28 April 2022

Gideon Holland
General Manager, Policy
Policy and Advice
Australian Prudential Regulation Authority

By email: PolicyDevelopment@apra.gov.au

Dear Mr Holland

Strengthening crisis preparedness

The Financial Services Council[1] (**FSC**) welcomes the opportunity to provide feedback to APRA on their consultation regarding two new draft prudential standards CPS 190 Financial Contingency Planning and CPS 900 Resolution Planning to strengthen the preparedness of banks, insurers and superannuation trustees to respond to future financial crises. We acknowledge and broadly support APRA's intention to have the regime apply across large institutions spanning across the financial services industry generally. Our submission focuses on the proposed changes in the context of life insurers and superannuation trustees.

The FSC recognises the benefits that can be achieved through appropriate financial contingency and resolution planning. We recognise upfront however that developing the financial contingency and resolution plans as envisioned by APRA will impose significant compliance costs on industry that cannot be readily estimated at this point. Our feedback therefore mainly relates to areas where we believe APRA's proposals could be amended to realise greater efficiencies to reduce burden on affected entities whilst still achieving the underlying regulatory intent.

In particular, we are concerned that the outcome of APRA's proposals would require Significant Financial Institutions (SFIs) to hold further amounts of "ring fenced" financial resources for recovery and resolution activities, including proposals to hold further "loss-absorbing capacity" (or LAC). A fundamental principle underpinning the viability of the Australian Financial Services industry and its provision of cost-effective services to the Australian public depends not only on entities being capitally sound but also capitally efficient. Adding further requirements that have the effect of materially raising total industry capital further should only be done where it has been established that total industry capital is insufficient.

Another area is the application of APRA's CPS 190 proposals to group structures involving overseas parent entities. For entities that are part of a group, the draft proposals would require financial contingency plans to be prepared for each APRA-regulated entity in the group. For these structures, crisis preparedness planning is formulated at a global level and overseen by the supervisory authority of the head of the international group. Effective coordination and cooperation among authorities responsible for the oversight of the group and its various subsidiaries is critical to ensuring the best possible outcome for policyholders across jurisdictions and help to avoid detrimental ring-fencing of assets prior to and during a crisis. Where an international group includes a local subsidiary regulated by APRA, regard should first be given to group plans. If these plans do not sufficiently cover the APRA-regulated entity, APRA should require improvements to these plans or the development of local plans. We would also ask that APRA clarify the intended treatment of small entities that form part of larger group structures but are not SFIs themselves. In our view, it would not be appropriate to

[1] The FSC is a peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services. Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advisory networks. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing $3 trillion on behalf of more than 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is the fourth largest pool of managed funds in the world.

subject small, low risk entities to the proposed requirements attached to SFIs by virtue of their connection to a group structure which contains other SFIs.

Greater efficiencies can also be realised by integrating part or all the new requirements for reviews into existing comprehensive triennial reviews and annual reviews. For SFIs, both the new prudential standards CPS 190 and CPS 900 will require comprehensive triennial reviews by operationally independent, appropriately experienced and competent persons. These additional requirements should be considered within the context of existing requirements, which together with the triennial reviews of the ICAAP (e.g., LPS 110 for life companies) and risk management framework (i.e., CPS 220 and SPS 220) and periodic reviews of superannuation trustee reserves (e.g., SPS 515) would result in a total of four similar reviews[2].

We understand that APRA's proposed CPS 190 supports and reinforces the objectives of existing requirements and is more narrowly targeted at scenarios where the entity finds itself under financial stress. In our view however, we believe there is potential to enhance the prudential standards in relation to reserve, capital and risk management that are already in place, in particular for RSE licensees, as a means of effecting these changes. APRA may want to consider looking at enhancing gaps in these Prudential Standards and where those enhancements cannot be made, then look to create new standards in consultation with industry. This would encourage and facilitate simplification and hence reduce the unnecessary compliance burden that comes with implementing new prudential standards.

To limit the additional burden imposed on industry, we request that APRA consider:

- 'Operationally independent' may include persons from within a Group structure – as is the case for the independent review of the ICAAP for example. This would mitigate some of the additional costs;
- that these reviews could be conducted within existing frameworks, say as a component of the ICAAP review; and
- in relation to insurance, LAC should form part of the existing ICAAP regime, and not comprise a new, separate ring-fenced capital amount or PCR extra for SFIs. Adding an additional material LAC to the PCR for SFIs would not meet the competitive neutrality test. If the LAC is not material, the added complexity and compliance costs of incorporating the allowance would seem unjustified;
- the unique features of the superannuation industry, such as the fact that superannuation fund members bear the risk associated with the investment of their monies, mean that there are no risk-based capital requirements for superannuation licensees. Indeed, superannuation licensees are not directly exposed to the adverse consequences of an economic downturn that would befall banks and insurers. For this reason, we strongly support an approach from APRA that better caters for superannuation and considers its response in the context of other recent consultations on strengthening financial resilience and investment governance. In our view, these consultations cover many of the areas of an effective contingency plan for RSE licensees and its outcomes should inform the extent to which any or all of APRA's strengthening crisis preparedness proposals might not be required.

