

***Banking, Insurance, Life Insurance and Health Insurance (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

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

- (1) subsections 11AF(1) and (3) of the *Banking Act 1959* (Banking Act), in relation to authorised deposit-taking institutions (ADIs) and authorised non-operating holding companies (authorised banking NOHCs);
- (2) subsections 32(1) and (4) of the *Insurance Act 1973* (Insurance Act), in relation to general insurers, authorised non-operating holding companies (authorised insurance NOHCs) and subsidiaries of general insurers and authorised insurance NOHCs;
- (3) subsections 230A(1) and (5) of the *Life Insurance Act 1995* (Life Insurance Act), in relation to life companies, friendly societies and non-operating holding companies (registered life NOHCs); and
- (4) subsections 92(1) and (5) of the *Private Health Insurance (Prudential Supervision) Act 2015* (PHIPS Act), in relation to registered private health insurers.

On 20 November 2023, APRA made *Banking, Insurance, Life Insurance and Health Insurance (prudential standard) determination No. 1 of 2023* (the instrument), which revokes *Prudential Standard CPS 510 Governance* made under *Banking, Insurance, Life Insurance and Health Insurance determination No. 1 of 2022* and determines a new *Prudential Standard CPS 510 Governance* (CPS 510).

The instrument commences on 1 January 2024.

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 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 and PHIPS Act allow APRA to issue legally binding prudential standards that set out specific prudential requirements with which APRA-regulated institutions must comply.

In 2021, APRA determined a new *Prudential Standard CPS 511 Remuneration* (CPS 511) which sets out requirements to ensure that APRA-regulated entities maintain remuneration arrangements that provide appropriate incentives to individuals to prudently manage the risks they are responsible for, and that there are appropriate consequences for poor risk outcomes. CPS 511 commenced on 1 January 2023.

With the commencement of CPS 511 existing requirements relating to remuneration, including those detailing requirements in relation to Board Remuneration Committees and Remuneration policies, currently set out in CPS 510 have become progressively redundant as these matters are covered by new requirements in CPS 511. The application of CPS 511 is on a staggered basis from 1 January 2023 and will be complete from 1 January 2024, at which time the Board Remuneration Committee requirements and Remuneration policy requirements set out in CPS 510 will no longer be applicable to APRA-regulated institutions.

2. Purpose and operation of the instrument

The purpose of the instrument is to revoke the existing CPS 510 and replace it with the new CPS 510 which incorporates necessary consequential amendments resulting from the commencement of CPS 511. The amendments to CPS 510 apply from 1 January 2024 to APRA-regulated institutions that are non-significant financial institutions (non-SFIs). APRA-regulated institutions that are significant financial institutions were previously carved out from applying these requirements under CPS 510.

Exercise of discretion by APRA

CPS 510 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. 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 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, and section 230B of the Life Insurance 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); or a life NOHC authorisation (section 28C of the Life Insurance 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; section 230F of the Life Insurance Act; and 30 penalty units each day under section 104 of the PHIPS Act). In nearly all cases,¹ 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, section 168 of the PHIPS 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 (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.

¹ 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.

Adjust and exclude powers

CPS 510 gives APRA the discretion to adjust or exclude a provision of the prudential standard (paragraph 90). 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; and
- 92(4) of the PHIPS 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 an 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 510 incorporates by reference the following documents as in force from time to time:

- Acts of Parliament and associated delegated laws;
- Australian Accounting Standards; 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.

The above documents are available on the Federal Register of Legislation at www.legislation.gov.au.

Under paragraph 14(1)(a) of the Legislation Act, CPS 510 incorporates by reference the following documents as they exist from time to time:

- *APES 110 Code of Ethics for Professional Accountants*, which may be freely used (available from the Accounting Professional & Ethical Standards Board (APESB) at <https://apesb.org.au>). The APESB is an independent, national body

that sets the code of ethics and professional standards with which accounting professionals who are members of CPA Australia, CA ANZ or IPA must comply; and

- *ASX Corporate Governance Council's Corporate Governance Principles and Recommendations* (2nd Edition 2007), which may be freely used (available from the ASX Corporate Governance Council at www2.asx.com.au). ASX stands for Australian Securities Exchange. ASX is an integrated exchange offering listings, trading, clearing, settlement, technical and information services, technology, data and other post-trade services. It acts as a market operator, clearing house and payments system facilitator. It oversees compliance with its operating rules, promotes standards of corporate governance among Australia's listed companies and helps to educate retail investors.

3. Consultation

These consequential changes were set out in various public consultation papers APRA issued as part of its consultation on new remuneration requirements. These included:

- Discussion paper - Strengthening prudential requirements for remuneration, APRA, July 2019;
- Response paper – Strengthening prudential requirements for remuneration, APRA, 12 November 2020;
- Response paper – Strengthening prudential requirements for remuneration, APRA, August 2021.

No comments were received in submissions to the consultation on these consequential amendments.

4. Regulation Impact Statement

The Office of Impact Analysis (formerly the Office of Best Practice Regulation) advised that no Regulation Impact Statement was required as the changes to the 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.

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 Instrument

The purpose of *Banking, Insurance, Life Insurance and Health Insurance (prudential standard) determination No. 1 of 2023* is to revoke the existing requirements under *Prudential Standard CPS 510 Governance* (CPS 510) for banking and insurance and replace it with the new CPS 510 which incorporates necessary consequential amendments resulting from the commencement of *Prudential Standard CPS 511 Remuneration*. The amendments apply from 1 January 2024.

Human rights implications

APRA has assessed the legislative instruments 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 legislative instrument is compatible with human rights.

Conclusion

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