Australian Banking Association

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Gideon Holland
General Manager, Policy
Australian Prudential Regulation Authority

By email: PolicyDevelopment@apra.gov.au

Dear Mr Holland,

Strengthening crisis preparedness

Thank you for agreeing to hold a workshop with the Australian Banking Association (**ABA**) and its members, ahead of formal submissions on 29 April 2022, on your important policy proposals to strengthen crisis preparedness within the Australian financial system.

The banking industry is broadly supportive of the Australian Prudential Regulation Authority's (**APRA**) proposals which should increase the safety and stability of Australia's financial system. This complements the rigorous prudential, legal and regulatory regimes already in place, and banks' strong management and unquestionably strong capital positions.

The draft CPS 190 Financial Contingency Planning (**CPS 190**) appears largely in line with APRA's ADI Recovery/Contingency Planning guidance and feedback provided over the years since its inception. That being said, further consideration needs to be given to the definitions, differences and implications of ADIs' developed recovery actions against the requirement to develop exit actions, which is a key additional requirement to APRA's previous expectations on ADI recovery plans.

As currently drafted, the standards, particularly CPS 900 Resolution Planning (**CPS 900**), are insufficiently detailed for industry to fully understand APRA's intent and, as such, to be able to fully assess their impacts, implications, costs or benefits. The ABA strongly encourages APRA to ensure this detail is provided, and industry is given sufficient time to consider and respond to that detail before the standards are finalised. Greater detail is also required for banks to be able to plan for and resource implementation of the new requirements.

Additionally, it is critical that the draft prudential guidance, which are set to accompany these standards, are descriptive and provides greater clarity on the requirements, including examples of expectations and application. An understanding of APRA's timeline for the development and release of these draft prudential guidance would also assist industry's preparations. If APRA is not able to provided increased clarity on the draft standards without the draft prudential guidance, industry recommends consideration be given to consulting on the draft prudential guidance concurrently with the draft standards.

The following preliminary observations and questions are provided to assist the APRA-industry workshop expected to be held on Thursday, 24 March 2022. The ABA and industry will provide further comments ahead of the consultation's 29 April 2022 deadline.

If you require further information or would like to discuss any of the content of this letter, please do not hesitate to contact me.

Regards,

Brendon Harper

Policy Director
Australian Banking Association

About the ABA

The Australian Banking Association advocates for a strong, competitive and innovative banking industry that delivers excellent and equitable outcomes for customers. We promote and encourage policies that improve banking services for all Australians, through advocacy, research, policy expertise and thought leadership.

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Appendix A: Key themes for discussion

The key themes that industry wishes to explore with APRA in the workshop are provided below with additional observations and detail included in Appendix B below.

Timeline and development plan for resolution planning: Industry is concerned that draft CPS 900 is insufficiently detailed to permit scoping and implementation of the new requirements and that APRA's timeline for working with entities to develop its resolution plans has not been clearly communicated. Industry is concerned that the risk obligations under the standard that could come into force before that engagement has concluded, if guidance that facilitates detailed scoping and resource mobilisation is not provided promptly.

Distinction between contingency and resolution planning: Some aspects of contingency planning described in CPS 190 (for example, exit actions in paragraph 13) have the potential to overlap with concepts that larger ADIs would expect to address in resolution planning. More generally, there is an unclear distinction under the draft standards as to where contingency/recovery activities stop and resolution actions begins. Clarity from APRA on this distinction and how individual banks' circumstances will be considered would be particularly useful. Additionally, greater clarity on whether draft CPS 190 will require banks with recovery plans currently in place to make materially changes is needed.

Pre-positioning planning versus implementation: APRA's expectations relating to the implementation of pre-positioning plans as distinct from detailed pre-positioning planning is unclear to industry. Significant costs and business distraction may be incurred, and commercial synergies may be significantly impacted, if steps to remove barriers to resolution are required to be implemented in a non-stress scenario where an entity remains clearly viable.

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Appendix B: Additional observations and detail

CPS 190 Financial Contingency Planning

As noted above, the draft requirements of CPS 190 appear largely in line with APRA's Recovery/Contingency Planning guidance and feedback provided over the years since its inception. Industry's initial feedback on CPS 190 focusses on components of the draft standard that introduce new requirements, or relate to existing components of recovery planning where the requirements in the draft CPS 190 appear to differ from previous guidance provided by APRA. These are outlined below, grouped into themes.

