INFORMATION PAPER

APRA's Policy Priorities

28 February 2019

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Contents

Executive summary

APRA undertakes a program of regular policy review to ensure that the regulatory framework on which its prudential supervision is based remains fit for purpose. This paper sets out APRA's policy agenda for the next 12 to 18 months.

The last 12 months have seen a number of significant events unfold, including major inquiries and policy reviews, legislative actions and the continuation of important industry trends. The existing policy agenda already reflected many of the potential outcomes of these events, but APRA has reviewed and updated priorities in light of these outcomes. This review of priorities will be ongoing, particularly as APRA and the Government move forward in implementing the recommendations of the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Royal Commission).

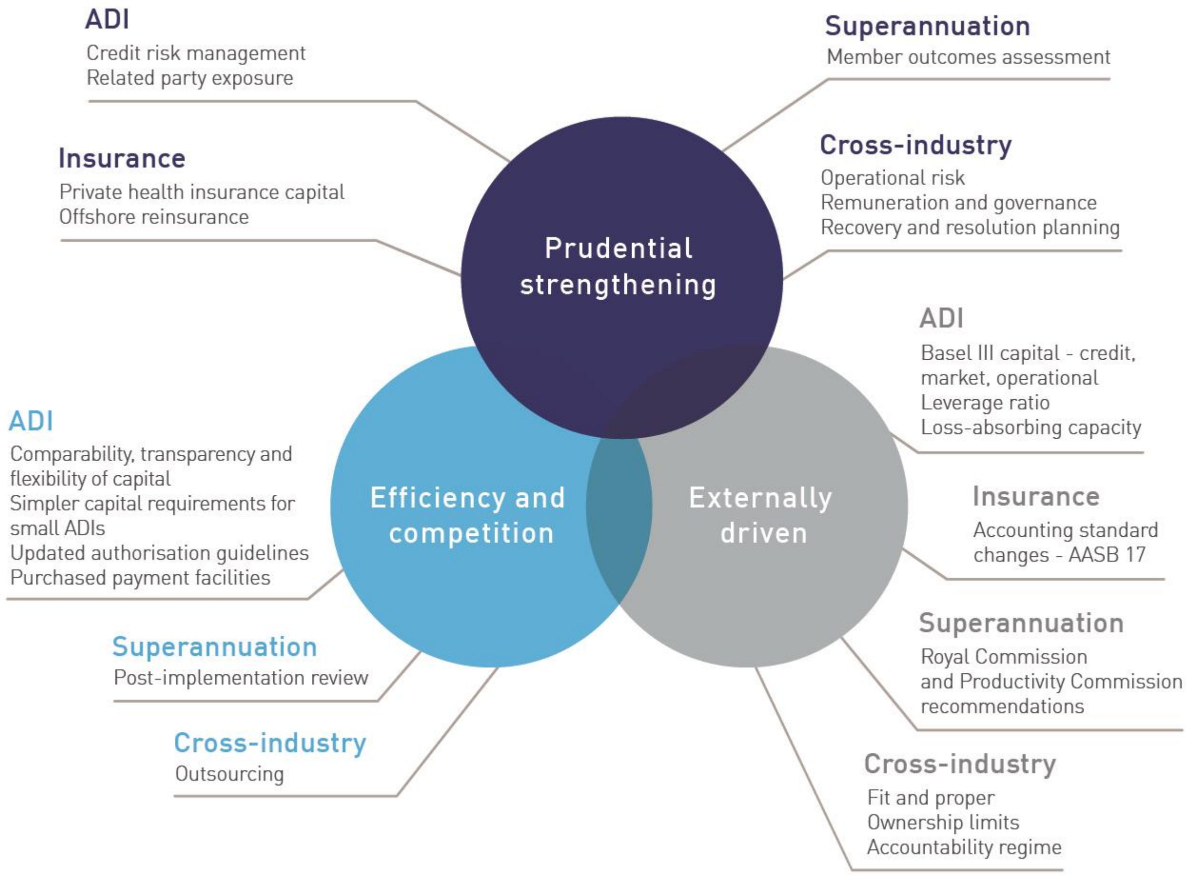
This is most notable in APRA's policy work program on governance, remuneration and accountability within financial institutions. In particular, APRA will be revising its prudential standards applicable across financial industry sectors in order to reflect the findings of the Royal Commission and APRA's Prudential Inquiry into the Commonwealth Bank of Australia. This will include findings relating to executive remuneration and non-financial risk management, among other things. APRA will also work with the Government and the Australian Securities and Investments Commission to extend the accountability model set out in the Banking Executive Accountability Regime (BEAR) to the insurance and superannuation industries and to address misconduct.

In the banking sector, APRA will progress its proposals to implement the Basel III capital reforms and give effect to its expectations for 'unquestionably strong' capital ratios for authorised deposit-taking institutions, to take effect in 2022. APRA will also finalise consultation on loss-absorbing capacity requirements. Other areas of focus include credit risk management, including for exposures to related parties, and updates to licensing guidelines and the purchased payment facility regime.

