



22 March 2021

TO: ALL AUTHORISED DEPOSIT-TAKING INSTITUTIONS

INDEMNITIES IN DIVESTMENTS

In recent months, APRA has been in discussion with several ADIs on indemnities provided to acquiring entities as part of divestment transactions. While indemnities are not a new feature of merger and acquisition activity, their scope and nature appears to be shifting in focus, particularly as entities manage matters of conduct and customer redress. Without appropriate controls, these indemnities can expose ADIs to potentially significant liabilities.

The guidance below is intended to ensure a consistent and prudent approach is taken by ADIs to managing the risks associated with indemnities in divestment transactions.

Industry Guidance

APRA expects that any indemnities that give rise to a material contingent liability for an ADI are reviewed and approved by the Board, as part of the oversight of significant transactions. An appropriate level of capital should be held for such risk exposures. ADIs should put in place ongoing oversight and monitoring by senior management and the Board of these indemnities, to ensure the associated risks are effectively managed.

APRA expects that:

- Indemnities are capped and time-bound. Uncapped indemnities are inconsistent with prudential requirements for ADIs that prohibit unlimited exposures;¹
- Indemnity types are clearly distinguished, to reflect the difference in risk profile of the underlying exposures. This is important for identifying, recording and monitoring the risk, capital treatment and management approach. The oversight of indemnities for conduct-related risks will require particular diligence, given their uncertainty;
- Governance arrangements and accountabilities are clearly defined and implemented to ensure appropriate oversight and controls around indemnities, both in setting them and monitoring and influencing the underlying risks post-transaction;
- ADIs will assess the need to provision for each material indemnity, both at inception and during the life of the indemnity, having regard to the likelihood that the indemnity will be called upon; and

¹ ADIs should refer to: paragraph 11 of *Prudential Standard APS 221 Large Exposures*; paragraph 6 of *Prudential Standard 3PS 221 Aggregate Risk Exposures*; and paragraph 10 of *Prudential Standard APS 222 Associations with Related Entities*.

- ADIs will hold an appropriate and commensurate level of operational risk capital for the financial risks associated with indemnities. ADIs should engage APRA to demonstrate the appropriateness of intended operational risk capital treatment for current or prospective material indemnities. Where this does not appropriately reflect the level of risk, APRA will consider an adjustment to operational risk capital requirements.

ADIs should consider gaining independent assessment and validation of provisioning and capital for material indemnities. For conduct-related indemnities, this could include independent advice on the likelihood and eventual amount of a claim on the indemnity, as well as expert opinion on the likelihood of claims and success of litigation at other ADIs for similar issues.

If you have any questions on the guidance above, please contact your supervisor.

Yours sincerely,

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