

Banking, Insurance, Life Insurance, Health Insurance and Superannuation (prudential standard) determination No. 1 of 2023

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

Private Health Insurance (Prudential Supervision) Act 2015, section 92

Superannuation Industry (Supervision) Act 1993, section 34C

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

- (1) subsection 11AF(1) of the *Banking Act 1959* (Banking Act), which applies to all authorised deposit-taking institutions (ADIs), authorised banking non-operating holding companies (authorised banking NOHCs), and subsidiaries of ADIs and authorised banking NOHCs;
- (2) subsection 32(1) of the *Insurance Act 1973* (Insurance Act), which applies to all general insurers and authorised insurance non-operating holding companies (authorised insurance NOHCs), and subsidiaries of general insurers and 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, registered life non-operating holding companies (registered life NOHCs), and subsidiaries of life companies and registered life NOHCs;
- (4) subsection 92(1) of the *Private Health Insurance (Prudential Supervision) Act 2015* (PHIPS Act), which applies to all private health insurers; and
- (5) subsection 34C(1) of the *Superannuation Industry (Supervision) Act 1993* (SIS Act), which applies to all Registered Superannuation Entity Licensees (RSE licensees), and connected entities of RSE licensees.

On 10 October 2023, APRA made Banking, Insurance, Life Insurance, Health Insurance and Superannuation (prudential standard) determination No. 1 of 2023 (the instrument), which determines a new cross-industry *Prudential Standard CPS 190 Recovery and Exit Planning* (CPS 190). Paragraphs 2 to 4 of the prudential standard specify the scope of APRA-regulated entities to which the standard applies, including the exclusion of some types of APRA-regulated entities.

The instrument commences on 1 January 2024 for all APRA-regulated entities, except for RSE licensees. The instrument commences on 1 January 2025 for RSE licensees.

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 bank depositors, insurance policyholders and superannuation fund members (beneficiaries) within a stable, efficient and competitive financial system.

APRA carries out this mandate through a multi-layered prudential framework that encompasses licensing and supervision of entities. The Banking Act, Insurance Act, Life Insurance Act, PHIPS 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.

In undertaking its role, APRA's key focus is the financial safety of regulated entities and minimising the risk of their failure. As a resolution authority, APRA is also responsible for minimising the impact of any entity failure, by ensuring that beneficiaries are protected and risks to financial stability are minimised.

This new prudential standard, CPS 190, requires APRA-regulated entities to develop and maintain a recovery and exit plan. This plan would set out how an entity could restore its financial resilience in periods of stress or, where this is not possible, exit regulated activity in an orderly and solvent manner. It aims to ensure that the financial system is adequately prepared to manage periods of severe financial stress.

These requirements are a common feature of international prudential frameworks. A credible recovery and exit plan is essential to ensuring that financial institutions can respond to scenarios which may threaten their viability, thereby protecting beneficiaries and avoiding the significant public costs associated with a possible disorderly failure.

For banks and insurers, many of whom have been required by APRA to undertake recovery planning for a number of years, the requirements of CPS 190 will commence on 1 January 2024. For RSE licensees, the requirements of CPS 190 will commence on 1 January 2025. This will allow additional time for implementation, given that recovery and exit planning is a new requirement for the superannuation industry.

2. Purpose and operation of the instrument

The purpose of the instrument is to determine a new prudential standard, CPS 190.

The key requirement of CPS 190 is that an APRA-regulated entity must develop and maintain a credible recovery and exit plan. The main components of a recovery and exit plan, as required under CPS 190, are set out in paragraph 19 of the prudential standard, and include:

- a trigger framework, for early identification and monitoring of stress;
- governance arrangements, for monitoring triggers and timely activation of the plan or specific actions within it;
- recovery and exit actions, for stabilising and restoring financial resilience, or affecting an orderly and solvent exit; and
- a communication strategy, to support the execution of recovery and exit actions.

Larger and more complex entities (significant financial institutions, or SFIs) are subject to additional requirements in developing their recovery and exit plans, consistent with the heightened risks they pose to financial stability. These entities are also required to include:

- scenario analysis, for assessing the effectiveness of triggers and recovery and exit actions, and an assessment of recovery capacity, to review the extent to which recovery actions can offset losses in stress (paragraph 20); and
- additional analysis around each recovery and exit action, including a timeline for implementation, an analysis of barriers to implementation, execution risks and key dependencies, a summary of preparatory measures needed to support the execution of the action and, where relevant, an estimate of the impact of the action on the entity's capital and liquidity position (paragraph 21).

Paragraphs 24 to 27 of CPS 190 set out the minimum requirements for capabilities, monitoring and execution of an entity's recovery and exit plan. These requirements are aimed at ensuring entities are adequately pre-positioned to execute their recovery and exit plans as intended during periods of stress.

Under paragraphs 28 to 31 of the prudential standard, entities are also subject to requirements for testing and reviewing the recovery and exit plan. These requirements aim to ensure that plans remain current and effective for the entity and the risks it faces.

Exercise of discretion by APRA

CPS 190 provides for APRA to exercise various discretions. Decisions made by APRA in 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, Life Insurance Act and PHIPS 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 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, section 131D of the SIS Act); and a direction to comply with all, or specified obligations, which includes prudential standards (section 96 of the PHIPS Act); or
- (b) 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 to revoke an authority to operate an APRA-regulated superannuation fund (section 29G 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; 30 penalty units each day under section 104 of the PHIPS Act; and 100 penalty units each day under section 131DD of the SIS Act).¹ In nearly all cases,² the decisions are preceded by a full consultation with the regulated entity to raise any concerns that the entity 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, section 168 of the PHIPS Act and section 344 of the SIS Act), which is appropriately available at the point where an entity could be exposed to a penalty.

