DISCUSSION PAPER

Strengthening crisis preparedness

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Executive summary

APRA has released draft prudential standards for financial contingency and resolution planning for consultation with industry and other key stakeholders. This Discussion Paper sets out the rationale for the proposed requirements and key questions for consultation.

Strengthening crisis preparedness

APRA's proposed new requirements aim to ensure that regulated entities are better prepared for situations that may threaten their viability, building on experience in Australia and lessons learned from international peer regulators. The new resolution planning standard also seeks to ensure that, in the unlikely event of an entity failure, depositors, insurance policyholders and superannuation fund members - collectively beneficiaries - remain protected and critical functions can continue to be provided, with minimal risks to financial stability.

The disorderly failure of a financial entity can have significant impacts for financial system stability and the broader economy. As demonstrated by international experiences during the global financial crisis, the costs to employment, incomes and economic prosperity from disorderly failure can be substantial. In some jurisdictions, governments have used taxpayer funds to stabilise their financial systems, creating moral hazard and pressures on government finances. APRA's proposals would strengthen the financial system's ability to withstand stress and, in the unlikely event of entity failure, minimise the need for taxpayer funded support.

While the Australian financial system has been resilient to recent stresses, maintaining this resilience will require robust contingency planning. APRA-regulated entities must be prepared to manage situations that could threaten their viability through developing effective financial contingency plans. Where entity-led contingency actions are not effective, APRA must be able to use its powers to resolve a failing entity in an orderly manner; for large or complex entities, this will often require preparatory steps to be taken well ahead of any stress emerging.

Current gaps

Despite improvements in line with APRA's supervisory guidance on recovery and exit planning over recent years, there remain significant gaps in the credibility of financial contingency planning at APRA-regulated entities. For banks and insurers, progress has been made over a number of years, though material inconsistencies between levels of readiness remain. In the superannuation industry, financial contingency readiness is considerably further behind. APRA is introducing new prudential requirements to improve the level of readiness across all APRA-regulated industries and ensure all entities continuously meet minimum standards in planning for financial stress events.

The proposed standards also reinforce earlier work undertaken by the Government to ensure the Australian financial system is adequately prepared for financial stress. In 2018, the Government's Crisis Management Act gave APRA the powers needed to resolve failing banking and insurance entities, and in 2021 the Your Future, Your Super reforms completed

the legislative framework for the superannuation industry.[1] The proposed standards aim to ensure that these powers can be implemented effectively by APRA when needed, and importantly that entities have taken the necessary pre-positioning steps to allow for orderly resolution.

Many advanced economies, particularly those most impacted by the global financial crisis, already have requirements in place consistent with the proposed standards. APRA has taken a measured approach to implementing international practices by tailoring requirements for the Australian context. Without effective resolution planning, options in a crisis would remain limited; by developing both APRA and industries' readiness, APRA will be better placed to manage the unlikely event of an entity failure.

Proposed standards

APRA is consulting on two new prudential standards to strengthen crisis preparedness:

- **Financial Contingency Planning:** the proposed new *Prudential Standard CPS 190 Financial Contingency Planning* (CPS 190) would require all APRA-regulated entities to develop credible plans for managing stress that may threaten their viability; this includes plans for rebuilding financial resilience or effecting an orderly exit. In doing so, this prudential standard seeks to minimise the risk of entity failure.

- **Resolution Planning:** the proposed new *Prudential Standard CPS 900 Resolution Planning* (CPS 900) would require large or complex APRA-regulated entities to be pre-positioned, where appropriate, so that – in the event of their failure – risks to beneficiaries and to financial system stability would be minimised. Complementing CPS 190, the proposed CPS 900 would seek to minimise the impact of entity failure.

In introducing new prudential requirements, APRA has sought to minimise undue impacts for smaller or less complex entities. APRA's requirements are principles-based, which allows entities to meet the prudential standards in a way that is appropriate to their particular business model and the risks they present to the financial system. Under the proposed standards, smaller entities would be subject to fewer requirements compared to larger entities. For example, the proposed CPS 900 would only apply to large entities or those that APRA considers provide functions critical to the economy given that these entities are often too complex to efficiently resolve without significant preparation. For smaller institutions that require APRA-led resolution, APRA has a range of tools for which the necessary preparations are less complex.

In designing the proposed framework, APRA has benchmarked against international peers. The majority of G20 jurisdictions are progressing or have completed initiatives to strengthen recovery and resolution planning requirements. APRA's proposed requirements would align with international better practice, thereby maintaining investors' confidence in the ability of the Australian financial system to withstand future stress.

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[1] See *Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Act 2018* and *Treasury Laws Amendment (Your Future, Your Super) Act 2021*.

