (3) subsection 230A(1) of the *Life Insurance Act 1995* (Life Insurance Act), in relation to life companies (including friendly societies) and registered non-operating holding companies (registered life NOHCs); and
- (4) subsection 34C(1) of the *Superannuation Industry (Supervision) Act 1993* (SIS Act), in relation to Registered Superannuation Entity Licensees (RSELs).

APRA may, in writing, vary or revoke a prudential standard that applies to an APRA-regulated institution under:

- (1) subsection 11AF(3) Banking Act, in relation to ADIs and authorised NOHCs;
- (2) subsection 32(4) of the Insurance Act, in relation to general insurers and authorised insurance NOHCs;
- (3) subsection 230A(5) of the Life Insurance Act, in relation to life companies (including friendly societies) and registered life NOHCs; and
- (4) subsection 34C(6) of the SIS Act, in relation to RSELs.

On 25 August 2020, APRA made Banking, Insurance, Life Insurance and Superannuation (prudential standard) determination No 1 of 2020 (the instrument), which revokes *Prudential Standard CPS 226 Margining and Risk Mitigation for Non-Centrally Cleared Derivatives* made under Banking, Insurance, Life Insurance and Superannuation (prudential standard) determination No 1 of 2019, and determines a

new Prudential Standard CPS 226 Margining and Risk Mitigation for Non-Centrally Cleared Derivatives (CPS 226).

The instrument commences on 1 September 2020.

1. Background

APRA's mandate is to ensure the safety and soundness of prudentially regulated financial institutions so that they can meet their financial promises to depositors, policyholders and fund members within a stable, efficient and competitive financial system. APRA gives effect to its mandate by establishing minimum expectations for prudentially regulated financial institutions. The Banking Act, Insurance Act, Life Insurance Act and SIS Act allow APRA to issue legally binding prudential standards that set out specific prudential requirements with which APRA-regulated entities must comply.

APRA's prudential standards are often informed by developments in international standards. APRA's prudential requirements are expected to be consistent with those set by international standard setting bodies, such as the Basel Committee on Banking Supervision (Basel Committee) and International Organisation of Securities Commissions (IOSCO). To facilitate an international level playing-field, APRA is also expected to align its domestic implementation of prudential requirements with the internationally agreed timetables.

In 2015, the Basel Committee and IOSCO finalised minimum standards for margin requirements for non-centrally cleared derivatives transactions ('the BCBS-IOSCO framework'). The BCBS-IOSCO framework requires the exchange of initial margin. Initial margin protects against the potential future exposure that may arise from future changes in the mark-to-markets value of a non-centrally cleared derivative during the period of time that is assumed to be required to close-out and replace the position following a counterparty default. In December 2016, APRA implemented margin requirements for non-centrally cleared derivatives based on the BCBS-IOSCO framework, which commenced in March 2017 and under which the initial margin requirements were subject to a multi-year phase-in timetable.

In April 2020 in response to COVID-19, the Basel Committee and IOSCO jointly announced the deferral by 12 months of the next two stages of the phase-in of initial margin requirements for non-centrally cleared derivatives. The next phase-in period will now commence on 1 September 2021. APRA gives effect to margin requirements for non-centrally cleared derivatives through CPS 226. CPS 226 applies to APRA-regulated entities that actively transact in non-centrally cleared derivatives. APRA-regulated entities are required to exchange collateral to manage the risk of counterparty default, and to have policies and procedures to manage the risks associated with derivatives activity.

2. Purpose and operation of the instruments

The purpose of Banking, Insurance, Life Insurance and Superannuation (prudential standard) determination No 1 of 2020 is to revoke CPS 226 and replace it with a new version of CPS 226. The changes to CPS 226 are limited solely to the deferral of the commencement of the next two phase-in periods of initial margin requirements for

non-centrally cleared derivatives by 12 months, consistent with the revised international timetable. This is achieved by amending the dates in Table 2 at paragraph 20 of CPS 226 so that:

- (a) the Margining period 1 September 2019 to 31 August 2020 in the fourth row, becomes 1 September 2019 to 31 August 2021;
- (b) the Reference period March, April and May 2020 in the fifth row becomes March, April and May 2021; and
- (c) the Margining period 1 September 2020 to 31 August 2021 in the fifth row becomes 1 September 2021 to 31 August 2022.

The amendment will have the flow-on effect of deferring the items in the sixth row of Table 2 by 12 months.

The deferral of the next CPS 226 phase-in period for initial margin requirements by 12 months is intended to enable APRA-regulated entities to focus their time and resources on dealing with the impact of COVID-19. The instruments do not trespass on personal rights or liberties, or amend or modify the operation of primary legislation.