Further detailed comments are included in the Appendix to this letter. We would be happy to discuss this submission further, and you can contact me at anguyen@fsc.org.au.

Yours sincerely,

Aidan Nguyen

Aidan Nguyen
Policy Manager, Superannuation

[2] This is in addition to the requirement for an APRA-regulated institution to ensure that compliance with, and the effectiveness of, the risk management framework of the institution is subject to review by internal and/or external audit at least annually.

APPENDIX: DETAILED COMMENTS

CPS 190 feedback

Contingency planning framework

1) Paragraph 13 states *"…The contingency plan must demonstrate how the APRA-regulated entity could:*
   (a) take actions to recover its financial resilience; and
   (b) *enable its orderly and solvent exit from regulated activity, if actions to recover financial resilience are not effective.*"

   We note that it would not be possible in all scenarios for entities to enable an orderly and solvent exit from regulated activities. This is implicitly recognised by APRA in the introduction of CPS 900. Such scenarios should therefore be noted explicitly as being out of scope of CPS 190.

2) Paragraph 15 requires in essence that the contingency plan be integrated into other relevant frameworks. In practice, entities would be able to benefit from potential synergies of integration by combining the proposed CPS 190 requirements into a single document, for example a financial contingency plan incorporated into the ICAAP Summary Statement. It would be helpful if APRA could clarify in further regulatory guidance if such approaches would be acceptable.

3) Paragraph 16 states "*An APRA-regulated entity must not assume extraordinary public sector. support or the use of APRA's powers in its contingency planning*".

   We note instances where APRA has imposed a supervisory adjustment on an entity's capital requirements to influence market behaviour rather than to simply reflect the risk the entity faces. Under a severe market-wide stress however, we submit that it may be more realistic for APRA-regulated entities to assume APRA would suspend such supervisory adjustments. We would ask for APRA's position in this scenario.

Contingency plan requirements

4) Paragraph 19(e) requires "*credible exit actions that could be taken to effect an orderly and solvent exit from regulated activity*".

   We note APRA's plan to develop accompanying guidance to assist entities in meeting their new requirements and that it will release draft guidance for consultation in the first half of 2022. We would appreciate if APRA could provide further guidance on the level of detail and specific examples that the exit plan should cover as we understand that exit action plans were not explicitly covered in the previous industry pilot for recovery plans.

5) Paragraph 19(f) requires "*scenario analysis that assesses the effectiveness of the trigger framework, shows how contingency actions <u>would</u> be implemented…*" (Underlined for emphasis)

   The word 'could' rather than 'would' is more appropriate here as the scenario analysis should not be taken as a binding commitment that the entity would follow the pre-specified course of action should a similar scenario eventuate. Rather, we consider that the overall level of preparedness of an entity for crisis situations is more important than the documentation of a response to a hypothetical scenario. This approach would also be consistent with the drafting approach APRA has taken for paragraphs 19(d) and 19(e).

   A scenario analysis is a material piece of work requiring the co-ordination of a significant number of senior resources. We would be concerned if paragraphs 19(f) and 28 were interpreted to create a requirement to carry out a full scenario analysis twice per year. We believe undertaking a full scenario analysis should only be required in the event of a material change in the internal or external environment which necessitates an update.

6) Paragraph 19(g) requires "*an assessment of recovery capacity, which is the aggregate impact of plausible recovery actions under each scenario*".

This requirement could be interpreted as having to value all possible recovery options in each scenario, many of which may never be considered should the scenario eventuate. We believe this requirement could be clarified that an assessment of recovery capacity in each scenario should not go beyond that required to restore the financial resilience of an entity.

7) We note that the requirements set out in paragraph 20 could result in an onerous level of detail for entities to document if applied to every recovery and exit action. Further guidance from APRA on the level of detail required would be useful here. We consider it would be more effective if paragraph 20 requirements apply only to the main actions and that further guidance would encourage entities to include only the minimum number of actions necessary in the contingency plan.

8) Paragraph 21 requires that the Board must form a view on the sufficiency of recovery capacity to restore financial resilience. Given it would not be possible in all scenarios for entities to enable an orderly and solvent exit from regulated activities, further guidance from APRA's expectations for how 'the sufficiency of recovery capacity' to be judged, including defining this concept in the context of the risk appetite of the entity, would be helpful.

9) In the Discussion Paper, APRA has asked whether it should indicate preferred contingency options. FSC believes these contingency options should be self-determined by the responsible entity. Where APRA has however formed a view on its preference, less prescriptive guidance would be beneficial because it would provide entities with greater flexibility to self-determine the most appropriate options.

