

**Banking, Insurance, Life Insurance and Superannuation (prudential standard)
determination No. 1 of 2022**

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), which applies to all authorised deposit-taking institutions (ADIs) and authorised non-operating holding companies (authorised NOHCs);
- (2) subsection 32(1) of the *Insurance Act 1973* (Insurance Act), which applies to all general insurers and authorised non-operating holding companies (authorised insurance NOHCs);
- (3) subsection 230A(1) of the *Life Insurance Act 1995* (Life Insurance Act), which applies to all 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), which applies to all 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) of the Banking Act, which applies to all ADIs and authorised NOHCs;
- (2) subsection 32(4) of the Insurance Act, which applies to all general insurers and authorised insurance NOHCs;
- (3) subsection 230A(5) of the Life Insurance Act, which applies to all companies (including friendly societies) and registered life NOHCs; and
- (4) subsection 34C(6) of the SIS Act, which applies to all RSELs.

On 8 April 2022, APRA made Banking, Insurance, Life Insurance and Superannuation (prudential standard) determination No. 1 of 2022 (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 2020, and determines a

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

The instrument commences on 18 April 2022.

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).

In 2015, the Basel Committee and IOSCO finalised minimum standards for margin requirements for non-centrally cleared derivatives transactions ('the BCBS-IOSCO framework'). Margining is the process of exchanging collateral to protect against counterparty credit risk on derivative contracts. The purpose of margin requirements is to reduce systemic risk by ensuring the availability of collateral to offset losses that may be caused by a counterparty default and promote central clearing. In December 2016, APRA implemented margin requirements for non-centrally cleared derivatives based on the BCBS-IOSCO framework. Consistent with the BCBS-IOSCO framework, CPS 226 requires an APRA covered entity to exchange variation margin and post-and-collect initial margin. APRA covered entities are all authorised deposit-taking institutions (ADIs), general insurers, life companies and registrable superannuation entities.

Attachment D to CPS 226 sets out the margin requirements of a foreign jurisdiction that are comparable in outcomes with the BCBS-IOSCO framework and the margin requirements in CPS 226.

2. Purpose and operation of the instruments

The purpose of Banking, Insurance, Life Insurance and Superannuation (prudential standard) determination No 1 of 2022 is to revoke CPS 226 and replace it with a new version of CPS 226.

In the new version of CPS 226, the list of foreign bodies contained in Attachment D has been updated to include the Prudential Regulation Authority and the Financial Conduct Authority, both in the United Kingdom. This change is in response to new regulatory jurisdictions resulting from the United Kingdom's withdrawal from the European Union.

The new version of CPS 226 also makes a minor changes to update an out-of-date reference.

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 may include the decision:

- (a) to revoke an authority to carry on banking business (section 9A of the Banking Act); a banking NOHC authorisation (section 11AB of the Banking Act); an authority to carry on insurance business (section 15 of the Insurance Act); an insurance NOHC authorisation (section 21 of the Insurance Act); registration of life insurance business (section 26 of the Life Insurance Act); a life NOHC authorisation (section 28C of the Life Insurance Act); or 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

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.

Act).² 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.

The decisions of APRA to impose a direction are subject to merits review (section 11CA of the Banking Act, section 104 of the Insurance Act, section 236 of the Life Insurance Act), which is appropriately available at the point where an entity could be exposed to a penalty.

All decisions to revoke authorisations/registrations under the Banking Act, Insurance Act and Life Insurance Act are subject to merits review, unless specifically excluded by the enabling legislation.

Revocation of an authorisation to carry on banking business or a banking NOHC authorisation is subject to merits review unless either:

- (a) APRA has determined that access to natural justice and merits review is contrary to the national interest or contrary to the interests of depositors with the body corporate; or
- (b) (in the case of ADIs only) the authority is an authority that is to cease to have effect on a day specified in the authority (section 9A(8) of the Banking Act).

Revocation of an authorisation to carry on insurance business or an insurance NOHC authorisation is subject to merits review (ss 15 and 21 of the Insurance Act).

Revocation of registration as a life insurance company or a life NOHC authorisation is subject to merits review (section 236 of the Life Insurance Act).

3. Consultation

APRA has undertaken public consultation on the proposed changes prior to making the instrument. Information concerning consultation on the making of the instrument is contained in APRA's discussion and response to submissions papers.⁴

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.

⁴ APRA Consultation – [Margining and risk mitigation for non-centrally cleared derivatives](#)

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*

Banking, Insurance, Life Insurance and Superannuation (prudential standard) determination No. 1 of 2022

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 Instrument

The purpose of Banking, Insurance, Life Insurance and Superannuation (prudential standard) determination No. 1 of 2022 (the instrument) is to revoke *Prudential Standard CPS 226 Margining and Risk Mitigation for Non-Centrally Cleared Derivatives* (CPS 226) and replace it with a new version of CPS 226.

CPS 226 applies to institutions in the banking, general insurance, life insurance and superannuation industries. Under CPS 226, an entity that actively transacts in non-centrally cleared derivatives is required to exchange collateral as appropriate to those transactions to manage the risk of counterparty default, and to have policies and procedures to manage its risks in undertaking the derivatives activity.

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 instruments are compatible with human rights.

Conclusion

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