Exit actions

Paragraph 13(b) outlines the requirement for a financial contingency plan to demonstrate an ADI's 'orderly and solvent exit from regulated activity if actions to recover financial resilience are not effective'. Industry would like to understand APRA's expectations for ADI's, and in particular how this would interact with APRA's requirements for ADI's under CPS 900. In particular, for larger ADIs, industry expects that the process to exit regulated activity would be more akin to a resolution of that entity, rather than a de-licensing process, as has been the case for smaller ADIs recently.

Scenario analysis and recovery capacity

Paragraph 19(f) outlines the requirement for entities to conduct 'scenario analysis that assesses the effectiveness of the trigger framework, shows how contingency actions would be implemented, and measures the impact and effectiveness of those actions'. Industry would like to understand further details on APRA's expectations for how to undertake scenario analysis to evidence these points.

Paragraph 19(f) also requires the inclusion of at least two scenarios – systemic and idiosyncratic. Industry notes that this deviates from previous APRA feedback, for example, 2017 ADI Recovery Planning which states, "such analysis would be expected to include at least the following three broad scenario types, encompassing both fast-burn and slow burn: idiosyncratic, systemic and a combination of idiosyncratic and systemic elements which occur simultaneously." It would be helpful to understand whether APRA expects an ADI to use detailed and specific scenarios (such as a Global Trade War or China Downturn), or whether these would be generic scenarios to make the plan more applicable to any stressed outcome.

Paragraph 19(g) requires 'an assessment of recovery capacity, which is the aggregate impact of plausible recovery actions under each scenario. Recovery capacity must be measured in quantitative terms by calculating the amount of capital and liquidity that can be rebuilt during or following stress'. Can APRA provide further clarity on its expectations for meeting and evidencing compliance with this requirement?

Role of the Board

Industry would like to understand APRA's expectations with respect to the role of the Board in contingency planning and how it can evidence its compliance, in particular for the requirements relating to:

- Paragraph 38(b) to 'oversee reviews of contingency plans';
- Paragraph 38(c) to 'oversee the execution of contingency actions'; and
- Paragraph 21 to 'form a view on the sufficiency of recovery capacity to restore financial resilience and where this is insufficient, consider other actions the APRA-regulated entity may add to the contingency plan or other actions to improve recovery capacity'.

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Comprehensive review

Paragraph 29 requires a three-yearly ‘comprehensive review’ of the plan which is to be undertaken by operationally independent, experienced and competent persons. The comprehensive review requires operational testing of the plan. Industry would like to understand APRA’s definition of “operationally independent” for the purposes of these review requirements. Additionally, is APRA comfortable that the comprehensive review continues to be conducted by Internal Audit?

In addition to the above, paragraph 30 outlines the requirement for an operational test to stimulate the use of the contingency plan as part of the comprehensive review. Industry notes previous APRA expectations in this regard, in particular 2017 ADI Recovery Planning which outlines – “It is advisable to conduct regular (for example, at least annual) dry-runs and training exercises focusing on internal escalation processes, functioning of crisis management teams and determination of communication plans.”

Given the above, industry would like to clarify APRA’s expectations for operational testing of contingency plans, and if annual testing is required in addition to the three-yearly ‘comprehensive review’ conducted by operationally independent persons. Additionally, from an operational perspective, industry would support the option to meet all testing scope requirements within a three-year cycle, rather than requiring all the components of the testing to be completed together once every three years.

Other matters

Paragraph 16 outlines that an entity ‘must not assume extraordinary public sector support’. Industry would like to understand APRA’s definition of “extraordinary public sector support” in this paragraph, and whether it remains consistent with APRA’s 2017 ADI Recovery Planning. Industry notes that paragraph 8 of the 2017 guidance considers existing liquidity facilities offered by the Reserve Bank of Australia in this definition.

Paragraphs 22(a)-(c) of CPS 190 allow APRA to require the inclusion or exclusion of a particular recovery or exit action within the contingency plan, the inclusion of an APRA-determined scenario within the contingency plan, or the use of particular assumptions when assessing recovery capacity. Industry would like further information from APRA about the circumstances in which APRA may require any element of these paragraphs to be implemented in the contingency plan. Industry’s view is that APRA may only seek to require these points where it deems that an entity’s contingency plan has a deficiency to be addressed.

Paragraph 26 outlines that an entity ‘must take reasonable preparatory steps to support the timely and effective implementation of the contingency plan…’. Industry would like to further understand APRA’s expectations for this requirement.

