# Banking (prudential standard) determination No. 6 of 2024

# 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 27 November 2024, APRA made Banking (prudential standard) determination No. 6 of 2024 (the instrument), which revokes *Prudential Standard APS 110 Capital Adequacy* made under Banking (prudential standard) determination No. 4 of 2022 and determines a new *Prudential Standard* *APS 110 Capital Adequacy* (APS 110).

The instrument commences on 1 January 2025.

## 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 institutions. In the case of the banking industry, APRA is empowered under the Act to issue legally binding prudential standards that set out specific prudential requirements with which ADIs must comply.

APRA regularly reviews its regulatory regime and amends its prudential requirements as a result of a number of factors, including:

* international developments;
* changes in financial market conditions or changes in risk management practices, in response to identified weaknesses in the prudential framework; and
* to reduce potential negative impacts of emerging industry issues.

A key component of APRA’s prudential framework is the suite of prudential standards that impose regulatory capital requirements on ADIs for the purpose of ensuring ADIs hold sufficient capital to address the risks associated with their operations. As Australia is a member of the Basel Committee on Banking Supervision (BCBS) and the Group of 20, Australia and APRA are committed to meeting internationally-agreed standards for prudential regulation for ADIs by implementing capital standards that are based on the framework agreed by the BCBS.

APS 110 is the core prudential standard among a suite of capital adequacy-related prudential standards that impose regulatory capital requirements on ADIs. It sets out minimum capital adequacy requirements to ensure that ADIs hold adequate capital on both an individual and group basis to act as a buffer against the risks associated with their activities.

APS 110 contributes to the protection of depositors and the maintenance of market confidence, and promotes financial stability, especially during potential scenarios of financial stress.

## Purpose and operation of the instrument

The purpose of the instrument is to revoke the existing APS 110 and replace it with a new version of APS 110. The new version makes minor amendments including:

* replacing a reference to *Prudential Standard APS 001 Definitions* with the recently finalised definitional prudential standard, *Prudential Standard CPS 001 Defined terms*; and
* extending a transition arrangement for market risk capital, with the arrangement to be revised as part of finalising the Fundamental Review of the Trading Book (FRTB) reforms.

APS 110 is a core standard in APRA’s prudential framework that requires the relevant ADIs to maintain an adequate level of capital for various risks and have an Internal Capital Adequacy Assessment Process. APS 110 requires ADIs to inform or seek approval from APRA on planned or unplanned changes to their capital adequacy.

Details of the new APS 110 are set out in Attachment A to this Explanatory Statement.

## *Documents incorporated by reference*

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

* Acts of Parliament and associated delegated laws;
* Prudential Standards determined by APRA under subsection 11AF(1) of the Act; and
* the Australian Accounting Standards determined by the Australian Accounting Standards Board under section 334 of the *Corporations Act 2001* (Cth);

These documents may be freely obtained on the Federal Register of Legislation at www.legislation.gov.au (all documents listed above except for Australian Accounting Standards), and https://www.aasb.gov.au/pronouncements/accounting-standards/ (Australian Accounting Standards).

### Exercise of discretion by APRA

APRA’s prudential standards include powers that may be exercised by APRA that involves an element of discretion and that may affect the interests of the ADIs to which the prudential standards apply. These powers include a power to adjust or exclude a provision of the prudential standard.

The need to apply discretion is driven by entity-specific issues and circumstances that are not adequately addressed by the generally applicable provisions of the prudential standards. For example, adjustment or exclusion of a provision 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.

When exercising its discretion, APRA considers a wide range of factors when exercising its discretion, including the considerations set out in the Act and the *Australian Prudential Regulation Authority Act 1998*.

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.

The power is also exercised following discussion with the relevant ADI about its appropriateness and the impact it may have on the entity.

### Review of decisions

Decisions made by APRA exercising powers in prudential standards are not themselves subject to merits review. However, they may facilitate or lead to substantive decisions which are subject to merits review.

A breach of a prudential standard is a breach of the Act, as section 11AG of the Act provides that ADIs must comply with applicable prudential standards. 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:

* to revoke an authority to carry on banking business (section 9A of the Act); and
* 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[[1]](#footnote-2) 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:

1. 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
2. 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).

## Consultation

On 6 September 2024, APRA released for public consultation a set of proposed minor updates to the prudential framework, including updates to APS 110. The purpose of the updates was to ensure that APRA’s prudential framework remains up to date in the intervening periods between comprehensive reviews of prudential standards. APRA finalised the proposed changes to APS 110 on 27 November 2024, following a one-month consultation period.

APRA received two submissions in response to its consultation on the minor updates, with non-confidential submissions available on APRA’s website. Respondents were industry participants that welcomed the proposal, given the objective of the amendments was to ensure APS 110 remains up to date and fit for purpose.