Next steps

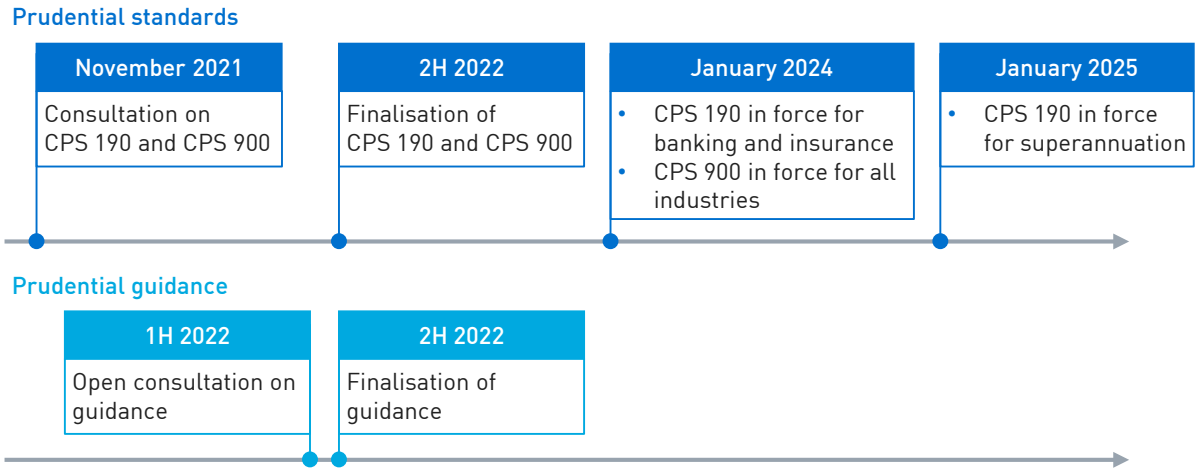
APRA's draft prudential standards (CPS 190 and CPS 900) are open for consultation until 29 April 2022. Subject to stakeholder feedback, APRA plans to finalise these standards in late 2022.

The new prudential standards are expected to be implemented under a staged approach:

- CPS 190 would come into effect on 1 January 2024 for banks and insurers and on 1 January 2025 for the superannuation industry; and
- CPS 900 would come into effect on 1 January 2024.

APRA also plans to develop accompanying guidance to assist entities in meeting their new requirements. APRA's draft guidance will be released for consultation in 2022.

Figure 1. Timeline on reforms to strengthen crisis preparedness



Strengthening crisis preparedness

Objectives

Reducing the likelihood of entity failure and risks to financial system stability

Minimising the impact of entity failure on beneficiaries and the financial system

Key features

CPS 190 Financial Contingency Planning	*Financial contingency plans respond to severe stress*	• Entities must develop credible financial contingency plans • Requires entities to maintain capabilities to support timely responses • Enhanced requirements for larger or more complex entities
CPS 900 Resolution Planning	*Resolution plans protect beneficiaries and minimise disruption to the financial system*	• APRA develops plans for large and complex entities • Entities must assess their resolvability • Entities must remove barriers to orderly resolution

Key outcomes for the community

Prepared	APRA-regulated entities will be prepared for stress that may threaten their viability
Protected	Where an entity fails, it will be resolved in an orderly manner, protecting financial promises made to beneficiaries and preserving system stability
Not reliant on public funds	Minimise the likelihood that public funds would be used in resolving a failed entity

Implementation

Banking and insurance industries	CPS 190: **2024** CPS 900: **2024**	**Superannuation industry**	CPS 190: **2025** CPS 900: **2024**

APRA intends to consult on guidance for all industries in 2022.

Glossary

ADI	Authorised deposit-taking institution
APRA	Australian Prudential Regulation Authority
APRA Act	*Australian Prudential Regulation Authority Act 1998*
FCS	Financial Claims Scheme
GI	General insurance
LAC	Loss-absorbing capacity
LI	Life insurance
PHI	Private health insurance
RSE	Registrable superannuation entity
RSE licensee	Registrable superannuation entity licensee as defined in s 10(1) of the *Superannuation Industry (Supervision) Act 1993*
RWA	Risk-weighted asset
SFI	Significant financial institution

Chapter 1 - Introduction

1.1 Strengthening crisis preparedness

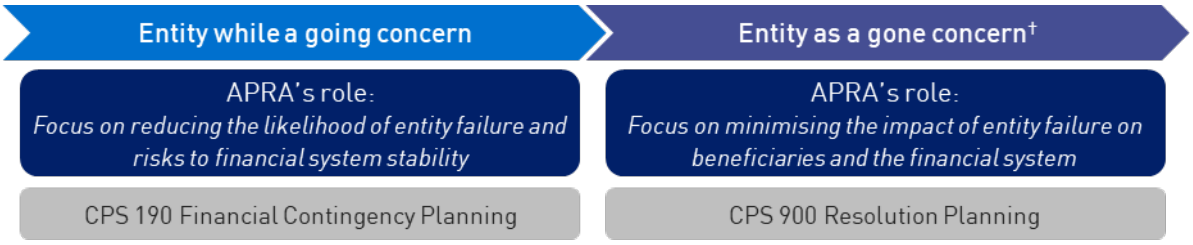
Under its mandate, APRA is responsible for protecting the interests of depositors, insurance policyholders and superannuation fund members (collectively beneficiaries), and for promoting financial system stability in Australia. APRA does this by focusing on the financial safety of regulated entities, thereby minimising their risk of failure. APRA is also responsible for minimising the impact of any entity failure, by ensuring that beneficiaries are protected and risks to financial stability are minimised.

