



**APRA**

# INFORMATION PAPER

## Modernising the prudential architecture

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# Executive summary

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APRA released its latest Corporate Plan in August 2022, with a focus on “protected today, prepared for tomorrow”. The Corporate Plan presented an update on APRA’s core strategic priorities, including the initiative to *Modernise the prudential architecture*.

This information paper outlines APRA’s approach to modernising the prudential architecture. It sets out the objectives, scope and next steps in the program, and provides an overview of what to expect over the next few years.

## Drivers of change

The financial landscape is changing at a rapid pace: the digitisation of finance is accelerating, new business models are emerging, and innovation is testing traditional regulatory boundaries. As the financial system evolves, regulation needs to adapt.

For the prudential framework, there is scope to make it clearer, simpler and more adaptable. There is also scope to reduce undue cost and complexity for industry, and support innovation. Over and above this, there is a need to ensure the framework can adapt to the challenges on the horizon, and continue to underpin financial safety in an ever-changing environment.

## An evolutionary approach

The program ahead to modernise the prudential architecture will be multi-year, iterative and evolutionary. It will involve incremental changes in the design of the framework, in how APRA writes policy, and in how industry accesses and navigates it. The end goal is a digital framework that will be easier for the industry to understand and comply with, and for APRA to supervise and maintain – and ultimately to better protect Australians’ financial interests.

Over the period ahead, APRA will deliver a series of initiatives focused on:

- **better regulation**, improving the design of the framework to ensure the prudential standards and guidance are easier to navigate, understand and implement;
- a **digital first** approach, exploring how to make use of suptech (supervisory technology) and regtech (regulatory technology) to support better regulation; and
- **new risks, new rules**, developing APRA’s approach to the regulation of new risks, and new business models on the prudential perimeter.

Over 2022, APRA has been building the foundations for the program and starting to develop longer-term plans. As a next step, APRA will engage with regulated entities and other key stakeholders to understand any pain points with the current framework and assess the appetite for change. To support this, APRA welcomes any initial feedback on the challenges and opportunities outlined in this paper by 30 November 2022.

# Chapter 1 - The prudential architecture

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## The architecture today

The prudential architecture is a fundamental building block for the financial system. It establishes minimum standards, in law, to support financial safety and system stability for banks, insurers and RSE licensees, and in turn outcomes for the Australian community.

APRA's focus in modernising the architecture is on the structure and design of the elements within the prudential framework (APRA's standards, guidance and advice). The architecture can also be thought of more broadly as encompassing primary legislation and other components, but what is beyond APRA's remit is out of scope. A high-level map of the current architecture is in Annex A.<sup>1</sup>

APRA has built a comprehensive prudential framework over the past 20 years, which has strengthened the resilience of the financial system: the banking industry is unquestionably strong, RSE licensees are delivering improved outcomes for their members, and the insurance industries have remained resilient in the face of challenging conditions.

## Size and complexity

The prudential framework has also, however, increased in size and complexity over time. Growth in the framework has been shaped and driven by higher standards globally, as well as recommendations from a range of internal and external reviews. This includes the Financial Systems Inquiry, the Financial Services Royal Commission, and the IMF's Financial System Stability Assessment of Australia.

As shown in the charts below, there are currently 140 prudential standards and prudential practice guides (PPGs) in total covering the five APRA-regulated industries. To provide further guidance, APRA has also produced a large volume of supporting advice in the form of industry letters, information papers and FAQs.<sup>2</sup>

Navigating the prudential framework and the network of supporting advice can be complex, as it continues to be updated over time. Complexity makes it difficult for regulated entities to find and understand requirements, complicating risk management and amplifying compliance costs.

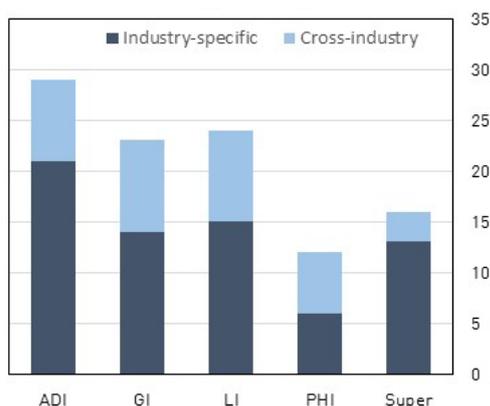
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<sup>1</sup> Prudential architecture and prudential framework are terms that are often used somewhat interchangeably in this information paper.

