APRA

INCOMING GOVERNMENT BRIEF

May 2022

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Contents

Executive summary

The Australian Prudential Regulation Authority (APRA) is the prudential supervisor of the financial services industry. It oversees authorised deposit-taking institutions (ADIs comprising banks, credit unions and building societies), general insurers, life insurers, private health insurers, friendly societies, and most trustees of the superannuation industry. APRA currently supervises around 2,000 institutions across the ADI, insurance and superannuation industries.

APRA's purpose is to protect the Australian community by establishing and enforcing prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by the institutions that APRA supervises are met within a stable, efficient and competitive financial system. In this way, APRA aims to assure:

- ADI depositors that their money is safe;
- insurance policyholders that insurers have the resources to pay valid claims;
- superannuation fund members that their savings are appropriately managed in their best financial interest; and
- the Australian community that the financial system is stable.

State of the financial system

Australia's financial system remains fundamentally sound and stable. The financial system and APRA-regulated institutions demonstrated their financial and operational resilience during the COVID-19 pandemic. Despite facing severe staffing and operational challenges from lockdowns and border closures, financial institutions continued to deliver services and support the community, including through initiatives such as loan repayment deferrals, insurance premium freezes and the early release of superannuation. APRA-regulated institutions remain well capitalised, liquid, profitable and operationally resilient, and are well-positioned to continue to deliver services and support the Australian economy.

Notwithstanding the strength of the financial system, the economic outlook and operating environment in Australia is rapidly shifting, with a number of system-wide issues impacting institutions and the consumers they serve. Inflationary pressures and increases in interest rates will increase the cost of finance for business and housing. More broadly, frequent natural disasters, increasing geopolitical tensions and cyber threats, and the lingering impact of COVID-19 are creating volatility in financial markets, increasing cost pressures for all industries and heightening risks in the financial system. These pressures are occurring alongside developments in technology and digital innovation which are rapidly changing the landscape and dynamics of the Australian financial system.

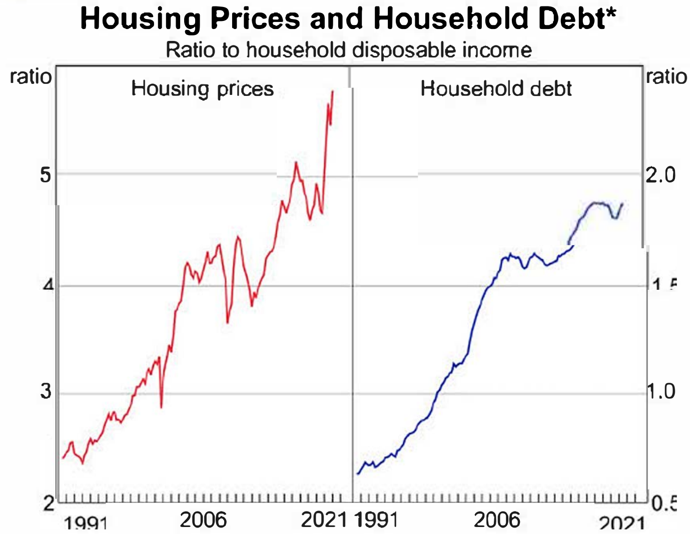
These issues are complex. They cross established regulatory boundaries, and will require coordinated responses by government, industry and multiple agencies, including the Council of Financial Regulators (CFR).

Focus areas

Housing risks

Risks in housing markets are heightened. A sustained period of record low interest rates has seen strong growth in housing prices in recent years (Figure 1), and this has been high relative to advanced economies globally. Households' debt levels relative to income are also elevated, both historically and internationally.

Figure 1.



* Household disposable income is after tax, before the deduction of interest payments, and includes income of unincorporated enterprises.

Sources: ABS; CoreLogic; RBA

Housing markets are cyclical, and APRA expects the shifting economic outlook in Australia to have a corresponding impact on housing markets. Housing prices have risen rapidly in recent years as a result of historically low interest rates, and households have become more leveraged. The faster-than-expected emergence of inflationary pressures and a rising interest rate environment is likely to place some strain on household balance sheets and place a number of households in financial distress.

Low interest rates have, in aggregate, assisted borrowers in building substantial mortgage repayment buffers. Nevertheless, a number will experience loan repayment shocks (particularly those on very low fixed rates) as interest rates increase. More generally, high interest rates will reduce borrowing capacity, increasing the likelihood of a decline in Australian housing prices. s47C [redacted]

The banking industry is strong and well placed to absorb a deterioration in asset quality (from housing portfolios, or other sources). While arrears rates are likely to increase as interest rates rise, non-performing loans are currently low and are expected to remain moderate even under a period of stress. APRA will continue to actively monitor lending standards and evolving risks in housing markets and review its macroprudential response in consultation with CFR agencies.

Climate-related financial risks

Climate-related financial risks pose challenges to the stability and resilience of the financial system. APRA seeks to ensure that APRA-regulated institutions manage both the risks and opportunities that may arise from a changing climate, in line with APRA's approach to other types of risks. The risks of a changing climate are acute and extend to all sectors of the economy, with implications for funding and investment markets, as well as the affordability and availability of insurance through rising premiums and reduced capacity.

Targeting climate-related financial risks at their root cause will require investment in risk mitigation to support the availability and affordability of both credit and general insurance for the Australian community. APRA will continue to work with Treasury and other stakeholders as appropriate to progress needed analysis and action. s47C [redacted]

Demands for the disclosure of information from financial institutions on the extent of climate-related risks, and how they are being managed, is growing. Some jurisdictions have begun to implement mandatory disclosure regimes, and the International Sustainability Standards Board has recently been established to develop high quality, transparent, reliable and comparable reporting by companies on climate and other environmental, social and governance (ESG) matters. Lagging international developments in these areas runs the risk that international investors begin applying a risk premium to Australia. s47C [redacted]

Availability and affordability of insurance

While well-capitalised, the general, life and private health insurance industries face varying availability, affordability and sustainability issues. Factors creating these pressures differ across products and, in some lines of business, are quite acute. If left unaddressed, these could see insurers withdraw from the market to the detriment of Australian consumers.

Collaboration with multiple stakeholders is essential to develop solutions that target the root cause of issues for specific insurance products. The drivers impacting affordability of home and commercial building insurance, such as a changing climate, differ to those impacting the availability of public liability or life insurance products. Solutions are likely to involve multi-faceted actions across the Australian and state governments, industry and other stakeholders.

s47C [redacted] APRA is working proactively with Treasury and other stakeholders to develop a deeper understanding of the drivers of affordability issues, and progress analysis needed to consider potential solutions.

Superannuation Performance Test

The superannuation system has generally performed well over the past few years in the face of several major financial and operational challenges. Nonetheless, there remains room for improvement. APRA has increased transparency on investment performance through a combination of its heatmaps and the annual performance test.[1] Together with APRA's supervisory oversight, this is delivering improved results for members, with trustees exiting underperforming products, reducing fees and updating investment strategies.

s47C and s47E(d) [redacted]

Technological change, digital innovation and new forms of finance

Broader economic pressures are unfolding against the backdrop of rapid technological change. Digital innovation and new forms of finance are transforming business and operating models in all industries and bringing new players and services into the market. These developments bring opportunities for consumers and the financial system more broadly, for example greater integration of banking and payment services with inventory, accounting and on-line retail platforms.

However, digital innovations are frequently at the periphery of existing regulatory settings, meaning regulatory treatment can be ambiguous. In the case of crypto-assets and stablecoins, regulatory treatment is unclear given the features of an asset may not align with the legislative definition of a financial product or service. New payment mechanisms have also raised questions around what constitutes a deposit. These issues are being considered by the CFR in considering proposals of the 2021 Farrell review - *Transforming Australia's Payments System* - to modernise Australia's regulatory framework for stored-value facilities (SVFs), which are of particular interest to APRA.

s47C [redacted]

Recent government announcements

Housing

As part of its election commitments, the Government announced the *Regional First Home Buyer Support Scheme* to assist first home buyers with a limited deposit enter the housing market. s47C and s47E(d) [redacted]

[1] The performance test was legislated under the *Your Future, Your Super* reforms, which came into effect on 1 July 2021.

s47C and s47E(d) [redacted]

[redacted]

s47C [redacted]

[redacted]

s47C and s47E(d) [redacted]

APRA's funding and resourcing

s47C and s47E(d) [redacted]

APRA is funded primarily from levies collected from regulated financial institutions. APRA levies are determined by the Treasurer, following consultation with industry. s47C and s47E(d) [redacted]

APRA is making significant investment in its data capabilities and in modernising its regulatory framework to ensure it remains fit for purpose into the future. [redacted] and s47E(d) [redacted]

[redacted]

Chapter 1 - Industry-wide issues

KEY POINTS

- Technology and digital innovation across the financial system is challenging established regulatory boundaries. s47C [redacted]
- APRA's cyber and climate-risk programs will support whole-of-government strategies and provide a strong framework to drive improvement across the financial system.
- APRA continues to invest in contingency arrangements to resolve the failure or near failure of a regulated institution. s47C and s47E(d) [redacted]
- s47C [redacted]

A substantial proportion of APRA's priorities are industry-wide in nature, spanning the banking, insurance and superannuation sectors. APRA-regulated institutions face a challenging operating environment and industry-wide risks will require more attention in the period ahead. To support sound prudential outcomes for the Australian community, APRA's industry-wide focus areas include:

- deepening its understanding of how digital innovation will transform the financial system, and modernising its approach to regulation;
- materially enhancing the financial sector's cyber and operational resilience;
- ensuring institutions take an orderly approach to manage climate-related financial risks;
- establishing plans for institutions' recovery from financial stress or, if no longer viable, resolution; and
- strengthening institutions' governance, risk culture, remuneration and accountability.