CPS 900: Resolution Planning

As noted above, the ABA encourages APRA to provide further details on resolution planning to ensure industry can understand APRA's intent and, as such, to be able to fully assess the implications of CPS 900. In particular, the ABA notes that in APRA's discussion paper, entities would not be required to meet the requirements of the standard until APRA commences resolution planning with individual entities. Further detail would be useful regarding APRA's broad timeline to engage ADIs on commencing resolution planning, as well as its expectations at a high-level of the timeline and steps to develop and implement a resolution plan under CPS 900, including:

- Supporting APRA in determining if an entity provides critical functions;
- Supporting APRA in developing a resolution plan;
- Conducting a resolvability assessment;
- Developing and implementing any required pre-positioning plans; and
- Developing the capabilities to execute the resolution plan (including post-crisis stabilisation).

Providing this additional detail would enable ADIs to start meaningful discussions and preparation work on resolution planning ahead of APRA engagement post 2024.

Further details on industry's specific questions on the requirements of CPS 900 are outlined below.

Definitions, and adjustments and exclusions

Paragraph 11(a): Further information on APRA's approach to determining whether an entity provides 'critical functions' would be helpful, including the frequency of the review and potential update of this assessment on an ongoing basis. Identification of critical functions for each ADI appears to be the foundation that the plan is then built on. Industry would also like to understand from APRA if its determination of critical functions is a 'gating' matter, and once a resolution plan is required there are no further implications for those critical functions.

Is APRA able to provide a list of potential critical functions to help guide banks? Additionally, has consideration been given to how APRA's critical functions assessment leverages off, complements, differs or otherwise interacts with other relevant assessments by other government agencies, such as the Cyber and Infrastructure Security Centre's work on Critical Infrastructure Resilience?

Paragraph 11(c): Clarification is required on APRA's definition of 'non-viable' for the purposes of resolution, and how this compares with the definition of 'resolution' per paragraph 11(c) of CPS 900 and section 5 of the Banking Act. Industry notes that the definition of 'resolution' contains elements of subjectivity, in particular where an entity could be "being considered likely to be unable, or considered likely to become unable, to meet its obligations". It is unclear to industry the process by which APRA would reach this assessment. This definition is important as, amongst other reasons, some Financial Market Infrastructures may base their decision of suspension or termination on some notion of non-viability, entry into resolution, use of mandatory transfer powers or appointment of a statutory manager.

Paragraph 12 notes APRA may adjust or exclude a specific requirement. The language throughout the draft standard is 'APRA may require', as such, it is difficult to gain clarity on what would be required. Can APRA provide greater clarity or guidance on which of the specific requirements may be adjusted or excluded?

Resolution planning

Paragraph 14 outlines that 'APRA may determine a resolution plan for an APRA-regulated entity or a cohort of APRA-regulated entities' and that 'this may include resolution options such as a solvent wind-down, transfer, or recapitalisation of the entity or entities'. Industry seeks clarification from APRA as to whether resolution of an entity would always be expected to result in APRA revoking the license of the entity, as for example, the recapitalisation of an entity as a resolution implies that the entity will continue as a going concern.

Further to this, and as noted above, industry would like to understand APRA's expectations on the support an entity would be required to provide APRA in the development and implementation of a resolution plan (per paragraph 15).

Role of the Board

Paragraph 17 outlines that the 'Board of an APRA-regulated entity is ultimately responsible for ensuring the entity is resolvable'. As outlined in APRA's discussion paper, entities would not be required to meet the requirements of the standard until APRA commences resolution planning with individual entities. Once APRA commences resolution planning with an entity, that entity would be required to support APRA in the development and implementation of a resolution plan, under CPS 900. As the resolution plan is developed by APRA, if APRA has not developed a resolution plan for the entity, then the Board may be unable to ensure that the entity is resolvable. For the avoidance of doubt, industry notes that this requirement of paragraph 17 may not be achievable, until such a time that:

- a resolution plan has been developed for the APRA-regulated entity;
- a pre-positioning plan has been developed and implemented by the APRA-regulated entity; and
- an APRA-regulated entity has developed capabilities that are reasonably necessary to implement the resolution plan.

Further, the appropriateness of the Board having ultimate responsibility for ensuring resolvability in circumstances where resolvability occurs under an APRA owned plan is contentious. It would be more aligned with the role of a Board under such a process, and with the formulation of the role of the Board in paragraph 17 of draft CPS 190, to more clearly frame this in the first sentence of paragraph 17 of CPS 900 as responsibility for oversight of resolution planning and preparedness to support enaction by APRA of the resolution plan.