Where CPS 226 refers to an Act, Regulation, prudential standard or Australian Accounting Standard,¹ 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.

CPS 226 also incorporates by reference the BCBS-IOSCO framework as it exists at 23 July 2019 and the IOSCO Risk Mitigation Standards as they exist at 28 January 2015. These documents are available at: BCBS-IOSCO framework: <https://www.bis.org/bcbs/publ/d475.pdf>; and IOSCO Risk Mitigation Standards: <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD469.pdf>.

CPS 226 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.

Under the Banking Act, Insurance Act and Life Insurance Act, a breach of a prudential standard is a breach of the enabling legislation, as each enabling Act provides that regulated entities must comply with the standard. Under the SIS Act, it is a condition on all RSE licences that the RSE licensee must comply with the RSE licensee law, which includes prudential standards. However there are no penalties prescribed for breach of the prudential standards under any of these Acts. Instead an entity's breach of the enabling legislation or RSE licence condition is grounds for APRA to make further, substantive decisions under the relevant enabling legislation in relation to the entity. Those decisions are:

¹ Australian Accounting Standards is defined in *Prudential Standard APS 001 Definitions* as the Australian Accounting Standards issued by the Australian Accounting Standards Board as may be amended from time to time.

- (a) to revoke an authority to carry on banking business (section 9A of the Banking Act), insurance business (section 15 of the Insurance Act), or life insurance business (section 26 of the Life Insurance Act), or to revoke an authority to operate an APRA-regulated superannuation fund (section 29G of the SIS Act); and
- (b) to issue a direction to the regulated entity, including a direction to comply with the whole or part of a prudential standard (section 11CA of the Banking Act, section 104 of the Insurance Act, section 230B of the Life Insurance Act or section 131D of the SIS Act).

It is only at this stage that an entity is exposed to a penalty: loss of licence or imposition of a penalty if it breaches the direction (50 penalty units each day under section 11CG of the Banking Act, section 108 of the Insurance Act and section 230F of the Life Insurance Act, 100 penalty units each day under section 131DD of the SIS Act).² The subsequent substantive decisions of APRA to impose a direction or revoke a licence are subject to merits review. In nearly all cases,³ the decisions are preceded by a full consultation with the regulated entity to raise any concerns they may have in relation to the decision.

3. Consultation

APRA did not engage in any formal public consultation prior to amending CPS 226. The decision-maker is satisfied that no public consultation in this instance was appropriate, given the changes are intended to provide relief to APRA-regulated entities at a time when their resources are more appropriately directed to dealing with the impact of the COVID-19 pandemic on their businesses and on the Australian financial system. Furthermore, the deferral to the phase-in periods had been requested by a number of APRA-regulated entities and industry bodies. APRA publicly announced its intention to defer the commencement of the next two phase-in periods of CPS 226 in April 2020.

4. Regulation Impact Statement

The Office of Best Practice Regulation has advised that no Regulation Impact statement is required as the changes to CPS 226 are minor and machinery.

² The exception is section 54B of the SIS Act, which provides that breach of a covenant under sections 52 or 52A is a civil penalty provision. The covenants include a requirement to comply with prudential standards in relation to specified topics (conflicts, capital requirements for operational risk, MySuper and choice products). CPS 226 is not a standard in relation to any of these topics.

³ The Banking Act, Insurance Act and Life Insurance Act specifically provide that APRA does not need to consult where APRA is satisfied that doing so could result in a delay in revocation that would be contrary to the national interest or the interests of depositors with the body corporate (subsection 9A(4) of the Banking Act), contrary to the national interest (subsection 15(4) of the Insurance Act), or contrary to the public interest (subsection 26(5) of the Life Insurance Act), respectively. Consultation is not specifically required under the SIS Act.

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.

ATTACHMENT A

Statement of Compatibility with Human Rights

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

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

Overview of the Legislative Instruments

The purpose of Banking, Insurance, Life Insurance and Superannuation (prudential standard) determination No. 1 of 2020 is to revoke CPS 226 and replace it with a new version of CPS 226. The changes to CPS 226 defer the commencement of the next two phase-in periods of initial margin requirements for non-centrally cleared derivatives by 12 months, consistent with the revised international timetable. The deferral relates to a prudential standard that is concerned only with imposing financial obligations on APRA-regulated institutions.

Human rights implications

APRA has assessed the instruments and is of the view that they do 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 instruments are compatible with human rights.

Conclusion

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