Addressing industry-wide risks is often a complex undertaking which can only be successfully addressed by APRA in concert with the Government, other agencies and industry. Consequently, APRA's approach is collaborative, and aligned with broader government frameworks and initiatives to avoid duplicative requirements for regulated institutions. APRA works closely with Treasury portfolio ministers, industry bodies, the CFR and other government agencies including the Australian Competition and Consumer Commission (ACCC), Australian Cyber Security Centre (ACSC) and Department of Home Affairs (DOHA). APRA also engages with other arms of government and regulators from other jurisdictions as needed (see chapter 6: *Interagency Collaboration*). Government initiatives will be critical in determining the broader legislative and operating environment for regulated institutions and APRA's approach to addressing industry-wide issues.

1.1 Technological change, digital innovation and new forms of finance

The financial services industry is rapidly evolving with new services, delivery mechanisms, products and participants (both regulated and unregulated) emerging as a result of digital innovation.[2] Innovation is also supported by initiatives such as the Consumer Data Right, which has provided consumers with the ability to share financial information and data between financial institutions and third parties to compare and access tailored services.

While new services and participants bring opportunities for better outcomes for consumers and the financial system more broadly, they also bring new complexities and risks. Digital innovations are frequently at the edge of existing regulatory boundaries, and regulatory treatment of new products, services and institutions can be ambiguous. For example, digital innovation is seeing an increasing prevalence of crypto-assets, new payment mechanisms and diversified organisations (such as technology firms and fintechs) which were not envisaged by the existing regulatory framework. Institutions are also partnering with, or placing increasing reliance on, non-regulated third-party service providers to provide critical functions and keep pace with digital innovation and cyber protections. While these partnerships are often a good outcome from a cost and efficiency perspective, they may create dependencies and potential vulnerabilities that are beyond the scope of regulators to oversee (this is particularly problematic when issues extend beyond national borders).

These developments are challenging established regulatory boundaries including the reach of APRA's prudential framework and mechanisms for protecting the interests of bank depositors, insurance policyholders and superannuation fund members. Responding to these developments requires a whole-of-government approach. Internationally, several jurisdictions have proposed or introduced new laws to clarify regulatory treatments of digital innovation and in particular crypto assets. Jurisdictions are taking differing approaches, however whilst much of the focus to date has been on disclosure and consumer protections, there are also considerations for the prudential treatment of risks associated with these assets, in particular stablecoins, and potential for risk transfer to assets in the traditional financial system.

In Australia, the CFR is focused on actioning the proposals of the 2021 Farrell review and is collaborating on the design and implementation of new regulatory measures with other agencies including ACCC and the Australian Transaction Reports and Analysis Centre (AUSTRAC). Of particular relevance to APRA is the work to modernise Australia's regulatory framework for stored value facilities (SVFs), including certain types of digital wallets and stablecoins, which APRA sees as a high-priority issue for ensuring the protection of depositor interests.

s47C [redacted]

[2] APRA is already seeing the outcomes of digital innovation: crypto-assets, Banking as a Service, non-bank payment providers, and new regulatory approaches for purchased payment facilities or SVFs. More specific examples include ANZ recently executing a pilot transaction through an ADI-issued Australian dollar stablecoin, and Westpac's partnership with Afterpay.

s47C [redacted]

Innovation is also raising complex policy issues related to payments and crypto-assets, including with respect to the de-banking of businesses that operate in this area. s47C and s47E(d) [redacted]

1.2 Cyber resilience

The financial system is part of Australia's critical infrastructure. Consequently, its ability to stand firm against cyber-attacks is of utmost importance.

Cyber incidents are increasing, as is the risk and sophistication of attacks. During 2020-21, the Australian Cyber Security Centre (ACSC) reported over 67,500 instances of cybercrime, an increase of almost 13 per cent from the previous financial year.[3] In its latest *Financial Stability Review*, the RBA reported that 55 per cent of data breaches of Australian financial institutions over the past two years have been malicious.[4] Against the backdrop of increasing threats, financial institutions are investing heavily in this area and have improved their capacity to deal with cyber threats. s47C [redacted]

Cyber-attacks are more likely than other types of operational incidents to have a systemic impact, with opportunity for adversaries to exploit vulnerabilities in cyber connections to magnify their attack. The increasing reach and interconnectedness of financial institutions – reflective of the digitalisation referred to above – means that cyber risks to APRA-regulated institutions may also originate outside of the regulated financial system. Although APRA supervises around 2,000 financial institutions, the wider financial system includes over 17,000 connected institutions and third-party actors. Building resilience against cyber risks that could originate from outside of the regulated system is therefore a key concern for all CFR members.

Addressing cyber risk requires a coordinated, cross-industry approach. Most importantly, APRA's *2020-2024 Cyber Security Strategy* is fully aligned with the *National Cyber Security Strategy* and ensures that relevant legislation and Government initiatives are implemented effectively by APRA-regulated institutions. APRA is also working closely with the ACSC, DOHA and the CFR to coordinate and strengthen collective defence strategies (see Box A).

[3] ACSC Annual Cyber Threat Report - 2020-2021

[4] RBA Financial Stability Review – April 2022

APRA takes a multi-pronged approach to cyber resilience for its regulated industries, involving:

- clear requirements of regulated institutions detailed in its *Prudential Standard CPS 234 Information Security* (CPS 234);
- establishing a domestic cyber-attack protocol with the CFR, in partnership with the ACSC, and working on an equivalent with New Zealand regulators to use in events that affect both Australian and New Zealand financial systems;
- collaboration with CFR and other peer agencies to manage cyber incidents affecting the financial sector, and advance initiatives identified by the *National Cyber Security Strategy*;
- working closely with regulated institutions on contingency planning, identification of vulnerabilities and mitigation strategies;
- collecting new data to improve understanding of cyber risk and resilience; and
- building a cyber information sharing community across industry and government, to improve awareness and practice.

While cyber risks cannot be fully mitigated, APRA's program of work to build cyber resilience, including its cyber strategy and CPS 234, is consistent with the whole-of-government cyber resilience strategy and provides a strong framework for driving improvement across the institutions and industries APRA regulates.

Box A: APRA's collaboration with agencies and industry on cyber resilience

s47C and s47E(d)

[redacted]

[redacted]

APRA's approach to cyber risk across institutions is proportional and involves working closely with regulated institutions to tailor engagement and promote better practice. APRA's approach is informed by engagement with international regulators to ensure its interventions and activities are consistent with better practice. As examples, APRA has worked with:

- the Customer Owned Banking Association and the mutual ADI sector to improve cyber resilience while managing regulatory burden for smaller ADIs; and
- the Association of Superannuation Funds of Australia to deliver a series of sessions to share information on cyber resilience weaknesses observed in the superannuation industry, and insights into how institutions could improve their cyber resilience practices.

s47C and s47E(d) [redacted]

1.3 Climate-related financial risks

Climate change poses significant challenges, and opportunities, for the global and Australian economies. Several risks arising from climate change are distinctly financial in nature, and arise from three sources: physical, transition, and liability risks.

Climate-related financial risks are many. Some risks are already acute, and many are foreseeable and actionable now. APRA has been actively raising the financial sector's awareness of climate-related risks since Australia became a signatory to the Paris Agreement, with the aim of ensuring that institutions are prepared for the impacts that may arise from climate change and the transition to a lower emissions economy.

APRA has not sought to prescribe how financial institutions should respond to a changing climate, but rather has sought to ensure they are well-equipped to respond by making informed decisions.

The financial system will play a critical role in funding the transition to a lower carbon economy. By improving the understanding of climate-related risks, APRA is seeking not only to ensure that risks are well managed, but also that the financial system is able to take advantage of the opportunities that a changing climate presents.

To assist the financial sector prepare for, and address, the financial risks of climate change, APRA has published industry guidance on climate change financial risks. APRA's Prudential Practice Guide CPG 229 *Climate Change Financial Risks* (CPG 229) outlines sound practice in areas such as governance, risk management and disclosure. APRA is encouraging regulated institutions to begin using CPG 229 immediately to strengthen their capability to identify, manage and build resilience to climate-related financial risks.

APRA recently conducted a survey of 79 large and mid-tier institutions to gauge their management of climate-related financial risks against the expectations set out in CPG 229 and the Taskforce on Climate-related Financial Disclosures guidance. s47C and s47E(d) [redacted]

Demands from investors for the disclosure of information from financial institutions on the extent of climate-related risks, and how they are being managed, is growing. Some jurisdictions have begun to implement mandatory disclosure regimes, and the International Sustainability Standards Board has recently been established to develop high quality, transparent, reliable and comparable reporting by companies on climate and other environmental, social and governance (ESG) matters. Lagging international developments in these areas runs the risk that international investors begin applying a risk premium to Australia. s47C [redacted]

s47C [redacted]

APRA, on behalf of the CFR, is also carrying out a Climate Vulnerability Assessment (CVA) with the five largest ADIs. The CVA explores the potential financial exposure and macroeconomic risks they face from physical and transition risks, which may include deterioration in asset values. The results of the CVA, expected in the second half of 2022, will inform an understanding of how ADIs might adjust their business models, and provide data to better understand climate risks and related disclosure issues for financial institutions. Experience from the CVA will be incorporated into APRA's ongoing development of its approach to climate risk.

Box B: APRA's role in domestic and international forums for climate risks

s47C and s47E(d) [redacted] APRA also supports industry initiatives on the risks from climate change and collaborates with regulatory peers through the Network for Greening the Financial System, Financial Stability Board (FSB), the Bank for International Settlements and the Executives' Meeting of East Asia Pacific Central Banks (EMEAP).