The proposed new prudential requirements for financial contingency planning and resolution planning reinforce APRA's ability to deliver these objectives for the community:

- CPS 190 places obligations on entities to plan for scenarios which may threaten their viability; and
- CPS 900 requires entities to take steps, where appropriate, to ensure they can be resolved by APRA in an orderly manner.

These requirements are a common feature of international prudential frameworks, reflecting the significant costs that can stem from disorderly failures.[2]

Figure 2. APRA's role in crisis management planning



† *Gone concern refers to where an APRA-regulated entity has failed and APRA must utilise its powers to resolve the failure to ensure beneficiaries are protected. Failure from a prudential regulation perspective may occur before insolvency.*

Chapter 2 provides an overview of financial contingency planning, Chapter 3 discusses resolution planning and Chapter 4 sets out next steps for the consultation.

[2] For example, during the global financial crisis, the UK Government injected public money of around £137bn to stabilise the UK financial sector. See https://commonslibrary.parliament.uk/research-briefings/sn05748/.

1.2 Balancing APRA's objectives

The APRA Act requires APRA to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality, and, in balancing these objectives, promote financial system stability in Australia. APRA considers that, on balance, the proposals in this discussion paper will improve financial safety and promote financial system stability, while not unduly impacting other objectives.

PRIMARY OBJECTIVES	
Financial safety ↑	**Financial system stability** ↑
Improved: The proposals would enhance the ability of APRA-regulated entities to effectively manage stress that may threaten their viability.	**Improved:** The proposals would reduce the risks of material disruption to the financial system, in the unlikely event of an entity failure.

OTHER CONSIDERATIONS	
Efficiency ↔	**No change:** To meet the new requirements, some entities would need to invest in capabilities and operations to enhance their crisis preparedness. This could reduce efficiency in the short term. However, international experience has shown that strengthened financial contingency and resolution planning can support more prudent risk management and longer-term viability. With entities more resilient to stress events, efficiencies are likely to build over the longer-term.
Competition ↔	**No change:** In designing the new requirements, APRA has sought to reduce adverse impacts on competition. The proposed approach to introducing new requirements is proportionate. Smaller and less complex entities will be subject to fewer requirements, compared to larger entities. This approach is reinforced by principles-based requirements, rather than prescriptive rules; a prescriptive approach would not allow entities to meet the requirements in a way that is most appropriate for their business models and risk profile. The proposed new requirements would reinforce the objectives of APRA's new licensing regime. The ability of entities to leave the market in an orderly manner supports APRA's approach to licensing new entrants, including being more comfortable with more innovative business models if these are supported by robust financial contingency plans should they prove non-viable.
Contestability ↔	**No change:** The proposed standards would impose proportionate requirements on new entrants, commensurate with their risks and business models. Effective financial contingency and resolution arrangements should enable new and viable entrants to be more robust competitors.
Competitive neutrality ↔	**No change:** The proposed standards would not create an advantage for public sector entities relative to other market participants.

Chapter 2 - Financial contingency planning

2.1 Objectives of financial contingency planning

Contingency planning, in general, involves entities preparing for adverse events. Financial contingency plans focus on threats to the viability of an entity.[3] These threats can come from a range of sources, and for financial institutions are most typically associated with an economic downturn. They could also be caused by idiosyncratic issues, such as fraud or operational failures arising from a cyber-attack, leading to losses that threaten an entity's ongoing viability.

Under the proposed CPS 190, entities would be required to develop financial contingency plans to respond to these threats to their viability, which the Board would be required to approve. Scenarios that threaten viability may be short, sharp and sudden, but typically play out over a period of months and years. For banks and insurers, there is likely to be a material impact on regulatory capital and liquidity, which may ultimately risk viability. Where an entity cannot recover and rebuild its financial resilience, it may need to exit the industry.

2.2 Recovery and exit actions

Under the proposed CPS 190, APRA-regulated entities would be required to develop credible contingency plans for:

- **recovering their financial resilience:** entities would be required to plan for credible actions that could stabilise their financial position during stress and restore their financial resilience. Recovery actions could include, for example, reductions in expenditure or ceasing certain business activities. Entities could also raise additional financial resources through equity issuances or asset sales; and

- **managing their own exit from the industry while remaining solvent and viable:** entities would also be required to develop credible actions for an orderly and solvent exit from regulated activity if recovery actions are ineffective in restoring financial resilience. These types of actions could include an orderly transfer or wind-down of business, or solvent run-off.

The credibility of an entity's recovery and exit actions will depend on its business model and risk profile. For example, larger or more complex entities would generally have access to a broad range of credible recovery actions, given their ability to raise new equity on listed markets and potential to divest non-core business lines or subsidiaries. Some smaller entities, on the other hand, may have more limited credible recovery actions. Regardless of

[3] APRA's existing prudential framework also requires entities to plan for operational disruptions through business continuity planning. See *Prudential Standard CPS 232 Business Continuity Management* and *Prudential Standard SPS 232 Business Continuity Management*.

the type of entity, credible financial contingency plans would not assume the use of public funds, nor the use of APRA's crisis powers in responding to stress situations.