The insurance policy agenda continues the implementation of the next phase of the policy Roadmap for private health insurers, where APRA will be developing a proposal for consultation on capital reforms. APRA will continue to work with the insurance industry on understanding the impact and progressing towards implementation of AASB 17. APRA is also examining the appropriate prudential treatment of offshore reinsurance in the life insurance industry.

The finalisation of prudential requirements for superannuation trustees to regularly assess member outcomes sets in place a key pillar of APRA's policy framework for superannuation. Legislation currently pending may, if passed by the Parliament, require modifications to these requirements. In addition, in 2019 APRA will consider enhancements to the 2013 suite of prudential standards arising from its post-implementation review and from recommendations of the Royal Commission and the Productivity Commission. APRA will also commence a major update of superannuation data reporting requirements.

In summary, APRA has a broad agenda of policy work underway directed at the key areas of APRA's mandate, including strengthening financial safety while having regard to efficiency and competition. The agenda also responds to important influences from the external environment, including industry trends and the findings of the Royal Commission. The diagram below summarises the different streams of policy development according to key drivers of change.



Chapter 1 – Introduction

1.1 Background

APRA undertakes a program of regular policy review to ensure that the regulatory framework on which its prudential supervision is based remains fit for purpose. This paper sets out APRA's policy agenda for the next 12 to 18 months.

The prudential policy framework comprises the set of legislation, prudential standards and guidance that establish expectations for prudential conduct by regulated financial institutions. The legislative framework is set out primarily in the *Banking Act 1959*, *Insurance Act 1973*, *Life Insurance Act 1995*, *Private Health Insurance (Prudential Supervision) Act 2015, Superannuation Industry (Supervision) Act 1993.* These Acts, together with the *Australian Prudential Regulation Authority Act 1998* (APRA Act), articulate APRA's prudential objectives and provide APRA with authority to issue prudential standards and other instruments to give effect to them.

Institutions are responsible for meeting the prudential requirements relevant to their operations. APRA supervisors, in turn, rely on the prudential framework as the benchmark against which to assess institutions' practices and, where necessary, to take action to enforce compliance.

As set out in APRA's Corporate Plan, APRA's policy function is directed at:

- establishing a robust prudential framework that reflects all elements of APRA's mandate;
- maintaining a robust and flexible failure and crisis resolution framework; and
- ensuring policy development processes are effective.[1]

1.2 Drivers of policy priorities

In 2019, APRA will continue to progress a number of policy initiatives that were outlined in the 2018 edition of this publication, in addition to commencing several new areas of policy redesign. APRA has, where necessary, adjusted its policy priorities based on developments over the last year. Policy priorities are regularly reviewed within an overall framework of emerging risk analysis, strategic priorities for each regulated industry, related supervision activities, and relevant resource considerations both within APRA and regulated financial industries.

APRA designs prudential standards with a view to them being forward-looking and enduring. As a result, material revisions to prudential standards generally occur no more frequently than every five years. These changes seek to take into account longer-term trends within the

[1] APRA, *2018-22 Corporate Plan*, 22 August 2017, available at: https://www.apra.gov.au/sites/default/files/Pages/2018-corporate-plan.html.

industry, underlying shifts in Government priorities and community expectations, and international standards.

In setting its policy priorities for 2019 and beyond, APRA has had regard to the significant inquiries, reviews and legislative actions over the course of the past year, most notably:

- APRA's Prudential Inquiry into the Commonwealth Bank of Australia;[2]
- the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Royal Commission);
- the Productivity Commission's *Review of Efficiency and Competitiveness of the Australian Superannuation System;*[3]
- the passage of the Banking Executive Accountability Regime (BEAR) and the *Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017* (the Crisis Management Bill); and
- the IMF's Financial Sector Assessment Program review of the Australian regulatory system.

Relevant industry trends and issues include:

- the need to ensure incentives within financial institutions promote high standards of conduct and for the management of non-financial risks;
- moves toward significant divestment or restructure of some of Australia's largest financial conglomerates;
- heightened attention to the housing market including a strengthening of residential mortgage lending standards;
- a focus on the performance of the superannuation system in meeting retirement income expectations;
- concerns about data privacy and the rising risk of cyber-security breaches; and
- a focus on innovation, open data, and the emergence of new entrants in the financial industries.

APRA's existing policy agenda encompassed the broad policy priorities emanating from these events and trends. However, APRA has, where needed, adjusted the priority or focus of some policy initiatives.

1.3 Policy process and APRA's mandate

As outlined in the 2018 edition of this publication, APRA must respond to these external events while considering its objectives for prudential strength and resilience together with opportunities for improving efficiency and competition, consistent with APRA's statutory mandate.

[2] APRA, *Prudential Inquiry into the Commonwealth Bank of Australia,* April 2018, available at: https://www.apra.gov.au/sites/default/files/CBA-Prudential-Inquiry_Final-Report_30042018.pdf.