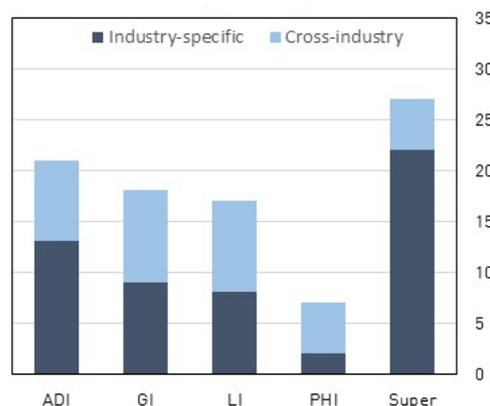
<sup>2</sup> This mirrors growth in regulation internationally. The Basel Framework, for example, has expanded from around 300 pages before the global financial crisis to over 1,600 pages today: a five-fold increase.

As the Australian Law Reform Commission (ALRC) has commented in their review of financial services legislation, complexity matters because it can make the law difficult to understand; this makes it harder for entities to comply with and for regulators to enforce, and can lead to increased costs for the system.<sup>3</sup>

**Number of prudential standards by industry**



**Number of PPGs by industry**



## Challenges on the horizon

Looking ahead, the prudential framework will also need to be more adaptable, to cater for new financial activities and risks on the horizon. The current pace of innovation is unlikely to abate, driving changes in who, what and how APRA regulates. Key trends include:

- **Digitisation:** increasing use of digital technology by banks, insurers, RSE licensees, and the third parties that support them. This technology, which continues to evolve rapidly, brings both risks and opportunities. It includes regtech, natural language processing, machine learning, artificial intelligence, and distributed ledger technology;
- **New business models,** which are testing traditional regulatory boundaries, with examples such as bank-like models, stored value facilities and banking as a service. More complex group structures are also emerging, blurring the demarcation lines between regulated and unregulated industries; and
- **Changing expectations,** leading regulators to focus on different areas of risk, including for example the financial risks from climate change. The advent of new products, such as crypto-assets, is also giving rise to novel risks, which will need to be carefully managed without stifling innovation.

<sup>3</sup> *Undue complexity in Australia's corporations and financial services legislation*, ARLC (ALRC News, November, 2021)

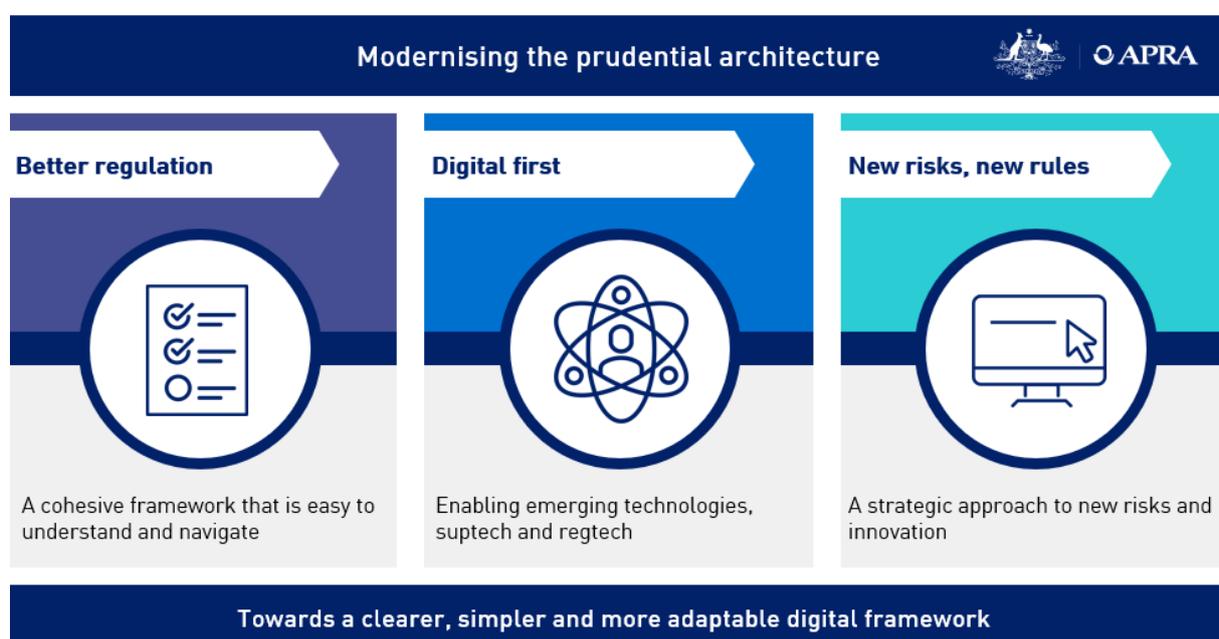
Both the financial system and the prudential framework appear to be at an inflection point. While the framework has been effective in supporting safety and stability over the past 20 years, it will need to change and adapt to continue to do so for the next 20 years and beyond.