APRA is satisfied the consultation was appropriate and reasonably practicable.

## Impact Analysis

The Office of Impact Analysis confirmed that a Regulation Impact Statement was not required.

## 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 B to this Explanatory Statement.

**ATTACHMENT A**

**Details of the new prudential standard**

Part 1 - Authority, commencement and interpretation

Paragraph 1 details that APS 110 is made under section 11AF of the Act.

Paragraph 2 specifies who the instrument applies to, namely, ADIs with the exception of foreign ADIs and purchased payment facility providers.

Paragraph 3 indicates that references in APS 110 to an ADI refer to (unless otherwise indicated) an ADI on a Level 1 basis and a group of which an ADI is a member on a Level 2 basis.

Paragraph 4 provides information on interpretating requirements for an ADI that is the holding company for a group or a subsidiary of an authorised non-operating holding company (NOHC).

Paragraph 5 details that APS 110 commences on 1 January 2025.

Paragraph 6 notes that terms defined in *Prudential Standard CPS 001 Defined terms* appear in bold the first time they are used in APS 110.

Paragraph 7 provides information on how APRA would exercise a power or discretion under APS 110.

Paragraph 8 notes that references to an Act, Regulations, Prudential Standard, or Australian Accounting Standards in APS 110 is a reference to the instrument as in force from time to time.

Part 2 - Definitions, adjustments and exclusions, and previous exercise of discretion

Paragraph 9 is a machinery provision setting out definitions used in APS 110.

Paragraph 10 provides APRA the power to adjust or exclude a specific requirement in APS 110 in relation to one or more ADIs or authorised NOHCs.

Paragraph 11 requires an ADI to contact APRA if it intends to rely on a previous exemption of a prudential requirement, or other exercise of discretion, provided by APRA under a previous version of APS 110.

Part 3 – Responsibility for capital management

Paragraph 12 requires the ADI’s Board to ensure that the ADI meets the capital adequacy requirements set out by APS 110.

Paragraph 13 requires that, for ADIs that are members of a Group, the ADI’s Board ensures that the capital adequacy of the ADI at Level 1 is sufficient to withstand risks it is exposed to by the Group.

Part 4 – Internal Capital Adequacy Assessment Process

Paragraph 14 requires an ADI to have an Internal Capital Adequacy Assessment Process (ICAAP) that is approved by the ADI’s Board, is documented, and is available to APRA upon request.

Paragraph 15 requires that the ADI’s ICAAP reflects the ADI’s size, business mix, and complexity of its operations and group structure.

Paragraph 16 allows an ADI that is a member of a Group to rely on the Group’s ICAAP.

Paragraph 17 sets out the minimum inclusions in an ADI’s ICAAP.

Paragraph 18 sets out the minimum inclusions in an ADI’s ICAAP summary statement, which is required to be included in an ADI’s ICAAP under paragraph 17(g) of APS 110.

Paragraph 19 sets out the requirements for an ADI to maintain its ICAAP, including that it is regularly and robustly reviewed by appropriately qualified persons. The ICAAP must be reviewed at least every three years.

Paragraph 20 requires an ADI to prepare a report on the implementation of its ICAAP (ICAAP report) on an annual basis, and to provide this report to APRA.

Paragraph 21 sets out the minimum inclusions for an ADI’s ICAAP report.

Paragraph 22 sets out the requirements relating to how an ADI must submit their ICAAP report to APRA.

Part 5 – Minimum risk-based capital adequacy requirements

Paragraph 23 explains that APRA determines prudential capital requirements (PCRs) for an ADI, which are expressed as a percentage of total risk-weighted assets (RWAs).

Paragraph 24 sets out the minimum PCRs that an ADI must maintain, in reference to Common Equity Tier 1 (CET1) Capital, Tier 1 Capital, and Total Capital. Paragraph 24 also notes that APRA may determine a higher PCR for an ADI.

Paragraph 25 requires an ADI to maintain minimum risk-based regulatory capital ratios above its PCRs at all times.

Part 6 – Capital floor

Paragraph 26 requires an ADI that has been approved by APRA to use the Internal Ratings-based Approach to calculating credit risk capital requirements to calculate its total RWA for capital adequacy purposes using the approach in paragraph 4 of Attachment A to APS 110.

Part 7 – Capital conservation buffer

Paragraph 27 requires an ADI to hold a capital conservation buffer above its CET1 Capital PCR and details the specific capital conservation buffer requirement depending on the type of ADI.

Paragraph 28 requires an ADI that APRA has determined as a domestic systemically important bank to add an addition 1.0 per cent to its capital conservation buffer.