[3] Productivity Commission, *Superannuation: Assessing Efficiency and Competitiveness,* 21 December 2018, available at: https://www.pc.gov.au/inquiries/completed/superannuation/assessment/report/superannuation-assessment-overview.pdf.

To achieve an appropriate balance and consider the trade-offs that often emerge, APRA undertakes a formal public consultation process and considers all submissions for each of its policy-making initiatives. This includes adopting the Office of Best Practice Regulation guidelines with respect to regulatory cost/benefit analysis and Regulation Impact Statements. APRA considers alternative options and assesses available data and other evidence on the likely impact of proposed policy changes.

APRA's legislative mandate across all of the industries it regulates is set out in the APRA Act:

> *In performing and exercising its functions and powers, APRA is to 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.*

These elements are summarised at a high level in Table 1, with illustrative examples of each in the context of the prudential framework.

Table 1: Elements of APRA's mandate

Objective	Policy is aimed at:	Examples
Financial safety	Financial soundness of individual regulated institutions	Minimum capital requirements for authorised deposit-taking institutions (ADIs) and insurers; risk management and governance expectations for all APRA-regulated entities
Efficiency	Least-cost regulatory option relative to delivery of prudential objective; avoiding distortion of resource allocation in the economy	Align regulatory requirements to industry sound practice; limit regulatory reporting to data that has most value in supervision or through publication
Competition	Institutions being able to compete with other regulated and unregulated providers through prices and features offered on their products and services	Focus on consistent treatment of common risks rather than product-specific requirements; consideration of level playing field in policy options and simpler options for smaller entities
Contestability	Not hindering ease of entry and exit; new entities able to enter the market at reasonable cost	Regulatory requirements for new APRA-regulated institutions are flexibly applied in a manner proportionate to risk to the community
Competitive neutrality	Ensuring state-owned and private entities compete on a level playing field	Not creating advantages for public sector entities relative to other market participants
Financial system stability	Resilience of credit, savings, insurance and investment markets and operations; maintenance of public confidence in financial sector	Minimum capital and liquidity requirements for ADIs and insurers; recovery planning expectations; the Financial Claims Scheme; expectations for assessment of outcomes provided to superannuation members

Most policy proposals involve potential impacts on regulated industries that involve multiple aspects of APRA's mandate. APRA considers how best to balance these objectives when it consults on new or revised aspects of the prudential framework. In particular, APRA's approach to consultation on substantive changes to the prudential framework, sets out the preliminary judgement of these consideration, and invites feedback on the assessment.

Chapter 2 – 2018 in review

During 2018, APRA completed or progressed a number of enhancements to the prudential framework. Those projects which are still underway are discussed further in the next chapter.

Banking

Over the course of 2018, APRA released a series of consultation papers relating to authorised deposit-taking institution (ADI) capital requirements. The proposals outlined in these papers constitute a major upgrade of the capital framework. This includes implementing the revisions to the Basel III capital framework issued by the Basel Committee on Banking Supervision in December 2017, as well as 'unquestionably strong' capital ratio benchmarks and loss-absorbing capacity recommended in the 2014 Financial System Inquiry.[4] These papers are listed below and next steps are discussed in the next chapter.

Table 1: 2018 ADI capital consultation papers

Month	Title	Summary of proposals
February	Revisions to the capital framework for authorised deposit-taking institutions	Revise requirements for credit and operational risk including for residential mortgages and constraints on advanced modelling approaches. Simplify treatment for smaller ADIs
February	Leverage ratio requirement for authorised deposit-taking institutions	Introduce a non-risk-based minimum leverage ratio including an advanced and standardised approach
August	Improving the transparency, comparability and flexibility of the ADI capital framework	Revise the calculation of capital requirements to explicitly reflect APRA's more conservative approach relative to international standards
November	Increasing the loss-absorbing capacity of ADIs to support orderly resolution	Increase total capital requirements for ADIs to help facilitate orderly resolution, set commensurate with resolution strategies
November	Response to submissions: leverage ratio requirement for ADIs	Following on from the February consultation, includes draft *Prudential Standard APS 110 Capital Adequacy*

APRA also finalised capital requirements for counterparty credit risk arising from derivatives and other capital markets transactions. These requirements are a key component of the Basel III framework, and have been under consultation since 2016. The final *Prudential*

[4] Basel Committee on Banking Supervision, *Basel III: Finalising Post Crisis Reforms,* 7 December 2017, available at: https://www.bis.org/bcbs/publ/d424.htm; *Financial System Inquiry Final Report,* 7 December 2014, available at: http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf.

Standard APS 180 Counterparty Credit Risk is effective 1 July 2019 and applies to all domestic ADIs.

In addition to progress on capital requirements, the prudential framework was strengthened in several important areas.

APRA worked with Government to finalise legislation to enact the Banking Executive Accountability Regime (BEAR) and subsequently to implement the regime. The changes to the *Banking Act 1959* introduced requirements for all ADIs to explicitly allocate accountability to bank executives for particular functions. The law provided greater powers, including monetary penalties, for APRA to take action on any breaches of these accountability obligations. The regime commenced on 1 July 2018 for the four major Australian banks. In October 2018, APRA published an information paper *Implementing the Banking Executive Accountability Regime* to provide a clear and consistent understanding of APRA's expectations.