In the banking and insurance industries, most entities have worked up plans for recovery options in recent years, in line with supervisory guidance. A number of entities have also started to develop exit options. The proposed CPS 190 would formalise these supervisory expectations, addressing gaps and inconsistencies in approach to improve the credibility of entity plans.

For the superannuation industry, the proposed CPS 190 would ensure that registrable superannuation entity (RSE) licensees are better placed to provide for the best financial interest of their members, by requiring RSE licensees to prepare for scenarios that threaten their viability. In doing so, the proposed CPS 190 would reinforce the objectives of *Prudential Standard SPS 515 Strategic Planning and Member Outcomes* (SPS 515). Section 2.4 provides further detail on how financial contingency planning requirements would apply to RSE licensees.

Proportionality

Under the proposed CPS 190, larger or more complex entities would be subject to heightened requirements, whereas smaller, less complex entities will have fewer and simpler requirements. Smaller or less complex entities will likely focus their efforts on a smaller range of credible contingency options, which reduces the planning required to achieve a prudent level of crisis preparedness. This is consistent with APRA's risk-based approach and will avoid undue burden for smaller entities.

Entities determined to be significant financial institutions (SFIs) would be subject to higher requirements. The categorisation of an entity as an SFI is determined by a total asset threshold or determined by APRA based on qualitative criteria, such as the complexity of an entity's operations or its membership of a group.[4] The asset thresholds for each industry are listed in Table 1 below. Consistent with the approach in other prudential standards, APRA does not consider it appropriate to add complexity to the total asset thresholds through indexation or averaging.

[4] This approach follows the methodology undertaken in *Prudential Standard CPS 511 Remuneration* (CPS 511). The asset thresholds in CPS 190 are aligned with CPS 511 but there are differences in the qualitative criteria given the respective focus of CPS 190 and CPS 511.

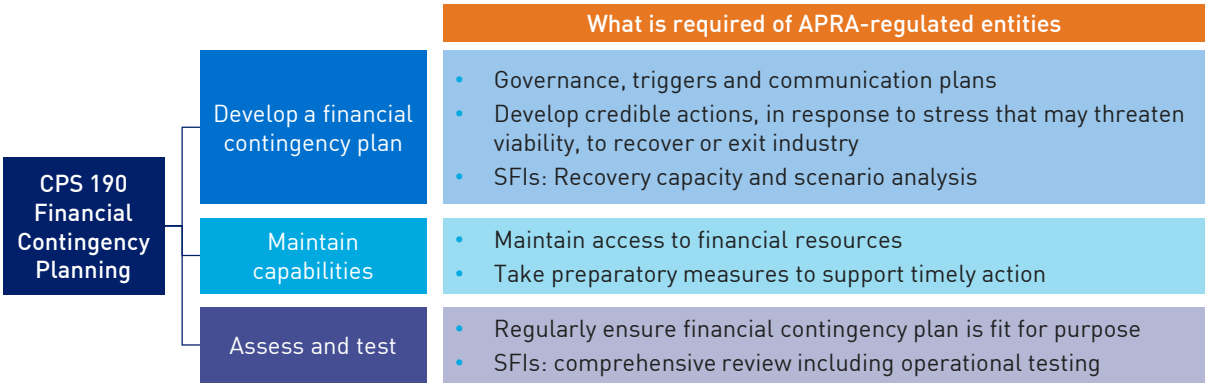
Table 1. Thresholds for significant financial institutions subject to higher requirements

	Industry	Assets
	Authorised deposit-taking institutions	>$20 billion
	General and life insurers	>$10 billion
	Private health insurers	>$3 billion
	Combined total assets of RSEs within the RSE licensee	>$30 billion

2.3 Key elements of CPS 190

The key elements of the proposed CPS 190 are outlined below.

Figure 3. Key elements of CPS 190



Developing a financial contingency plan

Under the proposed CPS 190, all entities must include in their financial contingency plans:

- a prudently calibrated trigger framework that supports an entity in taking timely action, with early warning indicators to identify emerging stress;
- credible recovery and exit options that consider the economic and operating environment, and potential barriers to their implementation;
- effective governance arrangements to support the monitoring of early warning indicators and the implementation of recovery or exit options; and
- communication plans to support the effective implementation of the contingency plan.

SFIs would also be subject to additional requirements, consistent with their greater complexity and risks to financial stability. An SFI's contingency plan would also need to include scenario analysis to assess the effectiveness of the trigger framework and credibility

of recovery options. Robust scenario analysis would inform an SFI's assessment of its recovery capacity, as set out in the box below.

Box 1: Assessing recovery capacity

Under the proposed CPS 190, an SFI would be required to assess its recovery capacity. This represents the aggregate quantitative net benefit to capital or liquidity from implementing recovery actions assessed under various scenarios, including an idiosyncratic and a systemic stress scenario.

Recovery capacity is a key indicator of the credibility of an SFI's recovery options. In calculating recovery capacity, APRA would expect SFIs to consider interdependencies between actions, rather than assuming a simple summation. Scenario analysis and stress testing are important inputs to assessing recovery capacity. An example of recovery capacity for an ADI could be the amount of Common Equity Tier 1 Capital that can be rebuilt in a stress scenario, measured in percentage points of risk-weighted assets.