Capabilities, monitoring and execution

10) Paragraph 24 requires an APRA-regulated entity to maintain the capabilities required to execute the contingency plan. We note the Discussion Paper includes some high-level commentary on APRA's expectations, there is limited detail provided for CPS 190. In relation to CPS 900, the Discussion Paper also describes four broad categories of capabilities (crisis governance arrangements, operational, data and systems and post-crisis stabilisation plan) that APRA anticipates could be required. We would be interested in understanding whether the same four categories of capabilities (albeit with slight differences in the details within each category) would apply for CPS 190.

11) We would appreciate further guidance on how to interpret 'sufficient' in the requirement to "maintain access to sufficient financial resources to support the implementation of recovery and exit actions" used in paragraph 27, notwithstanding the example of operational expenses the Discussion Paper. For example, is "sufficient" to be based on an entity's own risk appetite, or does APRA have expectations as to what is sufficient? We would also appreciate clarity as to whether any funds held to allow recovery and exit actions to be implemented would need to be segregated from other funds to ensure they remain available if needed as separating sources of funding would come at additional cost.

12) We note statements from APRA as part of the recent consultations relating to AASB17 that "*APRA's view is that the overall calibration of the LAGIC framework remains appropriate and it is not seeking to generally increase or reduce capital levels*" (November 2020 Discussion Paper). Paragraph 27 could be interpreted to mean that APRA is seeking to require companies to hold additional capital – APRA should clarify that this is not the case.

Requirements for Non-SFIs

13) We recognise that APRA has chosen to adopt a proportionate approach whereby smaller, less complex entities will have fewer and simpler requirements. However, for very small entities, such as insurers that are subject to the minimum prescribed capital amount requirement, we consider that the proposed CPS 190 requirements would be disproportionately onerous if applied and therefore these entities should be exempt from APRA's proposal.

CPS 900 feedback

Resolvability assessment

1) We note an apparent inconsistency between paragraph 19 which states "APRA may require an APRA-regulated entity to conduct a resolvability assessment" and the diagram on page 7 of the Discussion paper which states "Entities must assess their resolvability". In this instance, we also note that APRA's requirement for the resolvability assessment to be conducted by the regulated entity appears inconsistent with resolution planning being an APRA-led process.[3] For example APRA will be better positioned to form an assessment in regards to a transfer as a resolution option than would the regulated entity.

Pre-positioning plan

2) APRA proposes in paragraph 22 to have powers to require an APRA-regulated entity to develop and implement a pre-positioning plan. We submit that the pre-positioning plan's objective of 'removing barriers to the execution of resolution options' should also be balanced with additional wording to include the objective of ensuring the pre-positioning plan is not developed in such a way that results in disproportionate cost implications for the operating model of entities and ultimately policyholders/members. While avoiding major hurdles to resolvability is also an important consideration, it should not define an entity's strategy and governance, which should in the first instance be aligned with market and the interests of the entity's beneficiaries as well as ensure compliance with legal and regulatory requirements. Firms may need to make appropriate and proportionate changes to the legal and business structures where necessary, but with the important caveat that any decision to impose such requirements should be taken with due account of the effect on the soundness and stability of ongoing business.[4]

Capabilities for resolution

3) Paragraph 27 states that "An APRA-regulated entity must maintain the financial resources required to operationally execute resolution actions" and we note some commentary set out in the Discussion Paper around loss-absorbing capacity (LAC). Additional explanation is however required as to the meaning of Paragraph 27. We again refer to recent statements made by APRA as part of the recent consultations relating to AASB17 that "*APRA's view is that the overall calibration of the LAGIC framework remains appropriate and it is not seeking to generally increase or reduce capital levels*" (November 2020 Discussion Paper). Paragraph 27 could be interpreted to mean that APRA is seeking to require companies to hold additional capital – APRA should clarify that this is not the case.

Review

4) Paragraph 31 provides that SFIs must review and update the resolvability assessment at least every three years. While we do not a particular objection to the proposed three-yearly review period, we believe there is scope for less frequent review periods provided reviews of resolvability assessment are comprehensive and effective.

Miscellaneous

5) APRA's proposals do not make clear whether the resolution plan will be shared with the APRA-regulated entity. It would be helpful for APRA to clarify that the plan will be made accessible to the APRA-regulated entity so that it is well placed to implement the resolution plan where the entity has become non-viable.

[3] The expectation that the resolvability assessment is undertaken by the resolution authorities is consistent with the Financial Stability Board (FSB) in their document 'Key Attributes of Effective Resolution Regimes for Financial Institutions'.
[4] Financial Stability Board*, Key Attributes of Effective Resolution Regimes for Financial Institutions*, see Key Attribute 10.5.