APRA is also a member of the Basel Committee on Banking Supervision (BCBS) Task Force on Climate-related Financial Risks and participates in climate-related working group activities with organisations such as the International Organisation of Pension Supervisors (IOPS), the International Association of Insurance Supervisors (IAIS) and the Sustainable Insurance Forum.

APRA's involvement provides the ability to understand and influence the direction the global regulatory community takes in responding to climate-related financial risks. This includes development of global practices and identifying how to improve data availability and quality.

1.4 Recovery and resolution

Recovery and resolution planning are essential to maintaining the resilience and stability of the financial system. While APRA's prudential standards aim to strengthen institutions' resilience, APRA also has a critical role in ensuring institutions have robust plans which can be activated if they experience severe stress that threatens their viability.[6]

The *Crisis Management Act 2018* gave APRA a solid suite of powers to resolve failing banking and general and life insurance institutions, and in 2021 the *Your Future, Your Super* reforms established the complementary legislative framework for the superannuation industry.

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s47C [redacted]

[6] Unlike many other jurisdictions, which have a separate agency to oversee deposit/policyholder insurance and resolution, APRA is both prudential supervisor and resolution authority in Australia. Given the rarity of failure in Australia, this latter role is often not well understood.

Credible financial contingency plans are in place for most ADIs and insurers – these cover recovery or exit options. Along with driving improvement in the credibility of institutions' plans, APRA is expanding financial contingency planning into the superannuation industry. APRA also continues to develop its resolution capabilities to ensure that it can use its powers to resolve a failing financial institution if institution-led recovery actions are not effective. The importance of this planning was evident in January 2021, when Xinja Bank completed an orderly exit from the industry via a return of its deposits – the first time an Australian ADI had undertaken such a process.

To date, APRA's recovery and resolution work has largely occurred through supervision activities. To provide a stronger regulatory basis for this work going forward, APRA is consulting on a new prudential framework for financial contingency and resolution planning. This is expected to come into effect from 1 January 2024 for ADIs and insurers and from 2025 for superannuation trustees.

s47C and s47E(d)
[redacted]

If a regulated institution were to experience viability concerns, APRA has strong domestic and international coordination mechanisms to respond. In the case of ADIs and general insurers, the Financial Claims Scheme (FCS) provides a last resort backstop for depositors and policyholders that may be activated by the Treasurer and is administered by APRA. For superannuation members, in some situations where fraud or theft has occurred, a last resort compensation option may be available, with approval from the Treasurer.

1.5 Governance, risk culture, remuneration and accountability and the Financial Accountability Regime

Since the Royal Commission and implementation of the Banking Executive Accountability Regime (BEAR), APRA has seen clear evidence of greater clarity and transparency of individual accountability within ADIs. In APRA's view, there will be clear benefits from applying this experience more broadly.

As part of APRA's work to lift standards of governance, risk culture, remuneration and accountability (GCRA) across the financial system, APRA in 2021 released its cross-industry prudential standard, *Prudential Standard CPS 511 Remuneration* (CPS 511). CPS 511 aims to ensure that financial institutions have remuneration arrangements that appropriately incentivise individuals to prudently manage the risks they are responsible for, and that there are appropriate consequences for poor risk outcomes. The new standard comes into effect from the beginning of 2023 and will address several Royal Commission recommendations. APRA is currently working on new reporting and disclosure requirements to support the new standard, which will enhance transparency and further promote accountability. Consultation on these proposals will begin shortly; s47C [redacted]

APRA is also working with ASIC to prepare for the proposed FAR, which will extend the existing BEAR across all ADIs, insurers and superannuation trustees (as recommended by the Royal Commission). APRA and ASIC are working closely together on this initiative, including preparing a guide with principles for jointly administering the FAR, regulator rules and implementation guidance. s47C [redacted]

s47C and s47E(d) [redacted]

Chapter 2 - Authorised deposit-taking institutions

KEY POINTS

- The banking industry remains well capitalised and prudentially sound. Credit growth is relatively strong.
- However, ADIs face funding cost pressures and heightened risks in housing markets from an environment of higher interest rates.
- While a realisation of housing risks is unlikely to create stability issues, there will inevitably be pockets of stress from borrowers who have over-extended themselves. This will be exacerbated if borrowers also face a period of falling property prices.

Preserving the safety and soundness of the banking system and protecting the interests of depositors against systemic shocks that may jeopardise financial stability, is key to APRA's purpose.

The banking sector continues to be dominated by the largest ADIs (Figure 2). As measured by total group assets, the four major banks hold just under three-quarters of industry assets. Over recent years, there has been heightened merger activity among smaller ADIs as a result of sustainability pressures from increasing operating costs and competition from non-ADIs. APRA expects consolidation to continue. The banking industry has also seen the entry of several new ADIs (such as neobanks).

	Number	Consolidated Group Assets ($b)	Percentage of industry assets
Banks	96	5,572	99
Major banks	*4*	*4,062*	*72*
Other domestic banks	*36*	*717*	*13*
Foreign subsidiary banks	*7*	*192*	*3*
Foreign branch banks	*49*	*601*	*11*
Credit unions and building societies	36	51	1
Other ADIs	8	9	0
Restricted ADIs	3	n/a	n/a
All ADIs	143	5,631	100
of which: mutual ADIs	60	155	3

Following a decade of post-GFC regulatory reform, including the establishment of 'unquestionably strong' capital ratios (a recommendation of the 2014 Financial System Inquiry (FSI)), the banking industry is fundamentally sound and stable, with ADIs' strong capital ratios (Figure 3) supported by robust profitability (Figure 4). Although returns in the banking sector have declined over the decade as banks have become better capitalised, the overall industry return on equity remains healthy. Liquidity positions are well above regulatory minimums, and funding profiles have strengthened as banks have increased their share of funding sourced from domestic depositors and lengthened the maturity of their wholesale funding. Despite recent financial market volatility and tightening in funding conditions caused by the war in Ukraine, funding markets remain open and accessible. Overall, credit growth is strong (Figure 5), and ADIs are well-positioned to continue to lend to Australian households and businesses and support Australia's economic recovery from COVID-19.

Figure 2.

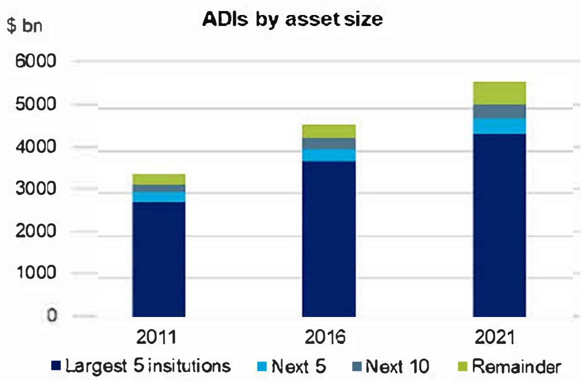


Figure 3.

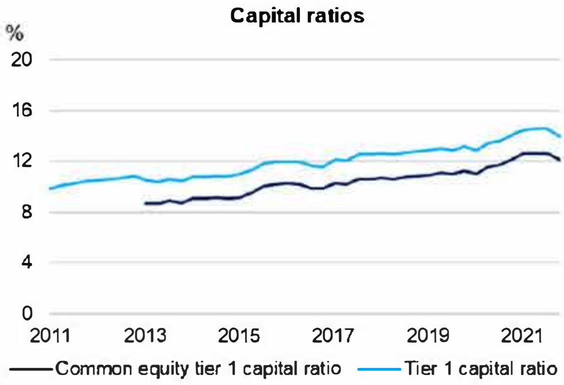


Figure 4.

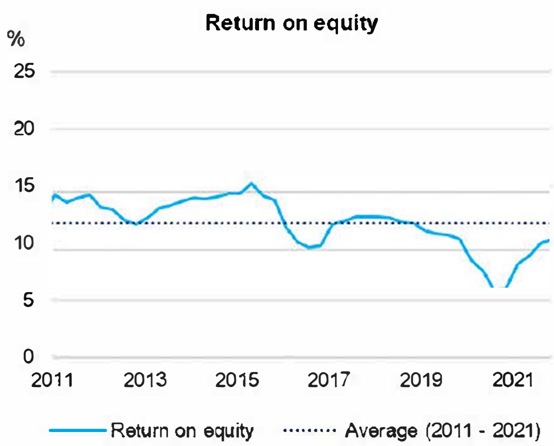
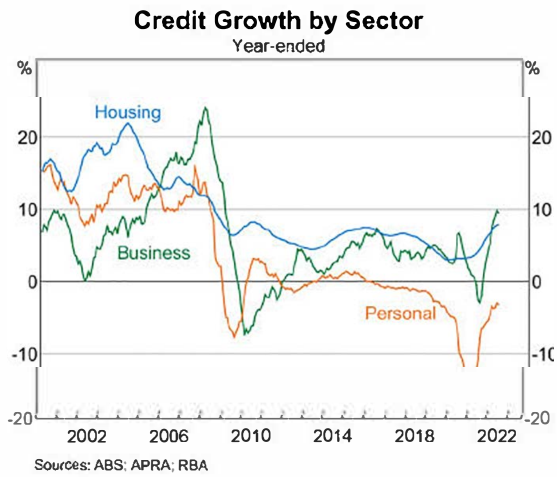


Figure 5.