Under the proposed CPS 190, the Board of an SFI is required to form a view as to whether the recovery capacity would be sufficient in restoring the financial resilience of the entity. Where recovery capacity is not sufficient, the Board must consider other actions, such as undertaking additional preparatory measures to improve the feasibility of particular options or broadening the pool of credible recovery options.

Maintaining capabilities

Under the proposed CPS 190, entities would be required to maintain, or maintain access to, capabilities to execute their financial contingency plan. This could include sufficient financial resources to support the implementation of contingency actions, such as for operational expenses.

Entities would also be required to take reasonable preparatory measures to support the timely and effective implementation of the financial contingency plan. This would include consideration of potential legal, financial, operational and structural requirements for executing contingency actions. These preparatory measures can help strengthen the credibility of contingency options and an entity's recovery capacity, where relevant.

Testing and review

The proposed CPS 190 would also include requirements for all entities to review regularly their financial contingency plans. These reviews seek to ensure that contingency plans remain appropriate for changes in an entity's business model, risk profile and developments in the broader environment.

Under the proposed CPS 190, SFIs would be required to review their plan on an annual basis, and for non-SFIs, at least every three years. The draft proposals would also require SFIs to carry out additional comprehensive reviews, at least every three years. These comprehensive reviews would include a simulation exercise to test the operation of the financial contingency plan.

Notification and group contingency plans

Under the draft proposals, entities would be required to notify APRA if they have activated their financial contingency plan. The decision to activate the plan ultimately rests with the Board; however, consistent with current supervisory practices, APRA expects entities to be engaging closely with supervisors in any emerging stress scenario.

For entities that are part of an APRA-regulated or non-regulated group, the draft proposals would require financial contingency plans to be prepared for each APRA-regulated entity in the group. APRA's objective is to ensure that there is adequate consideration of intra-group issues, such as support from parent entities and the risk of contagion. International groups would need to ensure that contingency plans for Australian operations meet the requirements of the proposed CPS 190.

2.4 Contingency plans in superannuation

While financial contingency planning has been a focus of the banking and insurance industries for a number of years, it is equally important for the superannuation industry. In introducing prudential requirements for RSE licensees to undertake financial contingency planning, APRA's objective is to ensure that, in circumstances where an RSE licensee itself is under financial stress, it could continue to act in the best financial interests of its beneficiaries.

The proposed CPS 190 would support the objectives of SPS 515; however, CPS 190 is narrowly targeted at scenarios where the RSE licensee itself is under financial stress. The proposed CPS 190 is not focused on rectifying identified poor member outcomes or underperformance, as required by the business planning and business performance review provisions in SPS 515.

There are important links between the proposed CPS 190 and SPS 515; in certain circumstances, poor outcomes to beneficiaries can have implications for an RSE licensee's viability. For example, where an RSE licensee relies on fee revenue to capitalise the RSE licensee company, significant outflows or downward pressure on fees could place pressure on the RSE licensee's financial position. An RSE licensee would be expected to consider the interdependencies between their business plan and their financial contingency plan.

Compared to banks and insurers, some RSE licensees may have more limited credible recovery actions; for example, only certain RSE licensees may have the ability to raise funds to recapitalise the RSE licensee or enact cost savings. Accordingly, APRA expects that exit actions are likely to receive greater focus in most RSE licensees' financial contingency plans. Table 2 below sets out hypothetical examples of scenarios that could be relevant for an RSE licensee's financial contingency planning.

Table 2. Hypothetical examples of financial contingency planning for RSE licensees

Potential scenario	Impact on viability	Potential response
The RSE licensee of a single fund has failed to improve performance. Major products have failed the performance test twice and become closed to new members.	• Member outflows reduce scale and raise administration costs. Actions to improve performance are ineffective, threatening the best financial interests of fund members. • This leads to financial stress at an RSE licensee level, as the entity is no longer able to demonstrate it will be able to meet its obligations to its members on an ongoing basis.	The RSE licensee could seek to initiate a successor fund transfer to an appropriate fund and exit the industry.
Group failure leading to the unavailability of key services ordinarily provided by the group to the RSE licensee.	• Operating reserves at the RSE licensee level are insufficient to meet financial obligations and further group support is unavailable.	Exit via transfer of RSE licensee.

Alongside this discussion paper APRA is also engaging with RSE licensees on potential ways to strengthen their financial resilience. On 19 November 2021, APRA released a discussion paper, *Strengthening financial resilience in superannuation*, which seeks information from superannuation trustees on their plans to prudently maintain the financial resilience needed to protect members' best financial interests.[5] APRA will consider feedback raised in this engagement as part of its finalisation of CPS 190, where relevant.

[5] See APRA, *Strengthening financial resilience in superannuation*, (November 2021), available at: https://www.apra.gov.au/strengthening-financial-resilience-superannuation.

Chapter 3 - Resolution planning

While entity-led contingency planning is aimed at ensuring that an entity can recover itself or achieve an orderly exit in the event of severe stress, resolution occurs at failure and is an APRA-led process. Planning for resolution well ahead of any stress emerging reduces the risk of a disorderly failure, particularly for large and complex entities. Entities need to work closely with APRA on the resolution planning process and to take the pre-positioning measures required to be resolvable.