When referring to the Board, is APRA referring to the full Board or relevant members of the Board through an appropriate Board Committee? Similarly, could responsibility be delegated to a Board sub-committee?

Resolvability assessment

Paragraph 19 notes that ' APRA may require an APRA-regulated entity to conduct a resolvability assessment to assess the feasibility of resolution options'. Industry would like clarification on:

- Whether this requirement is considered part of meeting the requirement of paragraph 15 for an entity to support APRA in the development of a resolution plan; and
- How this requirement interacts with the three-yearly review of the resolution plan (per paragraph 31). In particular, industry notes that paragraph 19 states 'APRA may require' a resolvability assessment, whereas paragraph 31 notes that 'an entity must' review the resolvability assessment.

Paragraph 19 "The resolvability assessment must be conducted by personnel with appropriate skills and experience": Further detail is required regarding how APRA assesses a party to be appropriately skilled in resolution planning, noting the challenges of having internal resources for this given resolution planning is a new area of regulation in Australia.

Similarly, guidance is required on APRA's thinking regarding an independent review of the resolvability assessment. For example, does this apply to the initial resolvability assessment only? Is the independent review to be conducted by an internal or external party?

Pre-positioning

Paragraph 22 outlines that 'APRA may require an entity to develop and implement a pre-positioning plan'. Industry would like to clarify APRA's expectations on the potential 'implementation' of pre-positioning for resolution, noting that steps such as changing an entity's organisational / legal structure could be costly and complex, compared to the remote likelihood of some ADIs requiring resolution. In this context, has APRA given consideration to an 'escalating pre-positioning' framework, similar to the trigger framework in recovery planning or, more broadly, how it would balance the guaranteed costs to customers and the broader economy of prepositioning against potential future benefits and APRA's various legislative objectives?

Paragraph 23(b), the renegotiation of contracts to incorporate resolution-ready terms may be challenging to deliver given the number of contracts an ADI may have, including those with third-party service providers, and that suppliers may be offshore and/or provide services to several industries. As a result, renegotiating contracts to capture "resolution-ready" terms may be highly complicated. Industry requests further guidance from APRA on its expectations on the scope and timing of renegotiating contracts, including with third-party service providers. Clear, public guidance would also assist third-party service providers understand APRA's expectations/banks' requirements. Clear guidance is also relevant for banks entering new contracts between now when the standards are implemented – currently there is insufficient detail on what terms would be required with third-party providers.

For some groups of third-party providers, it may be more practical to achieve the renegotiation of contracts with third-party service providers by coordinating with APRA and other industry bodies.

Can APRA clarify its definition of the term "key functions" in paragraph 23(d), and outline how it differs to the defined term of "critical function" per paragraph 11?

Capabilities for resolution

Industry seeks additional clarity on what is required by way of "capabilities required to execute a resolution plan" per paragraph 25, in particular:

- Crisis governance arrangements, and how these are expected to be integrated into the entity's current risk management framework;
- Data and systems, and what resolution-specific components APRA is expecting to be maintained; and
- Post-crisis stabilisation plan, including steps to rebuild long-term financial resilience such as capital and funding plans, and how this may differ from existing contingency plans which may contain similar actions or business as usual capital and funding plans.

Industry also recommends replacing reference to "crisis" with "resolution" for example: "resolution governance arrangements" and "post-resolution stabilisation plan". This will provide clarity that the resolution planning is separate to existing crisis management arrangements in place within all entities (as required by CPS 232) even if the resolution planning leverages parts of those crisis management arrangements.

Industry would also appreciate clarification on the capabilities 'reasonably necessary' for resolution (per paragraph 26), including the scope and criteria APRA may apply when making this assessment. Industry notes that this determination will influence ongoing compliance costs to meet the new requirements for resolution planning.

External advisors

Paragraph 30 covers requirements for an APRA-regulated entity to engage, at the entity's expense, external advisors to support with aspects of CPS 900. Industry suggest qualifying these requirements with "as it relates to the entity" to clarify that entities are not expected to pay for third-party advisers to

APRA who are working on the regime more broadly, such as industry reviews or drafting further guidance.

Disclosures

Paragraph 34 outlines that an ‘APRA-regulated entity must not make any disclosures on resolution planning without the approval of APRA’. Industry requests that APRA set out its proposed approval process for disclosures, for example, in the context that an APRA-regulated entity believes it is required to disclose information (such as under continuous disclosure obligations), and if APRA does not provide approval, would APRA propose to issue a direction (with a secrecy provision) to provide a regulated entity with protection?