APRA has taken a range of steps to strengthen the resilience of the banking system in recent years, including:

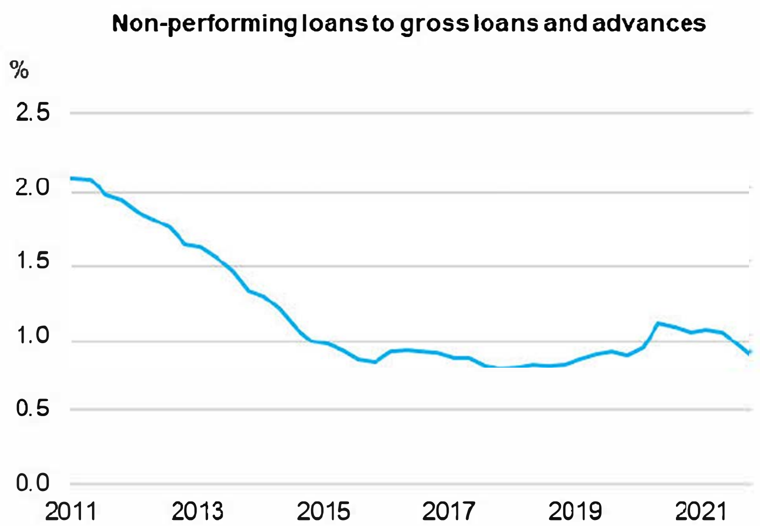
- embedding 'unquestionably strong' levels of capital;
- reinforcing sound lending standards through both microprudential supervision and macroprudential policy;

- encouraging improvements to funding and liquidity profiles;
- conducting more frequent stress testing; and
- refining and innovating data collections and analysis.

Nevertheless, ADIs remain exposed to significant financial headwinds and an uncertain outlook. Heightened geopolitical risks have the potential to adversely impact the ADI sector given Australia's significant exposure to international markets. Risks in housing markets are heightened, with inflationary pressures, an increasing interest rate environment and high levels of household indebtedness expected to place financial strain on a number of households. Commercial property lending may also be an emerging area of concern for ADIs, with higher interest rates, supply chain difficulties and post-pandemic changes to ways of working and consumer behaviour potentially having a negative impact on values for office and retail sector assets. These drivers may play out in increasing levels of non-performing loans in business lending, including construction. More generally, higher funding costs will be passed onto all borrowers.

While APRA's stress testing indicates ADIs are well placed to absorb an increase in non-performing loans, these remain low despite the disruption of the past couple of years (Figure 6).

Figure 6.



2.1 Capital management

In November 2021, APRA finalised a new ADI capital adequacy framework.[7] The framework, which will come into effect on 1 January 2023, is designed to preserve and formalise the

[7] https://www.apra.gov.au/news-and-publications/apra-finalises-new-bank-capital-framework-designed-to-strengthen-financial

unquestionably strong levels of capital held by the banking sector and ensure that Australian standards align with the internationally agreed Basel III framework.[8]

As evidenced above (Figure 3), the capital ratios of the Australian banking system have been substantially increased. In dollar terms, Australian banks have increased Common Equity Tier 1 Capital (CET1), the highest quality of capital, from around $130 billion at the time of the GFC to over $260 billion. However, beyond just strengthening capital levels, APRA also sought to make several other improvements to the capital framework including:

- providing more flexibility and responsiveness to risks in the operating environment;
- being more risk sensitive, through increasing capital requirements for higher risk lending and decreasing it for lower risks (in addition, capital requirements for lending to SMEs have been reduced, with lower risk weights under the standardised approach to provide additional incentive for ADIs to lend to SMEs);
- supporting competition by limiting differences in capital requirements between smaller and larger ADIs;
- improving the comparability of ADI capital ratios, both domestically and with global peers; and
- reducing operational burden for smaller ADIs.

Consistent with a recommendation from the FSI, APRA has also finalised requirements for the four major banks to maintain additional loss absorbing capacity so they could be recapitalised using private, rather than taxpayer, funds in the unlikely event of a failure.[9, 10] s56 [redacted]

2.2 Macroprudential policy actions and housing risks

Macroprudential policy is an important complement to traditional (micro)prudential requirements, referring to measures that a prudential regulator may take to mitigate risks to financial stability at a system-wide level. Macroprudential policy measures are typically temporary and operate in a counter-cyclical way to support stability through the financial cycle. They can also have an indirect impact on the broader economy, such as on asset prices.

In Australia and overseas, macroprudential measures have typically been deployed through the banking system and, while applicable to all types of lending, have been most commonly targeted at the risks to financial stability arising from housing markets. APRA also has

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[8] https://www.bis.org/bcbs/basel3.htm?m=2572

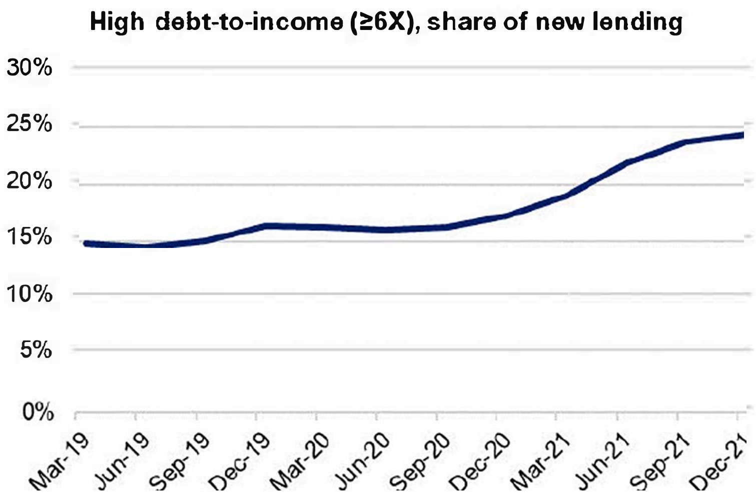
[9] This increases Total Capital requirements for the four major banks by 4.5 percentage points.

[10] https://www.apra.gov.au/finalising-loss-absorbing-capacity-requirements-for-domestic-systemically-important-banks

powers (so far unused) to apply macroprudential measures to non-ADI lenders, if those lenders are deemed to be materially contributing to financial stability risks.

Housing risks have been a longstanding focus for APRA and the CFR, given the dominance of housing loan portfolios on the balance sheets of the banking industry. APRA has been actively monitoring risks in housing markets for many years, and in 2015 and 2017 introduced temporary benchmarks for certain new residential mortgage lending. More recently, in October 2021, APRA sought to address risks to financial stability arising from increasing household indebtedness by raising the minimum interest rate buffer used by ADIs to assess a borrower's ability to service a loan (from 2.50 per cent to 3.0 per cent).[11] While the share of ADIs' new lending to highly leveraged borrowers appears to be stabilising in recent months as a result of this latest measure, the share of high debt-to-income lending remains elevated by both historical and international standards (Figure 7).

Figure 7.



In November 2021, APRA published its Macroprudential Policy Framework, setting out its approach to the use of macroprudential policy measures.[12] This includes the need for ADIs to be pre-positioned to implement particular macroprudential measures if needed. The framework also address how APRA may apply macroprudential measures to non-ADI lenders where their provision of finance is materially contributing to risks of instability in the Australian financial system. As set out in the framework, consultation with the CFR is essential to ensure alignment on the risk outlook and effective coordination of cross-agency responses. APRA will continue to monitor evolving risks to financial stability and review its macroprudential response in consultation with CFR agencies.

An important contributor to the success of APRA's past macroprudential interventions has been the strong support for the measures taken from other CFR agencies and, as needed, from the Government s47C and s47E(d) [redacted]

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[11] https://www.apra.gov.au/strengthening-residential-mortgage-lending-assessments

[12] https://www.apra.gov.au/macroprudential-policy-framework

2.3 Lenders' Mortgage Insurance

LMI is a niche and highly concentrated sector, serving clients ranging from the major banks to small credit unions. LMI is ultimately designed to protect the lender from losses due to borrower defaults, but the Australian housing loan market has evolved in such a manner that this product serves an important role for borrowers, enabling them to buy a home and borrow from a lender with a lower deposit.

s47C [redacted]

[redacted]

2.4 Updated approach to licensing

There continues to be strong interest by potential new entrants in obtaining a banking licence, following APRA's more accommodative approach to licensing adopted in 2018. While new entrants have increased choice for consumers, competitive pressure from these institutions has, to date, been limited and their market share remains low.

In support of a sustainable and competitive banking sector, APRA updated its approach to licensing and supervising new ADIs in August 2021.[19] The updated approach incorporates APRA's experience with new entrants since the introduction of the Restricted ADI licensing framework in 2018. APRA's updated licensing approach entails stronger requirements for granting a banking licence (related to capital, income-generating products, and financial contingency planning) and closer supervision of new entrants as they transition towards maturity. The approach is designed to encourage sustainable competition in the banking sector by ensuring that new ADIs are better equipped to succeed while ensuring that depositors remain adequately protected.

Since the release of the updated approach, APRA has authorised two Restricted ADIs and two foreign ADI branches s47C and s47E(d) [redacted]

[19] https://www.apra.gov.au/news-and-publications/apra-finalises-new-approach-to-licensing-and-supervising-new-banks

Chapter 3 - Insurance

KEY POINTS

- The general, life, and private health insurance industries remain well capitalised and prudentially sound. However, all three industries are confronted with varying availability and affordability issues.
- Addressing the underlying risks and costs that are driving higher premiums and reducing coverage will require a collective response from governments, regulators, industry and the community. To develop a better understanding of the drivers at a product level, APRA is working proactively with Treasury and other stakeholders to identify issues and consider potential solutions for specific insurance issues.
- Investment by government in climate mitigation strategies will be particularly important to reduce underlying risk and support the availability and affordability of general insurance.
- s47C [redacted]

Insurance plays an important role for the community and is a vital element of a safe and stable financial system. There are, however, a range of pressures on the affordability and availability of certain insurance products, which pose challenges across the general, life and PHI industries.