Paragraph 29 requires that any amount of CET1 Capital required to meet an ADI’s Tier 1 or Total Capital PCR, above the amount required to meet the CET1 PCR, is not eligible to be included in the capital conservation buffer.

Paragraph 30 places constraints of an ADI’s capital distributions (e.g. dividends) if an ADI’s CET1 Capital ratio falls within certain capital buffer ranges.

Paragraph 31 allows an ADI to apply to APRA to make payments in excess of the constraints imposed by the capital conservation buffer regime.

Part 8 – Countercyclical capital buffer

Paragraph 32 requires an ADI to hold a countercyclical capital buffer that must be met with CET1 and calculated using Attachment C to APS 110 (ADI-specific countercyclical capital buffer).

Paragraph 33 details that APRA will determine the Australian jurisdictional countercyclical capital buffer.

Paragraph 34 states that APRA will publish any decision on the level of the Australian jurisdictional countercyclical capital buffer up to 12 months before the date from which it applies (with reductions taking effect immediately).

Paragraph 35 explains that the ADI-specific countercyclical capital buffer is applied in practice by extending the range of the capital conservation buffer.

Part 9 – Minimum dollar amount of capital

Paragraph 36 provides that APRA may also determine an ADI’s PCR or capital buffers as a minimum dollar amount rather than as a percentage of RWA.

Part 10 – Minimum leverage ratio requirement

Paragraph 37 requires an ADI that has been approved by APRA to use the Internal Ratings-based Approach to calculating credit risk capital requirements to maintain a minimum leverage ratio of 3.5 per cent. APRA may vary the minimum leverage ratio requirement for an ADI.

Paragraph 38 requires an ADI to calculate its leverage ratio in accordance with Attachment D to APS 110, and specifies how the leverage ratio requirement should apply to ADIs depending on whether they are a member of a Level 2 Group.

Paragraph 39 notes APRA may apply a leverage ratio requirement to a standardised ADI.

Part 11 – Reductions in capital

Paragraph 40 requires an ADI or authorised NOHC to obtain APRA’s approval prior to making any planned reduction in capital.

Paragraph 41 details what a planned reduction in an ADI’s capital includes.

Paragraph 42 requires an ADI or authorised NOHC proposing a capital reduction to provide APRA with a forecast of its projected future capital position after the proposed capital reduction.

Paragraph 43 requires an ADI to satisfy APRA that its capital will remain adequate for its future needs after a proposed reduction.

Part 12 – Notification requirements

Paragraph 44 requires an ADI or authorised NOHC to notify APRA of any breach or prospective breach of requirements in APS 110 and to inform APRA of remedial actions taken or planned to address the breach.

Paragraph 45 requires an ADI or authorised NOHC to inform APRA of any significant departure from its ICAAP, concerns about capital adequacy and measures to address these concerns, indication of significant adverse changes in market pricing of (or trading in) the capital instruments issued by the ADI or Group, or any other significant adverse changes in its capital.

Attachment A – Risk-based regulatory capital ratios

Attachment A to APS 110 details how an ADI should calculate its risk-based capital ratios. This includes different measures for different cohorts of ADIs.

Attachment B – Constraints on capital distributions

Attachment B to APS 110 details the capital distribution constraints applied on an ADI when its CET1 Capital ratio is within its capital buffer range.

Attachment C – Countercyclical capital buffer

Attachment C to APS 110 sets out the requirements for an ADI calculating the ADI-specific countercyclical capital buffer requirement, which is the weighted average of the jurisdictional countercyclical capital buffers that apply in jurisdictions in which the ADI has exposures.

Attachment D – Leverage ratio

Attachment D to APS 110 details how an ADI must calculate its leverage ratio. This includes detailed requirements on the exposure measure, which includes on-balance sheet exposures, non-market related off-balance sheet exposures, derivative exposures, and securities financing transaction exposures.

**ATTACHMENT B**

**Statement of Compatibility with Human Rights**

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

# Banking (prudential standard) determination No 6 of 2024

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 legislative instrument is to revoke *Prudential Standard APS 110 Capital Adequacy* (APS 110) made under Banking (prudential standard) determination No. 4 of 2022 and replace it with a new version of APS 110.

APS 110 sets out requirements for an authorised deposit-taking institution (ADI) to maintain adequate capital on both an individual and group basis to act as a buffer against the risks associated with their activities. ADIs are bodies corporate that have been granted the authority, under the *Banking Act 1959*, to carry on banking business in Australia.

**Human rights implications**

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

**Conclusion**

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

1. 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:

   contrary to the national interest; or

   contrary to the interests of depositors with the ADI. [↑](#footnote-ref-2)