

## **Banking (prudential standard) determinations Nos. 5 and 8 to 16 of 2022**

### **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) and authorised non-operating holding companies (authorised NOHCs). Under subsection 11AF(3) of the Act, APRA may, in writing, vary or revoke a prudential standard.

On 1 December 2022, APRA made the following determination instruments (collectively, the instruments):

- Banking (prudential standard) determination No. 5 of 2022, which revokes *Prudential Standard APS 111 Capital Adequacy: Measurement of Capital* made under Banking (prudential standard) determination No. 3 of 2021 and determines a new *Prudential Standard APS 111 Capital Adequacy: Measurement of Capital* (APS 111);
- Banking (prudential standard) determination No. 8 of 2022, which revokes *Prudential Standard APS 114 Capital Adequacy: Standardised Approach to Operational Risk* made under Banking (prudential standard) determination No. 7 of 2012, *Prudential Standard APS 115 Capital Adequacy: Advanced Measurement Approaches to Operational Risk* made under Banking (prudential standard) determination No. 8 of 2012 and *Prudential Standard APS 115 Capital Adequacy: Standardised Measurement Approach to Operational Risk* made under Banking (prudential standard) determination No. 6 of 2020 and determines a new *Prudential Standard APS 115 Capital Adequacy: Standardised Measurement Approach to Operational Risk* (APS 115);
- Banking (prudential standard) determination No. 9 of 2022, which revokes *Prudential Standard APS 116 Capital Adequacy: Market Risk* made under Banking (prudential standard) determination No. 4 of 2014 and determines a new *Prudential Standard APS 116 Capital Adequacy: Market Risk* (APS 116);
- Banking (prudential standard) determination No. 10 of 2022, which revokes *Prudential Standard APS 120 Securitisation* made under Banking (prudential standard) determination No. 3 of 2017 and determines a new *Prudential Standard APS 120 Securitisation* (APS 120);
- Banking (prudential standard) determination No. 11 of 2022, which revokes *Prudential Standard APS 121 Covered bonds* made under Banking (prudential standard) determination No. 1 of 2019 and determines a new *Prudential Standard APS 121 Covered bonds* (APS 121);

- Banking (prudential standard) determination No. 12 of 2022, which revokes *Prudential Standard APS 180 Capital Adequacy: Counterparty Credit Risk* made under Banking (prudential standard) determination No. 1 of 2018 and determines a new *Prudential Standard APS 180 Capital Adequacy: Counterparty Credit Risk* (APS 180);
- Banking (prudential standard) determination No. 13 of 2022, which revokes *Prudential Standard APS 210 Liquidity* made under Banking (prudential standard) determination No. 1 of 2017 and determines a new *Prudential Standard APS 210 Liquidity* (APS 210);
- Banking (prudential standard) determination No. 14 of 2022, which revokes *Prudential Standard APS 220 Credit Risk Management* made under Banking (prudential standard) determination No. 1 of 2022 and determines a new *Prudential Standard APS 220 Credit Risk Management* (APS 220);
- Banking (prudential standard) determination No. 15 of 2022, which revokes *Prudential Standard APS 221 Large Exposures* made under Banking (prudential standard) determination No. 4 of 2019 and determines a new *Prudential Standard APS 221 Large Exposures* (APS 221); and
- Banking (prudential standard) determination No. 16 of 2022, which revokes *Prudential Standard APS 310 Audit and Related Matters* made under Banking (prudential standard) determination No. 2 of 2019 and determines a new *Prudential Standard APS 310 Audit and Related Matters* (APS 310).

The instruments commence on 1 January 2023.

## 1. Background

APRA recently released a new suite of prudential standards that impose regulatory capital requirements (the new capital standards) on ADIs for the purpose of ensuring ADIs hold sufficient capital to address the risks associated with their operations. The changes follow recommendations from the 2014 Financial System Inquiry to increase capital requirements for ADIs such that they meet ‘unquestionably strong’ capital benchmarks and to meet Australia’s commitment for internationally agreed standards for prudential regulation for ADIs by implementing capital standards based on the framework agreed by the Basel Committee on Banking Supervision.

The new capital standards, which come into effect from 1 January 2023, necessitate a series of consequential amendments to other existing prudential standards to ensure consistency of APRA’s broader prudential framework with the new capital standards. The key changes include:

- ensuring APRA’s broader prudential framework reflects changes made in the new capital standards. For example, in the treatment of exposures to New Zealand and in terms of liquidity requirements which need to be amended as a result of the changes to residential mortgage risk weights in the new capital standards; and
- updating cross references to the new capital standards.

In addition, the consequential changes to APS 115 reflect APRA's recent incorporation of greater proportionality within the prudential framework by subjecting smaller and less complex entities to simpler requirements. APS 115 will apply to ADIs determined to be significant financial institutions (SFIs). As defined in *Prudential Standard APS 001 Definitions*, ADI SFIs are entities with assets above a certain size or entities determined as such by APRA, taking into account matters such as complexity and group membership.

## 2. Purpose and operation of the instruments

The purpose of the instruments is to revoke:

- APS 111, APS 116, APS 115 (made under Banking (prudential standard) determination No. 6 of 2020), APS 120, APS 121, APS 180, APS 210, APS 220, APS 221 and APS 310 and replace them with the corresponding new versions of the prudential standards incorporating the amendments; and
- APS 114 and APS 115 (made under Banking (prudential standard) determination No. 8 of 2012) which are no longer relevant.