The number of insurers in each of the three industries has remained broadly stable in recent years, albeit increased concentration is evident. Insurers are generally well capitalised, with capital well above regulatory minimums. However, industry profits and returns are low in all three insurance industries (especially in the general and life insurance sectors, with return on net assets at 3.2 per cent and 3 per cent respectively). Industry profitability for PHI increased in 2021 after an 11-year low in the previous year, due to a recovery in investment income and COVID-related impacts on insurance profits. However, the longer-term trend for the PHI industry has been deteriorating profitability impacted by poor investment returns and a persistent downward trend in membership.

Sustainable insurance industries, which offer products that provide value for policyholders, will need an appropriate balance of risks between policyholders, government and insurers. Ultimately, the price of insurance is a risk signal. Supporting sustainable premium reductions across the insurance industries will require reducing the underlying risks that are driving higher premiums, such as the increased frequency and impact of insured events, and costs driving higher claims. s47C [redacted]

APRA will use available data and industry insights to help stakeholders understand the drivers and identify solutions to affordability and availability issues. APRA is also looking to address gaps in data needed to provide insights and advice to stakeholders.

APRA is working proactively with Treasury and other stakeholders, as appropriate, to progress analysis on specific insurance issues and develop potential solutions. As work is progressed, it could involve industry or state agencies, where they bring additional, and needed, expertise. Evidence from this work could support the Government to engage with state and territory governments on issues where they have responsibility (e.g. regulation of building approvals, business licencing and insurance taxes).

3.1 General insurance

The Australian general insurance industry remains well capitalised. However, a range of factors are impacting the affordability and availability of general insurance products. The most prominent challenges are premium rate rises for home and commercial building insurance, particularly in areas more exposed to natural disasters. Public liability and professional indemnity insurance are also under a degree of pressure, with more acute issues for the amusement and building sectors, as well as for financial advisors.

At the onset of the COVID-19 pandemic some deficiencies emerged in the wording and design of business interruption insurance policies. These have had to be resolved by the courts, unnecessarily prolonging the uncertainty for policyholders seeking to make a claim. In response, APRA is now seeing insurers being proactive in strengthening their insurance risk frameworks and addressing governance issues that allowed the problems to emerge. APRA is continuing to review the effectiveness of insurers' actions, which are also expected to reduce the risk of similar issues manifesting in other product lines.

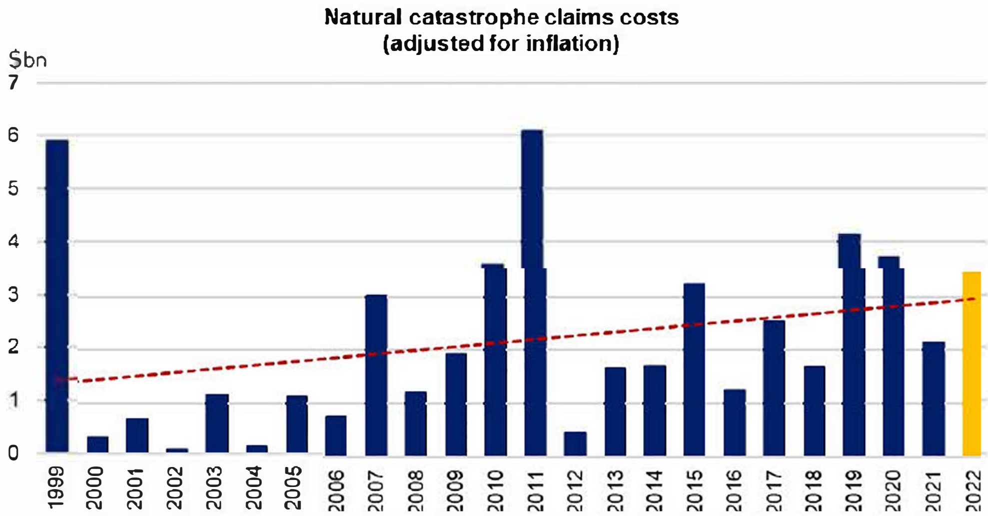
3.1.1 Home and commercial building insurance for natural disasters

To remain prudentially sound and financially viable, insurers need to set premiums that accurately reflect risk and recoup costs over time. As APRA has previously noted, reducing premiums without a commensurate reduction in the underlying risk will weaken the prudential strength of insurers and may see insurers choosing not to offer insurance in high-risk areas or ultimately exit the Australian market.

Recent floods in parts of New South Wales and Queensland have had a significant impact on the Australian community and demonstrate the rising financial impacts for insurers and the economy from an increasing prevalence of natural disasters (Figure 8). While all policyholder claims outcomes and the impact on insurers' capital positions are not final, APRA does not anticipate a material prudential risk to general insurers, which have the protection of robust reinsurance arrangements.[14]

[14] Reinsurance is the cover insurance companies purchase to manage risk relating to the impacts of large claims to ensure they can meet their obligations to policyholders.

Figure 8.



Source: Insurance Council of Australia

Note: Data for 2022 represents current estimates of the Southeast Queensland and NSW flood event.

The impacts of the floods, on top of the catastrophic bushfires in many parts of Australia in 2019-20, will however drive further premium increases for home and commercial building insurance. This will likely increase the prevalence of underinsurance for Australians living in areas which are highly exposed to natural disasters. In monitoring and responding to the floods, APRA is regularly engaging with the Insurance Council of Australia (ICA) and ASIC. APRA is also engaging with ICA and insurers about actions to respond to the growing affordability and availability challenges.

Premium increases after recent floods, in part, reflect increased costs of obtaining reinsurance as global reinsurers consider the profitability of their business and their appetite for Australian risks. Beyond the frequency and magnitude of natural disaster events, rising cost of labour and materials also contribute to the increased cost of these events. Reinsurance pricing has increased in recent times and that trend is expected to continue for at least the rest of the year.

Ultimately, targeting the root cause of higher insurance costs will require solutions which mitigate the frequency and impact of natural disasters in Australia. As an example, the ICA recently released estimates that $2 billion of resilience investment by the Australian and state governments could reduce financial costs to governments and consumers by $19 billion by 2050.[15] Systematically addressing issues for home and commercial building insurance may include changes to land-use zoning and building codes, as well as improvements in regulatory oversight of construction and planning sectors to create effective incentives for behaviour change.

s47C [redacted]

[15] ICA, *Building a More Resilient Australia*, February 2022.

s47C [redacted] The development and design of the cyclone reinsurance pool involved good collaboration by multiple stakeholders. s47C [redacted]

[redacted]

3.1.2 Public liability and professional indemnity insurance

Claims costs in a number of commercial insurance areas have been rising in recent years with insurers experiencing losses and low returns. Affordability and availability issues for professional indemnity are particularly acute in the building and financial services sectors while public liability issues are affecting amusement industries.

Australia's increasingly litigious environment, coupled with a global reassessment of the adequacy of pricing of professional indemnity and public liability insurance, has caused insurers to increase premiums, tighten terms and conditions and, in extreme cases, reduce or withdraw capacity. Additionally, for a number of these commercial insurance products, premiums are undergoing rebasing after a period of under-pricing relative to the risk. The ICA has reported price increases over the last four years of up to 30 per cent for public liability insurance, and up to 150 per cent for both professional indemnity and directors' and officers' liability insurance.[16] s47C [redacted]

3.2 Life insurance

The life insurance industry remains resilient from a capital perspective. However, the industry continues to be challenged by a range of issues that are impacting its sustainability. APRA is working with Treasury to explore the role of life insurance, and whether community expectations of life insurance are currently being met. The interplay between life insurance, superannuation and distribution channels also warrants review.

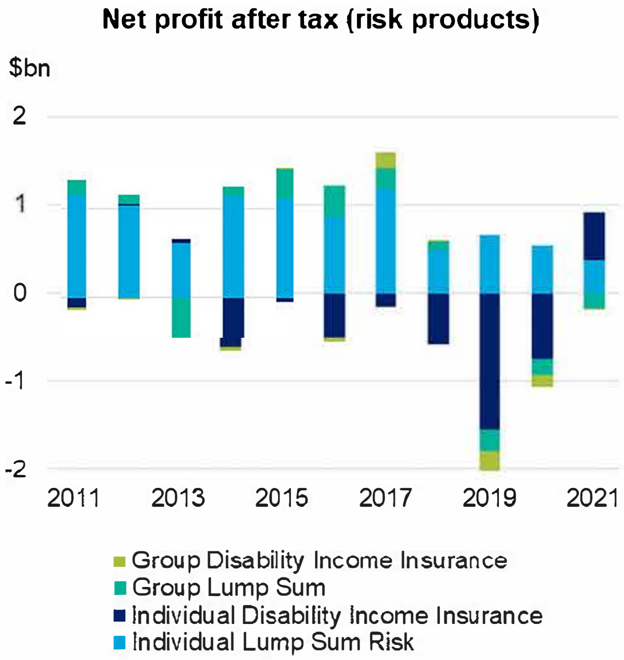
The existence of legacy products within the life insurance sector creates unnecessary cost, risk and inefficiency in the life insurance sector. The announcement in the 2021-22 Federal Budget for a Treasury-led review into the rationalisation of legacy life insurance products can support the sustainable provision of life insurance for policyholders. It will assist to reduce inefficiencies that arise from maintaining legacy life products and negative impacts on

[16] ICA, *Role of the Private Insurance Market – Independent Strategic Review: Commercial Insurance*

premiums for policyholders. s47C [redacted]

Sustainability challenges in the life insurance sector are particularly prominent with risk products such as individual disability income insurance (IDII), with substantial net losses over the past decade (Figure 9). Increasing benefit costs, including those associated with rising mental health costs and disincentives for policyholders to return to work, are also impacting group products (e.g. those provided through superannuation).

Figure 9.