In 2018, APRA introduced its framework for licensing certain new ADIs through a phased approach. The new framework is intended to promote competition by making it easier for applicants to navigate the ADI licensing process. Under the Restricted ADI framework, applicants may apply for and be granted a Restricted ADI licence for a period of up to two years (or other time specified by APRA) subject to strict caps on the size and nature of their business. The new framework is largely based around APRA's existing prudential standards, with some simplified requirements including for capital.

To support this framework a number of technical amendments have been made to the Banking Act.[5] In particular the amendments provided APRA the power to:

- grant a time limited banking authority where institutions are seeking a Restricted ADI licence; and
- revoke such authorities when the licence holder is found to be non-compliant with its regulatory requirements or unable to progress to an unrestricted ADI licence.

APRA also commenced formal public consultation on revisions to APRA's prudential standard governing exposures to related parties (*Prudential Standard APS 222 Associations with Related Entities*).

Insurance

In the insurance sector, APRA made significant progress in implementing its Private Health Insurance (PHI) Policy Roadmap. This included consultation and finalisation of Phase 2 of the Roadmap, which brought private health insurers under governance and fit and proper standards applicable to the other industries that APRA regulates, and introduced a new *Prudential Standard HPS 310 Audit and Related Matters* which expands the role of the auditor beyond financial reporting.

For the life insurance industry, APRA finalised a new reporting standard and definitions for the reporting of life insurance claims and disputes. APRA also updated aspects of the

[5] *Treasury Laws Amendment (Financial Sector Regulation) Act 2018*, schedule 2.

reinsurance framework for life insurers, including approval requirements for certain types of reinsurance arrangements under *Prudential Standard LPS 230 Reinsurance*.

APRA finalised a new standard on the role of appointed actuary for general insurers, life insurers and private health insurers *Prudential Standard CPS 320 Actuarial and Related Matters*, with the requirements regarding the valuation of insurance liabilities for general insurers moved to a new *Prudential Standard GPS 340 Insurance Liability Valuation*.

During 2018, APRA commenced informal consultation with general insurers, life insurers and private health insurers on integration of the new insurance accounting standard, AASB 17 Insurance Contracts (AASB 17) into the relevant capital and reporting frameworks. This initiative is described further in the next Chapter.

Superannuation

In the superannuation sector, APRA finalised a major addition to its prudential framework that substantially raises expectations for fund and trustee performance. In December 2018, APRA released new and enhanced prudential requirements designed to strengthen the focus of registrable superannuation entity (RSE) licensees on outcomes for members. The centrepiece is a requirement for all RSE licensees to conduct an annual assessment of outcomes achieved for their members across investment performance and other areas such as insurance and fees, and, as a result of this assessment, to incorporate areas for improvement into their business and strategic planning. The new framework includes *Prudential Standard SPS 515 Strategic Planning and Member Outcomes* and *Prudential Practice Guide SPG 515 Strategic and Business Planning* and *Prudential Practice Guide SPG 516 Outcomes Assessment*.

Separately, as it had previously flagged, APRA commenced a post-implementation review of its superannuation prudential framework introduced in 2013 as part of the Stronger Super reforms. This review process occurred over 2018, and into the first quarter of 2019, and included extensive external consultation, supported by the release of six short topic papers in respect of governance; risk management; financial requirements, operational risk and outsourcing; investments; insurance in superannuation; and member flows and products. The findings from this review will be published shortly.

APRA assisted in designing a suite of legislative reforms in superannuation. This includes recently passed legislation to address erosion of account balances, and a bill that would strengthen APRA's powers and introduce an annual outcomes assessment, among other things, which has recently passed the Senate.[6] The impact of this legislation is discussed further in the next chapter.

Cross-industry

Other policy initiatives spanned multiple regulated industries. During 2018, APRA finalised its requirements for the management of information security risk with the publication of *Prudential Standard CPS 234 Information Security*. This significant new standard is effective

[6] *Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2019*; *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2019*.

1 July 2019, and applies to all APRA-regulated institutions. Updated guidance on cloud computing was also released in September 2018.

The *Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017* (Crisis Management Bill) was enacted in March 2018. This important legislation strengthened APRA's powers to plan for, and respond to, the failure of an ADI or insurer. The Crisis Management Bill has positioned APRA to progress the next phase of its work on recovery and resolution planning, described in the next chapter.

Chapter 3 – Policy priorities for 2019

3.1 Banking

Capital

As noted in Chapter 2, in February 2018 APRA commenced consultation on revisions to the ADI capital framework to give effect to expectations for 'unquestionably strong' capital ratios and implement the recently finalised Basel III reforms. This stream of work is a multi-year process and likely to involve further rounds of consultation and quantitative impact studies (QIS) to enable APRA to gauge the impact and better calibrate proposed changes. Given the need for extensive consultation, APRA does not expect to finalise the suite of prudential standards until 2020-21, with the revised prudential standards likely to in effect from 2022, consistent with the international timetable.