A lack of preparedness for resolution generally risks transferring costs of failure from shareholders and other providers of capital to the taxpayer and financial system. It is not possible to make significant progress on resolution preparedness without a formal framework. APRA is therefore proposing to introduce new legally enforceable requirements to ensure entities take the pre-positioning steps needed for resolution, ultimately limiting the potential for adverse impacts on beneficiaries and financial stability, and minimising the need for taxpayer funded support.

3.1 Objectives of resolution planning

Resolution refers to the use of APRA's crisis management powers to manage the failure of an APRA-regulated entity. In using these powers, APRA seeks to ensure that, in the event of an entity failure, financial promises entities make to their beneficiaries are protected and that financial system stability is preserved. This is commonly referred to as an orderly resolution.

The effectiveness of APRA's powers in delivering an orderly resolution will depend on the level of planning done ahead of stress emerging, particularly where entities are large or complex. The experience of the global financial crisis clearly demonstrated that, without prior investment in resolution planning, there can be limited options for resolving failing entities in an orderly manner. Some jurisdictions instead used taxpayers' money to support failing entities, but in doing so, created new risks associated with moral hazard.

The proposed CPS 900 would be targeted at larger or more complex entities, and those that provide functions that are critical to the economy; for these entities it is crucial that steps are taken well in advance of stress emerging to ensure that they can be resolved in an orderly manner.[6] Under the proposed CPS 900, the Board of an APRA-regulated entity would be responsible for ensuring that the entity is resolvable, and would be required to provide oversight and approval of resolvability assessments and pre-positioning plans, where appropriate.

Smaller entities without critical functions would not generally require the same level of pre-positioning for resolution, as they tend to have simpler operations. Given the relatively lower complexity, APRA would be able to take over the deployment of an entity exit plan or deploy

[6] An example would be the collapse of a major bank, which would impact a material proportion of depositors, payments and other financial transactions, as well as broader investor and public confidence in the system.

an alternative resolution strategy (such as the Financial Claims Scheme (FCS)) without requiring extensive pre-positioning under CPS 900.

In seeking to achieve an orderly resolution, there are a range of options available to APRA. The most appropriate option will always depend on the particular circumstances at the time and the risks that APRA is seeking to address. Options could include, for example:

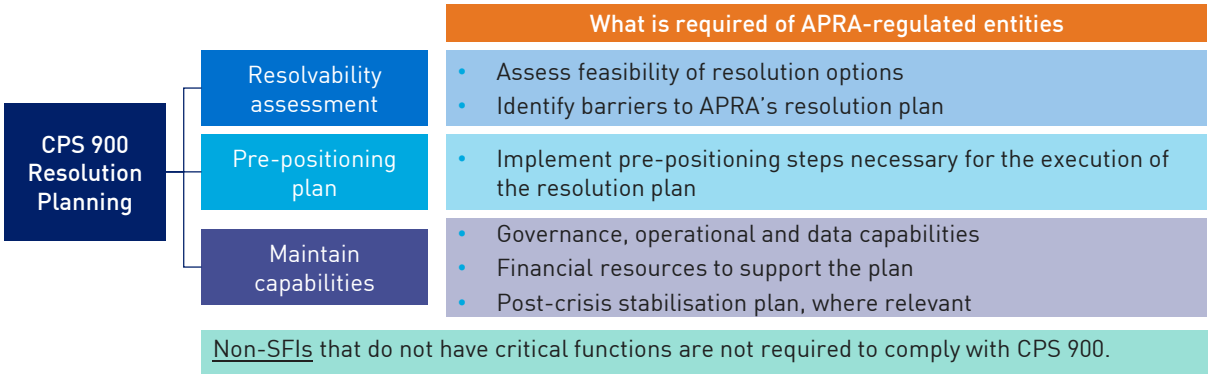
- the transfer of business of the failed entity to another APRA-regulated entity;
- recapitalisation of the non-viable entity using pre-positioned loss-absorbing capacity;
- an APRA-directed wind-down of the regulated business; or
- the activation of the FCS as a safety net for depositors and general insurance policyholders and claimants.

While the proposed CPS 900 would come into effect on 1 January 2024, entities would not be required to meet the requirements of the standard until APRA commences resolution planning with individual entities. Once APRA commences resolution planning with an entity, that entity would be required to support APRA in the development and implementation of a resolution plan, under CPS 900.

3.2 Key elements of CPS 900

The key elements of the proposed CPS 900 are outlined below.

Figure 4. Key elements of CPS 900



Proportionality

The proposed CPS 900 would only apply to SFIs or entities that APRA considers provide critical functions to the economy. In assessing whether an entity provides critical functions to the economy, APRA will consider a range of factors, such as those outlined in the box below.

Box 2: Critical functions

Critical functions are financial services that an entity provides which, if materially disrupted, would have a substantial impact on system stability or to sectors of the economy, for example, a particular industry or community. The continuation of critical functions in the event of entity failure is fundamental to an orderly resolution.

In assessing the criticality of an entity's functions, APRA would consider factors such as size, market share and the degree of readily available substitutes. An example of a critical function could be a very large deposit book that would impact large parts of the community if access was disrupted.