APRA responded to the acute challenges and financial losses in IDII products in 2020 with a range of measures designed to drive product changes to ensure the sustainability of new products. These actions reflected APRA's concern that a resolution to the issues had not been reached within industry, and insurers would look to exit the IDII market if they were unable to secure a commercial return. Since its action, APRA has observed new products in the market which should be more sustainable over time.

3.2.1 Product design

Addressing product sustainability issues is challenging and will require a balance between product coverage, terms and price for policyholders. To achieve this balance, APRA will encourage an increased focus by insurers on product design, including the pattern of claims expected over the term of the policy, policy renewal behaviours and interaction with superannuation settings. APRA expects insurers to consider pricing, distribution channels and their claims management practices. Life insurers could also have a stronger role in creating incentives and support the return to work of policyholders after a claim.

APRA expects the shift in industry ownership that has occurred in recent years – from domestic bank ownership of large life insurers to ownership by global specialist insurance groups – will also encourage innovation that could help address sustainability challenges (e.g. by bringing retirement income solutions from overseas into the Australian market to encourage competition and product innovation).

3.2.2 Financial advice and distribution channels

APRA welcomes the Quality of Advice review, which commenced in March 2022, as another mechanism to inform future distribution models for life insurance. The review seeks to improve the quality, efficiency and cost of advice.

Current constraints on the direct distribution of life insurance products mean that the costs of life insurance can be high and act as a deterrent to the access of individual cover. Consideration of appropriate products and distribution models for different cohorts of consumers have the potential to deliver access options that are less costly and better serve the needs of the community. Consumers will likely benefit as reductions in the cost of advice would be passed on through reduced life insurance premiums, improving affordability and superannuation retirement outcomes (by reducing superannuation account balance erosion).

In its interactions with insurers, APRA will reinforce its expectations for prudent design and management of products, as well as effective claims management. Regulatory requirements around product design and distribution, overseen by ASIC, will also encourage greater focus by insurers on product design.

3.3 Private health insurance

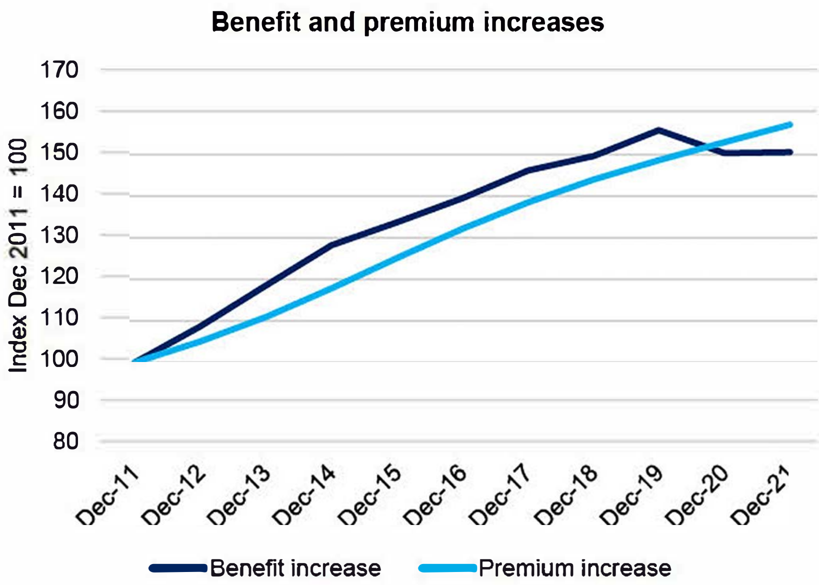
The PHI industry remains well-capitalised. Over recent years, insurers have acted to improve sustainability through measures which focus on improving health outcomes and reducing cost pressures, such as establishing preventative health partnerships, approaches for out-of-hospital care and digitalising services. Nonetheless, pressures on sustainability and delivering value for policyholders remain. s47C [redacted]

3.3.1 Affordability and sustainability challenges

Balancing affordability pressures against the need for insurer sustainability is an ongoing challenge for the PHI industry. In the last couple of years, APRA has observed insurers being more proactive in addressing rising benefit cost pressures. Insurers adapted rapidly to the implications of COVID-19, responding to suspensions of elective surgery, and facilitating virtual treatment for a range of health services. With guidance from APRA, insurers have also maintained adequate reserves to respond to expected future claims and uncertainty on longer-term health impacts. APRA is engaging with industry, the ACCC and Department of Health (DOH) to monitor the industry's commitment to return profits from the COVID-19 period to policyholders.

However, the PHI industry continues to be faced with an ageing population, high medical cost inflation and increased utilisation. Increases in health insurance benefits have outstripped the growth of premiums across the last decade prior to the COVID-19 pandemic (Figure 10).

Figure 10.



Given these pressures on sustainability, APRA has publicly outlined its expectations that insurers have a robust and proactive strategy to manage sustainability and affordability challenges. APRA's view is that insurers can, and should, continue to act to improve value for policyholders and reduce benefit growth pressures s47C [redacted]

[redacted]

[redacted] [redacted]

Premium increases are determined by the Minister for Health annually on application by private health insurers. s47C [redacted]

s47C [redacted]

s47C [redacted]

s47C [redacted]

Chapter 4 - Superannuation

KEY POINTS

- While the superannuation industry has provided good returns to members overall, Australians could be better served by the superannuation system and APRA will continue to push to rectify sub-standard trustee practices and eradicate underperforming products.
- Greater transparency on performance through APRA's heatmaps and the performance test is accelerating market exits of underperforming funds. APRA will run the second MySuper performance test in August 2022.
- s47C and s47E(d) [redacted]
- [redacted]
- APRA is also working closely with ASIC and other government agencies to encourage the industry to develop and implement retirement income strategies.

The superannuation system contains $3.4 trillion in assets, with around $2.3 trillion of this in APRA-regulated funds.[17] Over the past five years, the APRA-regulated sector and exempt public sector superannuation schemes (EPSSSs), have produced an average annualised rate of return of 6.8 per cent.[18]

Breakdown by fund type of APRA-regulated funds with more than four members:

	Number	Assets ($b)	Percentage of industry assets
Industry funds	33	1099	32
Retail funds	84	650	20
Public sector funds	15	488	14
Corporate funds	13	59	2

[17] The rest of the industry is made up by EPSSSs ($162 billion), self-managed super funds ($892 billion), and balance of life office statutory funds ($50 billion).

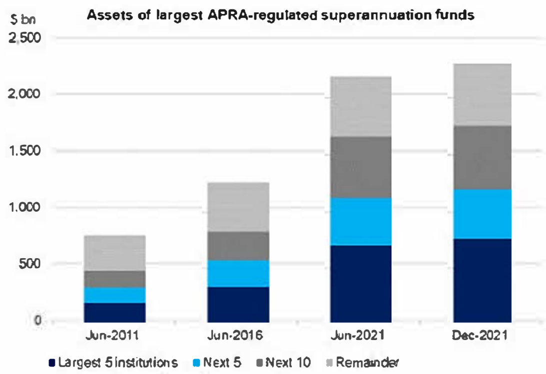
[18] Rate of return is for APRA-regulated funds and EPSSSs with more than four members.

The structure of the superannuation industry is undergoing a period of change. Over the last decade:

- several mega-funds with more than $100 billion in assets have emerged, and the ten largest funds hold more than half of APRA-regulated assets;
- average fund size has grown from $2.4 billion to $14.9 billion (Figure 13); and
- funds are becoming more efficient (operating costs as a percentage of assets falling from 0.58 per cent to 0.33 per cent) (Figure 14).

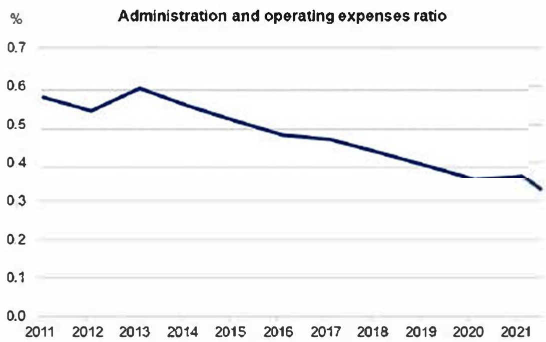
There are however 64 funds with less than $2 billion in assets and, in APRA's view, continued consolidation will be in the long-term best financial interest of members by removing underperforming products and addressing inefficiencies in the system.

Figure 13.



APRA-regulated entities with more than four members.

Figure 14.



Entities with more than four members. Ratio is calculated as total administration and operating expenses as a percentage of cash flow adjusted net assets.

4.1 Eradicating underperformance through increased transparency on performance, fees and costs

APRA's focus on increasing transparency of investment performance, fees and costs has resulted in demonstrable benefits. It has enabled easier performance comparisons and benchmarking, identifying the products delivering poor outcomes to members. APRA's supervision of underperforming trustees continues to drive them to improve their investment approaches, reduce fees and costs, and, importantly, consider their strategic future as a trustee in the superannuation industry.

APRA's annual MySuper heatmaps started in 2019 and provide detailed data for industry stakeholders. The subsequent introduction of the legislated performance test for MySuper products in 2021 further intensified pressure on trustees given the significant consequences of failing to meet prescribed benchmarks. Thirteen (out of 80) MySuper products failed the first test – ten of these have already exited or have plans to exit the industry. APRA issued licence conditions on two of these trustees to require them to explore an exit.