The initial proposals focused on better aligning regulatory capital with the risk in ADIs' residential mortgage portfolios, as well as revisions to the broader credit, operational and market risk frameworks. The proposals also included a simplified prudential framework for smaller and less complex ADIs as well as the proposed introduction of a leverage ratio, consistent with the international framework. Certain advanced modelling approaches are being removed with simplified formulae (for operational risk modelling) or restricted in their application (aspects of credit risk modelling).

As part of the finalisation of the Basel III reforms, APRA is considering changes to its overall approach to capital requirements to improve comparability, transparency and flexibility in areas where APRA's methodology is more conservative than minimum international requirements. If APRA proceeds in this direction, the outcome would be significant presentational and calculation changes to a number of prudential standards, although these would not affect the quantum of capital required.

APRA expects to consult on draft prudential standards for credit and operational risk (*Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk* and *Prudential Standard APS 114 Capital Adequacy: Standardised Approach to Operational Risk*) during the first half of 2019. Following this, in late 2019 or early 2020, APRA will consult on revisions to *Prudential Standard APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk* and *Prudential Standard APS 117 Capital Adequacy: Interest Rate Risk in the Banking Book (Advanced ADIs).* These proposals will also incorporate any changes to the presentation of capital requirements that APRA is considering to improve comparability and transparency.

APRA has not yet determined the timeframe for proceeding with recently released changes to international standards for market risk, although it is unlikely APRA will choose to be an early adopter of these reforms.[7]

[7] Basel Committee on Banking Supervision, *Minimum Capital Requirements for Market Risk,* January 2019, available at: https://www.bis.org/bcbs/publ/d457.pdf.

In November 2018, APRA commenced formal consultation on a requirement for ADIs to maintain additional loss absorbency for resolution purposes. The 2014 Financial System Inquiry recommended that APRA implement a framework for minimum loss-absorbing and recapitalisation capacity in line with emerging international practice, sufficient to facilitate the orderly resolution of ADIs.

APRA's proposed approach would be implemented by adjusting the amount of Total Capital ADIs must maintain commensurate with resolution strategies, thereby using existing capital instruments rather than introducing new forms of loss-absorbing instruments as has occurred in some other jurisdictions. For domestic systemically important banks, APRA proposed an increase in the Total Capital ratio requirement of between four and five percentage points. After considering submissions received in the first quarter of 2019, APRA expects to finalise the requirements later in 2019.

Licensing and related matters

APRA's existing guidelines for authorising new ADIs, insurers and RSE licencees pre-date many of the current elements of the prudential framework and APRA's updated licensing approach. As a result, APRA plans to update its licensing guidelines, starting with the ADI and non-operating holding company (NOHC) guidelines. The first updates are expected to be published in late 2019, with licensing guidelines for other industries following in 2020.

In 2018, the Council of Financial Regulators (CFR) established a working group to review the broad regulatory framework for Purchased Payment Facilities (PPFs) which currently involves oversight from RBA, ASIC and APRA. Following a consultation paper in September 2018, the CFR is working towards formulating a proposal for a simplified framework in mid-2019. APRA will subsequently review its approach to regulating those PPFs that fall within its remit to ensure that it is proportionate to the risks and appropriate in the context of the CFR's proposed framework.

Credit risk management

Formal consultation will commence in the first half of 2019 on updated prudential requirements for credit risk management in *Prudential Standard APS 220 Credit Quality*. APS 220 addresses risk management for loans and other credit exposures, including problem asset management and loan-loss provisions. The standard was last substantively updated for the adoption of relevant provisions in international financial reporting standards (IFRS) in 2006. Since then, there have been a number of developments in provisioning, notably the adoption of *IFRS 9 Financial Instruments,* which requires an expected loss approach to provisions.[8] In addition, given developments in industry practices, APS 220 does not adequately address prudential expectations for loan underwriting standards. This includes expectations that APRA has incorporated recently in *Prudential Practice Guide APG 223*

[8] International Financial Reporting Standards Foundation, *IFRS 9 Financial Instruments*, January 2018.

Residential Mortgage Lending. The update to APS 220 will also incorporate the Royal Commission's recommendation regarding the independence of valuations.[9]

APRA will also continue its consultation on the framework for the management of ADIs' exposures to related parties (*Prudential Standard APS 222 Associations with Related Entities*). Consultation so far has focussed on the definition of related parties, the limit framework and the extended licensed entity regime, which serves to exclude certain intra-group exposures from related party limits. APRA will publish a response to submissions received and progress toward finalisation of a revised standard and reporting framework in mid-2019. APRA also intends to develop further guidance or FAQs on the recently updated *Prudential Standard APS 221 Large Exposures*.