Resolvability assessment

An important first step in the resolution planning process is an assessment of resolvability. Under the proposed CPS 900, APRA would require an entity to assess the feasibility of potential resolution options, as determined by APRA. For each resolution option, entities would be required to identify whether there are barriers to their effective execution, including potential legal, structural, operational or regulatory impediments. Entities would also be required to identify potential pre-positioning measures that would be needed to support the implementation of the resolution plan.

Pre-positioning plan

Following an assessment of resolvability, APRA may also require entities to develop and implement a pre-positioning plan. This would set out the steps that an entity must take to remove any impediments to their orderly resolution. Where there are material impediments to effective execution, APRA could require entities to make changes to their operating structures, contracts with third parties, or implement measures to ensure the operational continuity of key functions and services. Some examples of potential pre-positioning actions are provided in the box below; specific actions will depend on the particular circumstances of an entity.

Box 3: Examples of pre-positioning actions

- **Structural changes:** changes to group structure, legal entities, or shared support services.
- **Contractual adjustments or operational improvements:** changes to the arrangements or terms for delivery of important business services to allow for the ongoing provision of those services during resolution.
- **Adjustments to capital management:** this could include steps to ensure capital and funding plans pre-position adequate financial resources to support orderly resolution, including for solvent run-off, policy renewal management or FCS preparations.

Capabilities

Once the pre-positioning plan is implemented, entities would need to maintain their resolvability on an ongoing basis. An entity subject to CPS 900 would need to maintain a minimum level of capabilities to action the resolution plan. Table 3 below illustrates four broad categories of capabilities that APRA anticipates could be required to support orderly resolution. In some instances, it may be necessary for entities to engage external advisors to support the development of its capabilities and the resolution planning process.

Table 3. Illustrative resolution capabilities

Capability	Further detail
 **Crisis governance arrangements**	• The Board may consider whether its directors possess the necessary skills and experience to provide appropriate oversight and challenge. Effective implementation of a resolution plan would be based on sound decision-making and adequate Board oversight. • An entity may consider whether the composition, frequency and terms of reference for crisis governance arrangements remain fit for purpose. This may include reviewing communication plans to key stakeholders.
 **Operational**	• The operational continuity of critical functions may require additional planning and resources. • Entities may need to take practical steps to ensure that the conversion or write-down of capital instruments would perform as expected. • ADIs with resolution plans that rely on contingent funding may need to test that these arrangements will be effective.
 **Data and systems**	• Entities may need to invest in data or systems to support resolution. • There may be a need for timely information sharing or for an entity to conduct valuations in a compressed timeframe.
 **Post-crisis stabilisation plan**	• An entity may need to consider a post-crisis stabilisation plan. This could include steps to rebuild long-term financial resilience, such as capital and funding plans. It may also include the disposal or wind-down of non-core assets or lines of business.

3.2.1 Financial resources

Under the proposed CPS 900, an APRA-regulated entity must maintain the necessary financial resources, or access to them, to execute resolution actions. APRA may also require entities to have funding arrangements in place or, for entities with existing capital requirements, to maintain additional loss-absorbing capacity (LAC) to support an orderly resolution, as set out below.

Loss-absorbing capacity

In requiring entities to maintain additional LAC, APRA's objective is to ensure that, in the event of failure, an entity could be resolved with private (not taxpayer) funds. Depending on

APRA's resolution plan for the entity, this could involve using LAC to facilitate a recapitalisation or stabilisation and transfer to another entity.

While APRA has already determined an amount of LAC for domestic systemically important banks, the proposed CPS 900 would provide a framework for extending this approach to other entities, where appropriate.[7] APRA's assessment of LAC for other entities would be determined on a case-by-case basis, as part of broader resolution planning. Under the proposed CPS 900:

- where APRA determines that an ADI must maintain additional LAC for resolution purposes, APRA would increase the ADI's minimum Total Capital requirement under *Prudential Standard APS 110 Capital Adequacy*;[8]
- for insurance, if APRA determines that additional LAC is required to support the orderly resolution of an insurer, this would be met through an adjustment to an insurer's minimum Prudential Capital Requirement;
- RSE licensees would not be required to maintain LAC to support resolution. Instead, access to financial resources may be relevant.

[7] APRA, *Response to Submissions – Loss-absorbing capacity* (Response to Submissions, July 2019) https://www.apra.gov.au/news-and-publications/apra-responds-to-submissions-on-plans-to-boost-loss-absorbing-capacity-of.

[8] A number of international regulators have made changes to regulatory capital instruments, such as Additional Tier 1, in their jurisdiction to better position those instruments to absorb losses in resolution. APRA continues to monitor and consider international developments on this topic.

Chapter 4 - Consultation and next steps

APRA invites written submissions on the proposals set out in this discussion paper. Written submissions should be sent to PolicyDevelopment@apra.gov.au by 29 April 2022 and addressed to the:

General Manager, Policy
Policy and Advice
Australian Prudential Regulation Authority.

Important disclosure notice – publication of submissions

All information in submissions will be made available to the public on the APRA website unless a respondent expressly requests that all or part of the submission is to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in confidence should provide this information marked as confidential in a separate attachment.