APRA expanded its heatmaps to the choice sector in December 2021 s47C and s47E(d) [redacted]

[redacted]

[redacted]

s47C [redacted] s47C [redacted]

[redacted]

[redacted]

s47C and s47E(d) [redacted]

[redacted]

4.3 Ensuring trustees enhance their financial resilience

Superannuation operations, in particular the larger, more complex institutions need to be resilient to financial stress. In late 2021, APRA commenced industry consultation to gain more information regarding trustees' current practices for managing financial resources. This includes the protections afforded to trustees through insurance, and how these practices may need to adapt over time.[19] APRA also gathered information about trustee plans for legislative amendments which from 1 January 2022 have further limited trustees' access to trust assets to pay penalties.

s47C and s47E(d) [redacted]

4.4 Impact of the best financial interests duty

The best financial interests duty (BFID) came into effect from 1 July 2021. This duty places the onus on trustees to ensure, and be able to demonstrate, that all decisions are consistent with the best financial interests of their members. In light of the implications of the reversal of the burden of proof, decisions must be supported by strong analysis and evidence.

Acting in the best financial interests of members is broad and covers any exercise of trustee powers and performance of trustee duties relating to all aspects of a trustee's business operations – including investments, offering insured benefits to members, and offering services that represent value for money to members.

APRA has observed that trustees are building BFID into their frameworks, including considering investment and expenditure decisions in a different (better) way and in some instances ceasing, or not renewing, contractual arrangements. APRA will supervise and, where necessary enforce, to make sure that trustees are meeting their BFID, including by focusing on fund expenditure practices for advertising, sponsorships, partnerships and other significant expenditures. s47C and s47E(d) [redacted]

4.5 Retirement income strategies

Under the new legislation for the retirement income covenant, trustees are required to have a retirement income strategy in place from 1 July 2022.

APRA, together with ASIC, wrote to trustees on 7 March 2022, setting out expectations of industry in meeting the new retirement income covenant requirements. Trustees are

[19] https://www.apra.gov.au/strengthening-financial-resilience-superannuation

expected to continue to assess, develop and improve their retirement income strategy, at all times consistent with their core obligations, including the best financial interests of members. Trustees must avoid creating legacy product issues that have hindered the industry and superannuation members in the past.

APRA will monitor how trustees are meeting the retirement income covenant through regular supervisory work and will consider the need for consequential changes to the prudential framework in late 2022.

Chapter 5 - About APRA

KEY POINTS

- APRA is governed by four Government-appointed members.
- s47C and s47E(d) [redacted]
- APRA is making significant investment in its data capabilities and in modernising its regulatory framework. s47C and s47E(d) [redacted]

APRA was established on 1 July 1998 as the prudential supervisor of the financial services industry. APRA's purpose is to establish and enforce prudential standards to ensure Australians' financial interests are protected and the financial system is stable, competitive and efficient.

APRA's specific mandate is to protect bank depositors, insurance policyholders and superannuation fund members. It also protects the community more broadly through promoting actions that support financial system stability.

Consistent with its current Statement of Expectations, APRA seeks to reduce the likelihood of a financial institution failing but it cannot, and does not, guarantee that failure may never occur. In the unlikely event an APRA-regulated ADI or general insurer were to fail, APRA seeks to facilitate an orderly exit. It also has the role of administering the Financial Claims Scheme (FCS) when activated by the Government.

APRA also acts as a statistical agency for the financial sector, collecting data both for its own use and on behalf of the RBA and the Australian Bureau of Statistics (ABS). APRA also publicly releases data in APRA's statistical publications.

5.1 Legislative underpinnings

Under the *Australian Prudential Regulation Authority Act 1998* (the APRA Act), APRA's main purposes are to licence and regulate the banking, insurance and superannuation institutions under five 'Industry Acts' and to administer the FCS for depositor and insurance policyholders.[20] The APRA Act provides that, in performing and exercising its functions and powers, APRA must 'balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and, in balancing these objectives, is to promote financial system stability in Australia'.[21]

[20] The industry Acts are *Banking Act 1959*, *Insurance Act 1973*, *Life Insurance Act 1995*, *Private Health Insurance (Prudential Supervision) Act 2015* and *Superannuation Industry (Supervision) Act 1993*.

[21] *Section 8, APRA Act*

APRA also has responsibilities under other Acts, including:

- data collection from regulated and non-regulated institutions under the *Financial Sector (Collection of Data) Act 2001* (FSCOD Act); and
- reviewing foreign shareholding applications under the *Financial Sector (Shareholdings) Act 1998*.

5.2 Organisational structure

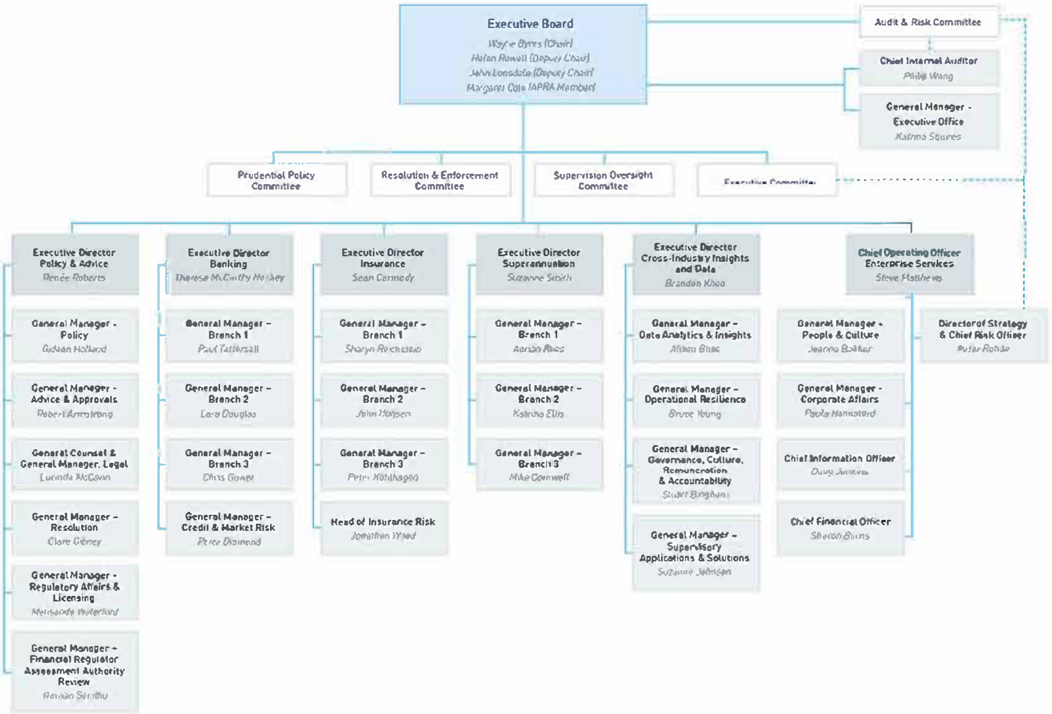
APRA currently comprises four members. These are statutory appointments. The terms of office for current APRA Members are:

- Mr Wayne Byres (Chair) – 1 July 2019 to 30 June 2024.
- Ms Helen Rowell (Deputy Chair) – 1 July 2018 to 30 June 2023.
- Mr John Lonsdale (Deputy Chair) – 8 October 2018 to 7 October 2023.
- Ms Margaret Cole (APRA Member) – 1 July 2021 to 30 June 2026.

APRA employs 860 staff across five offices (Sydney, Melbourne, Brisbane, Adelaide and Canberra), with its head office based in Sydney.

APRA's current organisational structure is broadly aligned with recommendations of the APRA Capability Review (Figure 15). APRA's supervisory divisions are structured along industry lines: one each for banking, insurance and superannuation. Supporting these 'vertical' industry divisions are three 'horizontal' divisions that perform cross-industry functions: policy and legal advice; risk specialists and data analytics; and corporate services. The Internal Audit team advises on the effectiveness and compliance of processes and the management of risks, with a reporting line to an independent Audit and Risk Committee (comprised of three independent members, as required by the *Public Governance, Performance and Accountability Act 2013*).

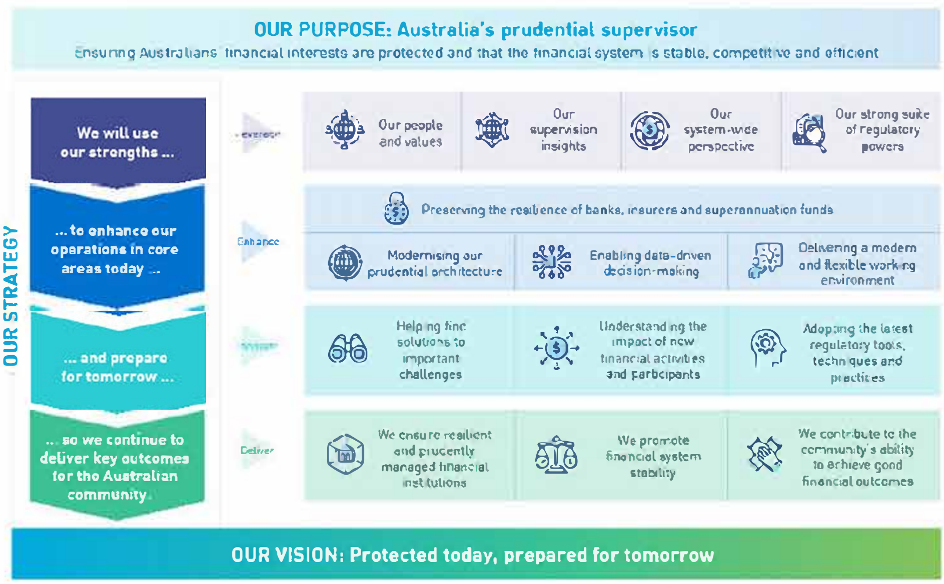
Figure 15.