Table 2: ADI policy priorities

	1st half 2019	2nd half 2019	1st half 2020	Target effective date
Standardised approach to credit risk capital (APS 112)	Consult		Finalise	2022
Advanced approach to credit risk capital (APS 113)		Consult, QIS		2022
Operational risk (APS 114)	Consult		Finalise	2022
Leverage ratio	Consult		Finalise	2022
Loss absorbing capacity	Consult	Finalise		2023
Measurement of capital (APS 111)		Consult		2022
Interest-rate risk in the banking book		Consult		2022
Counterparty credit risk (APS 180)		Implement		July 2019
Credit risk management (APS 220)	Consult	Finalise		2020
Large exposures (APS 221)	Implement			Jan 2019
Related party exposures (APS 222)	Finalise	Finalise	Implement	2020

[9] *Final Report: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, February 2019, available at: https://financialservices.royalcommission.gov.au/Pages/default.aspx, Recommendation 1.12.

	1st half 2019	2nd half 2019	1st half 2020	Target effective date
Authorisation guidelines		Finalise		2020
PPF framework review	CFR consultation		APRA consultation	to be determined

3.2 Insurance

APRA's policy agenda for the insurance sector remains stable. Key initiatives are summarised in Table 3, below.

In 2019, APRA will continue to engage with the Actuaries Institute's AASB 17 Task Force to build understanding of technical issues in the new accounting standard for insurance, and potential options for addressing them in the prudential framework. The options developed through this process will inform APRA's development of a discussion paper currently planned for release in the second half of 2019. Concurrently with any amendments to prudential standards for AASB 17, APRA intends to consider whether other amendments to the insurance capital framework are warranted in light of experience.

During 2018, APRA initiated a review of the treatment of exposures of life insurers to non-APRA authorised reinsurers, in light of increasing involvement of offshore life reinsurers in the Australian life insurance market. APRA plans to commence consultation on options and implications of revising *Prudential Standard LPS 117 Capital Adequacy: Asset Concentration Risk Charge* to strengthen the capital requirements for reinsurance risks. Pending the results of that initial consultation, this would be followed by consultation on possible changes to the prudential standard later in 2019.

In the private health insurance sector, APRA will continue to proceed with initiatives outlined in its PHI Roadmap released in 2016. Following release of prudential standards under Phase 2 of the Roadmap, which addressed the governance and related components of the framework, APRA will support private health insurers through implementation to ensure they meet the requirements which commence from 1 July 2019.

In November 2018, APRA outlined plans for Phase 3 of the Roadmap (Capital) and implementation of AASB 17.[10] APRA intends to consult on adopting the capital framework that currently applies to the life and general insurance industries (LAGIC framework) to private health insurers. Throughout 2019, APRA will consult with the industry, actuaries and auditors to identify and design appropriate modifications to the LAGIC framework to reflect differences in private health insurance industry compared with other insurers. This will include roundtable discussions, and the release of a discussion paper consulting on the key principles underpinning the framework. This paper is expected to be released in mid-2019.

[10] APRA, *Roadmap for APRA's Review of the Private Health Insurance Capital Framework*, 16 November 2018, available at: https://www.apra.gov.au/sites/default/files/phi_capital_roadmap_letter.pdf.

Over the medium term, APRA expects that changes to the prudential framework for insurance may be needed to address issues with the provision of life insurance in superannuation, as well as potential innovative post-retirement products. APRA does not anticipate consulting on these issues in 2019, unless Australian Government priorities necessitate an earlier commencement.

The Royal Commission did not make any other recommendations relating specifically to APRA's insurance prudential framework; however, APRA has a strong prudential interest in a number of the Royal Commission's recommendations relating to insurance, such as the recommendation to legislate universal definitions and terms for MySuper insurance products, and will advise Government on the potential impacts of these changes as required.

Table 3: Insurance policy priorities

	1st half 2019	2nd half 2019	1st half 2020	Target effective date
PHI Phase 2: Governance (CPS 510); Fit and Proper (CPS 520) and Audit (HPS 310)	Implement			2019
Role of the appointed actuary	Implement			2019
Offshore reinsurance (LPS 117)		Consult		2021
PHI Phase 3: Capital		Consult		2022
AASB 17-related changes	Consult			2021

3.3 Superannuation

Over 2019, the superannuation policy agenda will fall into four broad areas:

- implementation work relating to the new member outcomes prudential requirements (SPS 515 and related changes to existing prudential standards), including addressing relevant legislative changes;
- finalising APRA's post-implementation review of the superannuation prudential framework and developing proposals for addressing identified areas where the prudential framework could be improved;
- developing enhancements to APRA's data collection; and
- working with the Government and ASIC to implement recommendations arising out of the Royal Commission in relation to superannuation, including extension of the BEAR.

In February 2019, new superannuation legislation passed the Senate which would grant APRA significant new and enhanced powers. The bill includes among other things:

- a requirement for an annual outcomes assessment – for trustees to determine annually, for each product, whether the financial interests of the beneficiaries are being promoted based on a set of factors and benchmarks;
- civil penalty powers for contraventions of the trustee obligations set out in covenants;
- a new broad directions power for APRA that will enable APRA to direct trustees to take remedial actions where it has concerns; and
- powers over change of ownership or control of a trustee and enhanced powers to cancel an authority to offer a MySuper product.