Where the standards refer to an Act, Regulation, prudential standard or Australian Accounting 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](http://www.legislation.gov.au).

APS 111 incorporates by reference the *Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution* issued by the Financial Stability Board on 9 November 2015. This document is available at: [Total Loss-Absorbing Capacity \(TLAC\) Principles and Term Sheet - Financial Stability Board \(fsb.org\)](http://www.fsb.org/Total-Loss-Absorbing-Capacity-TLAC-Principles-and-Term-Sheet-Financial-Stability-Board)

APS 180 incorporates by reference the Committee on Payments and Market Infrastructures and International Organization of Securities Commission's *Principles for Financial Market Infrastructures* (CPMI-IOSCO Principles) as it exists from time to time. Under APS 180, the calculation of the capital charge to be applied to exposures to a central counterparty (CCP) is dependent on whether the CCP is treated as a qualifying CCP or a non-qualifying CCP. Whether a CCP is a qualifying CCP involves a question of fact, which is dependent on whether the CCP is subject to rules and regulations that are consistent with the CPMI-IOSCO Principles, rather than an application of the CPMI-IOSCO Principles. The CPMI-IOSCO Principles are not intended to be incorporated into APS 180, and are freely available at [https://www.bis.org/cpmi/info\\_pfmi.htm](https://www.bis.org/cpmi/info_pfmi.htm).

APS 210 incorporates by reference the Basel III leverage ratio framework and disclosure requirements as set out by the Basel Committee on Banking Supervision in *Basel III leverage ratio framework and disclosure requirements* as it exists at 12 January 2014. This document is available at <http://www.bis.org/publ/bcbs270.htm>.

APS 221 incorporates by reference APRA's Information Paper: Domestic systemically important banks in Australia as at 23 December 2013. The paper is available at [APRA releases framework for domestic systemically important banks in Australia | APRA](http://www.apra.gov.au/APRA-releases-framework-for-domestic-systemically-important-banks-in-Australia).

The prudential standards provide 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 also a breach of the Act, as the Act provides that regulated entities must comply with the standard. However, there are no penalties prescribed for such breaches. 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). In nearly all cases<sup>1</sup> the decision is preceded by a full consultation with the ADI to raise any concerns it may have in relation to the decision.

A decision of APRA to impose a direction is subject to merits review under section 11CA of the Act, which is appropriately available at the point where an ADI could be exposed to a penalty.

A decision of APRA to revoke an authority under the Act 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 ADI; or
- (b) the authority is an authority that is to cease to have effect on a day specified in the authority (section 9A(8) of the Act).

### **3. Consultation**

APRA undertook public consultation on its proposed consequential amendments to the ADI capital reforms in July to August 2022. In October 2022 APRA released a letter to industry that outlines feedback from the July 2022 consultation and summarises the amendments.<sup>2</sup>

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<sup>1</sup> 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.

<sup>2</sup> [Revisions to the capital framework for authorised deposit-taking institutions | APRA](#)

The amendments to APS 115 were part of a separate consultation on aligning and centralising the definition of an SFI. This consultation took place in April 2022, with APRA releasing a response to submissions in July 2022.<sup>3</sup>

#### **4. Regulation Impact Statement**

The Office of Impact Analysis advised that no Regulation Impact Statement was required for the consequential amendments as the changes to the prudential standards are minor and machinery.

#### **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.

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<sup>3</sup> Consultation: [Consultation on minor amendments to centralise the definition of a significant financial institution | APRA](#)

Response: [Minor amendments to centralise the definition of a significant financial institution | APRA](#)

## 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) determinations Nos. 5 and 8 to 16 of 2022**

These Legislative Instruments (the instruments) are 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 these instruments is to revoke *Prudential Standard APS 111 Capital Adequacy: Measurement of Capital*, *Prudential Standard APS 115 Capital Adequacy: Standardised Measurement Approach to Operational Risk*, *Prudential Standard APS 116 Capital Adequacy: Market Risk*, *Prudential Standard APS 120 Securitisation*, *Prudential Standard APS 121 Covered Bonds*, *Prudential Standard APS 180 Capital Adequacy: Counterparty Credit Risk*, *Prudential Standard APS 210 Liquidity*, *Prudential Standard APS 220 Credit Risk Management*, *Prudential Standard APS 221 Large Exposures* and *Prudential Standard APS 310 Audit and Related Matters*, and replace them with new versions of the corresponding prudential standards with the appropriate amendments, and to revoke *Prudential Standard APS 114 Capital Adequacy: Standardised Approach to Operational Risk* and *Prudential Standard APS 115 Capital Adequacy: Advanced Measurement Approaches to Operational Risk* as they are no longer relevant.

The instruments ensure consistency of APRA's broader prudential framework with APRA's release of a new set of prudential standards that impose regulatory capital requirements on authorised deposit-taking institutions (ADIs) for the purpose of ensuring ADIs hold sufficient capital to address the risks associated with their operations. ADIs are bodies corporate that have been granted the authority, under the *Banking Act 1959*, to carry on banking business in Australia. The consequential amendments also update cross references to the capital prudential standards and make minor clarifications requested by ADIs.

#### **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 instruments are compatible with human rights as they do not raise any human rights issues.