5.3 Corporate Plan

APRA's *2021-2025 Corporate Plan* sets out how APRA will fulfil its purpose. The Corporate Plan, represented in Figure 16, sets out APRA's strategic direction under the theme of 'protected today, prepared for tomorrow'.[22]

Figure 16.



[22] https://www.apra.gov.au/news-and-publications/apra%E2%80%99s-new-corporate-plan-focuses-on-protecting-today-while-preparing-for

Consistent with the 'protected today and prepared for tomorrow' theme, APRA has commenced a number of multi-year strategic initiatives. s47C and s47E(d) [redacted]

5.3.1 Modernising the prudential architecture

APRA has commenced a strategic initiative to modernise its prudential architecture, consistent with better regulation and digitisation initiatives across government agencies. The aim of this multi-year initiative is to make the prudential standards and guidance more accessible for industry, more adaptable to cater to new risks and new entrants and ensure better alignment to the needs of users. The goal is to build a modern and adaptable prudential framework that provides a platform to maintain system stability and supports innovation in the increasingly digital economy.

5.3.2 Data Strategy

Understanding the evolving nature of institution, industry and system risks and the likely impact of interventions is dependent on good data and analytics. APRA is therefore accelerating its data and analytics capability over the next few years, building on the substantial progress it has made to date.

APRA's multi-year data strategy involves considerable investment in data infrastructure, skills and tools to deliver benefits to government and industry. This aligns with established strategies for government agencies to contribute to a whole-of-economy vision for data and the global trend of increased use of automation of financial sector regulation. In executing its data strategy, APRA will collaborate closely with stakeholders, and partner with government agencies to collect data that meets all agencies' needs and reduce duplicative and ad hoc data requests.

A significant milestone in this initiative was the launch in 2021 of 'APRA Connect', APRA's solution to collecting data from regulated institutions. APRA Connect will serve both APRA and industry by enabling the collection and analysis of more granular and diverse data to support better policymaking and data-driven decision-making.

s47C [redacted] APRA expects to deliver greater efficiency and lower the burden on industry through automating and streamlining collections.

5.4 Funding and Resourcing

APRA is funded primarily through levies collected from regulated financial institutions. APRA levies are calculated annually following consultation with industry. s47C and s47E(d) [redacted]

[redacted]

s47C and s47E(d)
[redacted]

	2020-21 Actual ($'m)	2021-22 Forecast ($'m)	2022-23 Budget ($'m)	2023-24 Budget ($'m)	2024-25 Budget ($'m)	2025-26 Budget ($'m)
Total expenses	196.4	221.6	227.8	228.4	230.3	232.9

APRA's recently renegotiated Enterprise Agreement took effect on 1 April 2022. It is in line with the *Performance Bonus Guidance* published in August 2021 for all Commonwealth institutions and companies and involves the removal of performance bonuses for all APRA staff.

s47C and s47E(d)
[redacted]

5.5 Accountability

APRA has been granted the ability to operate with a high degree of independence and recognises the importance of the mechanisms that are in place to hold it accountable for its actions. These are extensive:

- APRA is accountable to the Australian Parliament through:
  - APRA's Annual Report to Parliament. This includes performance reporting such as the Annual Performance Statement, as well as the Performing Entity Ratio and Money Protection Ratio which are indicative of APRA's supervisory performance.
  - The APRA Members and senior executives regularly appear before Senate and House of Representatives Parliamentary Committees.
  - APRA is subject to the *Public Governance, Performance and Accountability Act 2013* (PGPA Act).
  - APRA is required to publish a Corporate Plan setting out information on APRA's key strategies and activities over a rolling four-year period.
  - APRA is subject to, and complies with, the best practice regulation process administered by the Office of Best Practice Regulation. This includes cost/benefit assessments of regulatory changes and Regulation Impact Statements.

- As a practical matter, APRA also works closely with the Government of the day. Government oversight of APRA's activities occurs in the following ways:
  - A Statement of Expectations that sets out the Government's expectations about APRA's role and responsibilities. APRA's Statement of Intent outlines its response to this Statement of Expectations.
  - APRA holds regular meetings with the Treasurer and relevant Ministers to provide briefings on matters across banking, insurance and superannuation.
  - The Government reviews APRA's annual budget and approves the levies that are imposed on industry each year to fund APRA's operations.
  - The Treasurer will receive reports on APRA's effectiveness from the newly established Financial Regulator Assessment Authority. The first assessment will begin in mid-2022 and is due to report in mid-2023.
- APRA is also subject to a range of other oversight mechanisms which include the following:
  - The Australian National Audit Office audits APRA's annual financial accounts and undertakes ad hoc reviews of APRA's performance.
  - The prudential framework comprises legislation enacted by Parliament and administered by APRA. The prudential standards for banking and insurance may be disallowed by Parliament.
  - Specific decisions made by APRA under the Industry Acts are 'reviewable decisions' with an internal APRA review. These decisions may also be appealed to the AAT.
  - The International Monetary Fund and Financial Stability Board periodically assesses APRA against international codes and practices.
- In addition to the above, APRA also regularly consults and engages with its stakeholders, which includes the following:
  - APRA consults widely and comprehensively in a transparent and timely manner when developing prudential requirements to ensure all relevant views are properly considered.
  - APRA conducts a major independent survey of its stakeholders on APRA's performance every two years, the results of which are published.
  - APRA actively explains its activities through regular speeches and presentations by APRA senior executives.
  - APRA provides written submissions to relevant Parliamentary Inquiries, which are published on the APRA website.

- APRA publishes statistics and some analysis in respect to each of the industries it regulates and follows international standards to ensure the statistics are both reliable and timely.
- APRA publishes APRA Insight on a regular basis with articles on key industry issues and topics of current relevance for industry and other stakeholders.
- In addition to the reporting noted above, APRA regularly publishes reports on administrative activities, such as financial performance, contracts and grants, and other information that APRA holds.

Chapter 6 - Interagency collaboration

KEY POINTS

- Interagency collaboration is critical to address issues which cross the remit of multiple agencies and jurisdictions.
- APRA has strong relationships with domestic and international agencies to deliver regulatory outcomes and help shape the international financial regulatory architecture.

6.1 Domestic relationships

6.1.1 Council of Financial Regulators

The CFR is the primary coordinating body for Australia's main financial sector authorities (APRA, ASIC, RBA and the Treasury). The CFR has no powers of its own but provides a means for cooperation and coordination among member agencies on issues which impact the broader financial system, including macroprudential policy measures, to ensure all perspectives inform appropriate actions and advice to the Government.

APRA works closely with the CFR agencies in coordinated action to support the economic response to recent global geopolitical uncertainty, the impacts of COVID-19 and increasing innovation in the financial system. s47C and s47E(d) [redacted]

6.1.2 ASIC

Reinforcing Australia's twin peaks model of regulation, APRA and ASIC have a longstanding commitment to working together to optimise outcomes and minimise regulatory burden in protecting the financial well-being of the Australian community. Over recent years, the relationship has been deepened and strengthened through collaboration to better address the types of misconduct, poor performance and weak accountability mechanisms that were raised during the Royal Commission.

Infrastructure for regular engagement was established under an updated Memorandum of Understanding in 2019. The structure is led by APRA Members and ASIC Commissioners, as the APRA-ASIC Committee. It is supported by several standing committees to share information on important and emerging issues and enable coordination of joint activities.

APRA and ASIC have worked together on a range of matters over the years. Recent examples include implementation of the 'member outcomes obligations' and 'design and distribution obligations' (administered by APRA and ASIC respectively); loan repayment deferrals and borrower hardship; and issues concerning the insurance sector during the COVID-19 pandemic. APRA and ASIC also have joint working groups in anticipation of the joint administration of the proposed FAR.

6.1.3 Treasury and other agencies

APRA works with the Treasury on the development of legislative changes as well as providing data and advice to inform development of policies in areas of APRA's responsibilities.

APRA has strong relationships from its interactions with other domestic agencies, including the ABS, ACCC, ACSC, the Australian Tax Office (ATO), AUSTRAC, DOH and DOHA.

APRA engages the ACCC in its consideration of competition matters through the policy development process, and in considering its approach to licencing and supervising new entrants.

An MOU between APRA and the ATO, and informal data sharing, supports each agencies' regulatory oversight responsibilities of the superannuation industry. Data collected by APRA was jointly used by agencies to deliver the Your Future Your Super performance test and comparison tool.

APRA participates in the Regulator Leadership Cohort, led by the Department of the Prime Minister and Cabinet, to share best practice and collaborate on improved regulator capability, performance and culture.

6.2 International relationships

APRA's international engagement and collaboration is strong. APRA's international activities provide important benefits, including strengthening relationships and information exchange with peer regulators, supervision of institutions which operate across jurisdictions and providing cost-effective and valued technical assistance in the Asia-Pacific region.

APRA is engaged in a range of global forums that shape the international financial regulatory architecture. This includes membership on the global standard-setting bodies for banking (BCBS and FSB), insurance (IAIS), superannuation (IOPS) and central banks in the Asia-Pacific region (EMEAP).

Membership of the Trans-Tasman Council on Banking Supervision (TTBC) allows discussion of mutual interests in bank and financial sector matters with New Zealand counterparts. This includes key issues such as cyber resilience and resolution planning for trans-Tasman banks.

6.2.1 Reserve Bank of New Zealand

In carrying out its statutory mandate under the *Australian Prudential Regulation Authority Act 1989* APRA is required to support the Reserve Bank of New Zealand (RBNZ) in meeting its statutory responsibilities relating to prudential regulation and financial system stability in New Zealand and to avoid any actions that is likely to detrimentally affect financial stability in New Zealand. APRA regularly engages with the RBNZ about its policy, supervisory and resolution work and about regulated institutions operating in both jurisdictions.

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