APRA has welcomed the legislation, which it has sought for some time to enable APRA to take timely and effective action on superannuation trustees and funds that are not meeting their obligations.

Although broadly consistent with APRA's approach to member outcomes, the legislated outcomes assessment, if passed, will likely necessitate some technical changes to SPS 515. APRA will consult on any required changes as soon as practical.

APRA supervisors will be reviewing plans and progress of RSE licensees in meeting the heightened expectations for assessing member outcomes. This heightened policy and supervision focus will achieve many of the aims of the Productivity Commission's final superannuation review report in setting clear expectations for performance, and a mechanism for APRA to enforce these expectations. SPS 515 requires RSE licensees to consider a broad range of performance indicators and integrate the trustee's assessment of outcomes for its members into its business planning process.

In early 2019, APRA will conclude its post-implementation review of the superannuation prudential and reporting frameworks. This review has involved formal and informal consultation with a broad range of internal and external stakeholders on the effectiveness of the 2013 prudential standards, as well as consideration of issues raised by the Royal Commission and the Productivity Commission.

Findings that support changes and improvements to the framework will be consolidated into a package of consequential policy changes. Other amendments required to address the Royal Commission's recommendations will be considered as part of this process, including the recommendations for APRA to revise its insurance prudential standard to address related party outsourcing and member insurance status attribution.[11] As part of this work, APRA will also review its guidance on the Sole Purpose Test.

Transparency on fees, expenses and investment returns, among other things, is crucial to allow APRA, industry and the public to understand performance of the superannuation sector and of individual funds. APRA has been working with the industry to improve the quality and consistency of superannuation data over a number of years. The Productivity Commission's

[11] Royal Commission recommendations 4.14 and 4.15.

report *Superannuation: Assessing Efficiency and Competitiveness* also made a number of recommendations and findings on the scope and quality of publicly available data on superannuation. APRA will progress this major project over the course of 2019. This will be aided by passage of legislation which would enable APRA to collect more accurate and meaningful expense information from trustees. The Productivity Commission's proposed cross-agency working group on superannuation data will also be an important factor in driving the success of this initiative.

Finally, the significant recommendations of the Productivity Commission, including those relating to default fund selection and the elevated member outcomes assessment, if adopted by the Government, will require legislative change and consequential changes to prudential standards. APRA will work with Government to determine the scope and timing of this work, if it is to go ahead. Due to this uncertainty, the Productivity Commission's recommendations have not been included in the list below at this time.

Table 4: Superannuation policy priorities

	1st half 2019	2nd half 2019	1st half 2020	Target effective date
Strengthening superannuation member outcomes			Implement	Jan 2020
Superannuation data collection enhancements		Consult		2022
Post-implementation review	Finalise			NA
Consequential changes to prudential standards		Consult	Finalise	2021

3.4 Cross-industry

In addition to industry-specific prudential requirements, APRA's prudential framework includes a number of core prudential standards and guidance that apply to entities across multiple regulated industries. These cross-industry standards and guidance are also subject to regular review and are updated as needed to incorporate prudential expectations and evolving industry sound practice. Where possible and appropriate, APRA takes opportunities to harmonise requirements across industries. Cross-industry policy initiatives and expected timeframes are shown in Table 5.

An important new initiative is a set of reforms across the core cross-industry standards to strengthen prudential expectations for governance, remuneration and non-financial risk management at regulated financial institutions. APRA's Prudential Inquiry into the Commonwealth Bank of Australia highlighted a number of failings across board governance and oversight, lack of clear accountability, and incentive structures that encouraged poor conduct or lack of attention to non-financial risks. These deficiencies were further highlighted in the Royal Commission's investigations. APRA had also previously identified the need to strengthen its prudential framework in areas such as remuneration and operational risk management.

This work will proceed through a series of discussion papers over the course of 2019, as outlined below.

Remuneration

In April 2018, APRA released a paper summarising its review of current practices at regulated institutions with respect to executive remuneration. The review examined whether these practices are meeting objectives of the prudential framework. The paper noted that APRA will consider strengthening its prudential framework to support a more robust and credible implementation of its objectives and to reflect evolving international standards such as the recent Financial Stability Board (FSB) *Supplementary Guidance on Sound Compensation Practices*, and the remuneration concepts, such as minimum deferral periods, contained in the BEAR.[12]

The Royal Commission's Final Report subsequently made further recommendations in this area.[13] These included incorporating the FSB standards and guidance and to ensure the framework targets not only institutions' financial risks, but also misconduct, compliance and other non-financial risks, as well as other aspects of remuneration design.

As a result, APRA expects to release for consultation a revised prudential standard on remuneration in mid-2019 encompassing these and other proposed changes, to focus on better alignment of remuneration and prudent risk management outcomes and long-term financial soundness.