Submissions may be the subject of a request for access made under the *Freedom of Information Act 1982* (FOIA). APRA will determine such requests, if any, in accordance with the provisions of the FOIA. Information in the submission about any APRA-regulated entity that is not in the public domain and that is identified as confidential will be protected by section 56 of the *Australian Prudential Regulation Authority Act 1998* and will therefore be exempt from production under the FOIA.

Request for cost-benefit analysis information

APRA asks that all stakeholders use this consultation opportunity to provide information on the compliance impact of the proposals, and other substantive costs associated with the changes. Compliance costs are defined as direct costs to businesses of performing activities associated with complying with government regulation. Specifically, information is sought on changes to compliance costs incurred by businesses as a result of APRA's proposals.

Consistent with the Government's approach, APRA will use the methodology behind the Regulatory Burden Measurement tool to assess compliance costs. This tool is designed to capture the relevant costs in a structured way, including a separate assessment of upfront costs and ongoing costs. It is available at https://rbm.obpr.gov.au/

APRA requests that respondents use this methodology to estimate costs to ensure the data supplied to APRA can be aggregated and used in an industry-wide assessment. When submitting their costs assessment to APRA, respondents should include any assumptions made and, where relevant, any limitations inherent in their assessment. Feedback should address the additional costs incurred as a result of complying with APRA's requirements, not activities that institutions would undertake due to foreign regulatory requirements or in their ordinary course of business.

4.1 Consultation questions

To assist interested stakeholders in providing feedback on the proposals outlined in this discussion paper, APRA offers the following considerations to guide, but not limit, responses:

Table 4. Consultation questions

Framework design	1. Is the approach to proportionality well-balanced and appropriate? 2. What are the estimated compliance costs to meet the new requirements?
Financial contingency planning (CPS 190)	3. Should APRA indicate preferred contingency options? 4. Are the proposed contents of the financial contingency plan comprehensive? 5. Are the frequency and type of reviews appropriate?
Resolution planning (CPS 900)	6. Is the scope of entities subject to CPS 900 appropriate? 7. Is the frequency and type of review appropriate?

Attachment A: Policy options and estimated comparative net benefits

APRA is considering three policy options for financial contingency and resolution planning as set out in Table 5 below. Also set out below is APRA's preliminary analysis of the costs and benefits of each option.

Table 5. Policy options

Option 1	No new prudential requirements for financial contingency and resolution planning, relying on informal guidance and current practice.
Option 2	New prudential requirements for financial contingency and resolution planning, with proportionality applied.
Option 3	New prudential requirements for financial contingency and resolution planning, consistent for all entities and without proportionality applied.

Option 1 – No new prudential requirements

Under Option 1, APRA would not implement new prudential requirements for financial contingency planning or resolution planning. APRA-regulated entities would not incur any additional compliance costs. However, the potential costs to financial safety and financial system stability of this option may be high.

Financial institution failures, or broader system instability, impose substantial costs on the community. This includes direct costs on employment and the provision of essential financial services. Disorderly failure also raises the risk of public funds being used to resolve financial institutions.

Under Option 1, there would remain a heightened risk that, in the unlikely event of the failure of an APRA-regulated entity, this could cause material disruption to financial stability. Without the introduction of new legally enforceable requirements, APRA has limited options for ensuring that entities take necessary pre-positioning steps that would limit the risk of a disorderly failure, with potential adverse impacts for financial stability.

Under Option 1, there would also be a heightened risk that APRA-regulated entities are poorly prepared for managing stress that may threaten their viability. While entities have generally improved their practices in recent years, there remains significant gaps and a need for uplift overall across industries to address this risk.

Option 2 – New prudential requirements, with proportionality applied

Under Option 2, APRA would implement new prudential requirements for financial contingency and resolution planning, as described in this paper. Under this option, larger or more complex entities would be subject to more heightened requirements, consistent with their greater risks to financial stability. Smaller and less complex entities would be subject to simpler requirements.

The advantages of introducing new prudential requirements under Option 2 are a reduction in risks to financial safety and financial system stability. As noted above, the costs to the community from financial institution failures, or financial instability, can be high. APRA-regulated entities would, however, incur additional compliance costs under this option. These compliance costs would likely include updates to policies, practices and frameworks or operational changes to enhance crisis preparedness or capabilities.

Under Option 2, a proportional approach to the proposed new requirements would ensure that smaller entities are not disproportionately impacted by additional compliance costs. These entities will be subject to simpler requirements, more appropriate to their size and the risks they pose to financial safety and system stability. This would reduce the impact from the additional compliance costs of these proposals.

Option 3 – New prudential requirements, without proportionality applied

Under Option 3, APRA would apply the same requirements to all APRA-regulated entities. This would ensure greater consistency in crisis preparedness across the industry and would have the same advantages as Option 2 in reducing risks to financial safety and financial system stability. However, Option 3 would have higher proportional cost effects on smaller or less complex entities, despite a lesser need for detailed planning given their level of complexity. The costs for larger or more complex entities would be the same as under Option 2. APRA does not consider there to be material additional benefits to financial soundness and financial stability under this option, when compared to Option 2.

APRA