All decisions to revoke authorisations or registrations under the Banking Act, Insurance Act, Life Insurance Act and SIS 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 (subsection 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 (sections 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). The situation in relation to cancellation of registration under the PHIPS Act is different to the other enabling legislation.

Application to the Australian branch operations of foreign ADIs

Under paragraph 3 of the prudential standard, APRA may determine that all or part of the requirements of CPS 190 are to apply to the Australian branch operations of foreign ADIs.

¹ 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 190 is not a standard in relation to any of these topics.

² 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.

This power is to be exercised under subsection 11AF(1) of the Banking Act, which gives APRA the power to determine standards that must be complied with by one or more specified ADIs, or a specified class of ADIs. A decision to determine a prudential standard to be complied with by one or more specified ADIs is a reviewable decision under Part VI of the Banking Act.

Adjust and exclude powers

CPS 190 gives APRA the discretion to adjust or exclude a provision of the prudential standard (paragraph 12). The power to create such a discretion is provided for under subsections:

- 11AF(2) of the Banking Act;
- 32(3D) of the Insurance Act;
- 230A(4) of the Life Insurance Act;
- 92(4) of the PHIPS Act; and
- 34C(5) of the SIS Act.

APRA may exercise this power when it is satisfied that the adjustment or exclusion of a specific requirement for one or more specified regulated entities will better support APRA in meeting its objectives. For example, the adjustment or exclusion may be necessary to obtain a better prudential outcome than would be the case if the prudential requirement were applied unaltered to a particular regulated entity. A tailored approach would give APRA comfort that the prudential requirements apply appropriately to protect the interests of depositors, policyholders and fund members. APRA will also take into account other considerations, such as efficiency, competition, contestability, competitive neutrality and regulatory burden, including comparisons with the entity's peer group.

The exercise of APRA's powers is governed by a robust decision-making framework which is documented in APRA's internal policies. This framework supports APRA in fulfilling its mandate by limiting decision making to those senior APRA officers with the appropriate experience and skill to exercise prudent judgement. The framework also requires decision makers to seek advice from internal technical experts.

Documents incorporated by reference

Under paragraph 14(1)(a) of the *Legislation Act 2003* (Legislation Act), CPS 190 incorporates by reference the following documents as in force from time to time:

- Acts of Parliament and associated delegated laws; and
- Prudential Standards determined by APRA under:
 - subsection 11AF(1) of the Banking Act;
 - subsection 32(1) of the Insurance Act;
 - subsection 230A(1) of the Life Insurance Act; and
 - subsection 92(1) of the PHIPS Act.

Under paragraph 14(1)(b) of the Legislation Act, where CPS 190 incorporates by reference another Superannuation Prudential Standard determined by APRA under section 34C of the SIS Act, the Superannuation Prudential Standard referred to is the version that exists at the time the Instrument was determined.

All documents incorporated by reference in this standard are available on the Federal Register of Legislation at www.legislation.gov.au.

3. Consultation

APRA released a draft version of CPS 190 for consultation in December 2021.³ This consultation ran until April 2022, with APRA receiving 23 submissions in response. During this time, APRA also met with a variety of stakeholders, including individual entities, industry associations and consultants.

APRA also released related draft guidance, *Prudential Practice Guide CPG 190 Recovery and Exit Planning* (CPG 190), for public consultation in September 2022. Consultation on the guidance involved further meetings with industry associations and regulated entities in late 2022, to engage feedback on the proposed prudential standard and guidance.

In December 2022, APRA released a letter responding to issues raised during consultation on draft CPS 190.⁴ The major changes made to CPS 190 in response to consultation feedback were presentational in nature and aimed at simplification – for example, a reordering of the standard to avoid restating common requirements between SFIs and non-SFIs. Other changes were relatively minor and did not significantly change the proposed requirements. The letter also provided further clarity on certain requirements. More detailed guidance on the requirements of CPS 190 was also provided in the finalised CPG 190.⁵

4. Regulation Impact Statement

In developing CPS 190, the Office of Impact Analysis (formerly known as the Office of Best Practice Regulation) confirmed that a Regulation Impact Statement was not required as CPS 190 was assessed as likely to only have a minor regulatory impact.

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 the Attachment to this Explanatory Statement.

³ See APRA Media Release – [APRA moves to strengthen crisis preparedness in banking, insurance and superannuation | APRA](#), dated 2 December 2021.

⁴ See APRA Letter – *Letter to all APRA-regulated entities: Recovery and exit planning* – on APRA’s website at [Recovery and exit planning | APRA](#), dated 1 December 2022.

⁵ See final *Prudential Practice Guide CPG 190 Recovery and Exit Planning* on APRA’s website at [Strengthening crisis preparedness | APRA](#), dated 18 May 2023.

ATTACHMENT

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 Instrument

The purpose of the instrument is to determine a new *Prudential Standard CPS 190 Recovery and Exit Planning* (CPS 190).

CPS 190 requires APRA-regulated entities to develop and maintain a recovery and exit plan, which would enable them to restore financial resilience in response to financial stress (recovery) or, where recovery is not possible, exit regulated activity in an orderly and solvent manner. APRA-regulated entities must also maintain the capabilities and financial resources necessary to execute their recovery and exit plan, when and if required, and regularly review, update and test their plans.

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.