Executive accountability

APRA is implementing the BEAR regime for medium and small ADIs effective 1 July 2019. APRA will provide additional guidance where necessary, potentially in the form of published Frequently Asked Questions (FAQs) to supplement the information paper released in 2018.

Over 2019, APRA expects to consult on updates to the existing fit and proper requirements in *Prudential Standard CPS 520 Fit and Proper* to align and integrate the legislative requirements under BEAR with the broader prudential framework.

The Government has announced that it will adopt the recommendation of the Royal Commission to extend the BEAR to the insurance and superannuation sectors, as well as broaden the scope of the BEAR to provide a greater focus on conduct matters, and provide for ASIC involvement in enforcement. APRA will work with Government and ASIC to develop the necessary legislative amendments to give effect to the new regime. APRA expects that its experience in implementing the BEAR for ADIs will provide useful lessons in designing the legislation for this purpose.

[12] Financial Stability Board, *Supplementary Guidance to the FSB Principles and Standards on Sound Compensation Practices,* 9 March 2018, available: http://www.fsb.org/wp-content/uploads/P090318-1.pdf.

[13] See Royal Commission recommendations 5.1 through 5.5.

APRA will also consult in the first half of 2019 on an addition to the existing BEAR to incorporate a responsibility for the design, delivery, and maintenance of products offered to customers and any remediation required, as recommended by the Final Report of the Royal Commission.[14] APRA expects to implement this change before the end of the year.

Operational risk and related standards

APRA has commenced an important project to update its existing prudential standards and guidance on outsourcing, business continuity and information security, which apply to entities in the banking, insurance and superannuation industries. The objective of this initiative is to align prudential requirements with industry better practice and community expectations for a high degree of resilience to material operational risk incidents.

In conjunction with these more technical standards, APRA's intention is to issue broad-based expectations for operational risk management and resilience that align to the overarching risk management framework. APRA will take the opportunity to streamline existing requirements where appropriate.

The first stage of this project, involving a new prudential standard on information security was finalised in late 2018, with the new standard to commence on 1 July 2019. APRA will consult on associated guidance on information security in the first half of 2019. Subsequently, requirements for operational risk management and revised standards for business continuity and outsourcing (updated to cover service provision more broadly) will be the focus of consultation over the course of 2019.

Governance and risk management

In light of other potential revisions to prudential standards relating to remuneration and accountability, APRA will take the opportunity to review the broad governance and risk management provisions set out in *Prudential Standard CPS 220 Risk Management* and *Prudential Standard CPS 510 Governance*, to ensure they continue to be fit for purpose. In particular, in light of the findings of APRA's Prudential Inquiry into the Commonwealth Bank of Australia, expectations of boards and senior management may need to be more clearly articulated. APRA will also review the relative emphasis on non-financial risks and the consistent use of concepts such as risk appetite in CPS 220 and risk-specific prudential standards to ensure they are fully aligned.

Until APRA's review of the governance requirements of the prudential framework is complete, APRA has withdrawn prudential practices guides *APG 510 Governance*, *GPG 510 Governance* and *LPG 510 Governance* which have become out-of-date with the relevant prudential standards and current expectations.

Recovery and resolution planning

Following the passage of the Crisis Management Bill, APRA is committed to building its resolution capability by building a strong prudential framework for managing potential entity failure. Over the last several years, APRA has conducted pilot exercises with a number of ADIs and insurers to develop their plans to address recovery from scenarios where the entity is at risk of failure. The prudential framework will set out requirements for entities to work

[14] Royal Commission recommendation 1.17.

with APRA in the resolution planning phase and to support APRA in facilitating orderly resolution.

Table 5: Cross-industry policy initiatives

	1st half 2019	2nd half 2019	1st half 2020	Target effective date
Information security (CPS 234 and CPG 234)	Consult on PPG	Implement		July 2019
Remuneration (CPS 510)	Consult	Finalise		2020/21
Fit and Proper (CPS 520)		Consult	Finalise	2020/21
Operational risk (new CPS 230)	Consult		Finalise	2020/21
Outsourcing/service provision (CPS 231)		Consult	Finalise	2021/22
Business continuity (CPS 232)		Consult	Finalise	2021/22
Recovery and resolution planning (ADIs and insurers)		Consult		2022
Ownership limits (FSSA)	Consult	Finalise and implement		2019

Ownership limits

There have been legislative changes to ownership requirements that will necessitate action by APRA. In 2018, changes to the *Financial Sector (Shareholdings) Act 1998* (FSSA) raised the minimum shareholding in ADIs, general insurers and life insurers requiring approval from 15 per cent to 20 per cent and introduced a new streamlined approval path. These changes, will come into effect on 1 April 2019.

Under the new streamlined path, owners of new or recently established domestically incorporated financial sector companies (with assets below the relevant asset threshold) will not be assessed against the current national interest framework. Instead, FSSA approval will be granted subject to the owners being 'fit and proper', the entity undertaking regular reviews of its ownership structure and the owner providing relevant information to APRA each year. APRA intends to consult on associated rules in the first half of 2019, and to finalise these rules by the end of 2019.