# Chapter 2 - Objectives and approach

## Objectives for modernisation

To meet these challenges, APRA has embarked on a new strategic program to modernise the prudential architecture. The overall aim is to build a digital framework that will be easier for the industry to understand and comply with, and for APRA to supervise and maintain.

Delivering this program will involve *better regulation* and incremental changes in the design of the framework, the use of *digital* technology, and a strategic approach to *new rules for new risks*. These integrated goals are set out in the graphic below.



## A multi-year program

APRA's approach will be iterative and evolutionary; modernisation cannot be achieved through a single step, but through a series of initiatives over a multi-year period. APRA is not planning a rewrite of every standard at one time, or to develop a new framework in isolation of the existing one. To do so would be destabilising for regulated entities, and impose significant transition costs and execution risk.

Instead, APRA will progress new initiatives over time, and take the opportunity to consolidate and review standards as and when they are updated. This approach allows APRA to learn what works and what doesn't, and refine over time. It also ensures key initiatives are integrated into ongoing policy development, rather than overlaid or adjunct to it.

## What will change ...

There are three key areas of focus for APRA in modernising the prudential architecture: changes that will make the framework clearer, simpler and more adaptable:

- **Clearer:** this will involve changes in the way APRA develops and presents the prudential standards, guidance and advice. The current PDF-based approach could, for example, be replaced by new web-based portals that allow the framework to be searched, filtered and downloaded, enabling greater customisation to the needs of the users – be they Board members, senior executives, risk managers, investors, or aspiring new entrants;
- **Simpler:** while complex risks require comprehensive standards, the framework that houses them should be as simple, straightforward and accessible as possible. Undue complexity in the design of the framework can make it harder to comply, amplify cost for industry and detract from risk management. Conversely, rationalisation and simplification, such as removing duplication and inconsistencies across standards, can speed up compliance and provide a more robust platform for governance and risk management;
- **More adaptable:** it will be important to ensure standards and guidance can be updated, and keep pace with industry practice and emerging risks. In the context of ongoing change in the financial system, requirements and guidance will need to be kept up to date without a patchwork of FAQs and supporting advice that is difficult for industry to piece together.

The end product will be a clearer, simpler and more adaptable “digital handbook”, bringing together all of the prudential standards, guidance, information papers, industry letters and FAQs into a more cohesive and dynamic format. Ensuring entities understand and meet prudential requirements ultimately delivers better outcomes for the community, protecting Australians’ financial interests in good times and bad.

## Scope and boundaries

A high-level scope for the program is set out below. Although there may be restructuring of the framework, improvements in drafting and simplification of standards, APRA does not intend to move away from a principles-based philosophy or to rewrite every existing standard.

In scope	Out of scope
<ul style="list-style-type: none"><li>• The design and structure of the prudential framework and supporting advice.</li><li>• The way APRA writes, explains and updates prudential standards and PPGs.</li><li>• How APRA assesses regulation and its impact, and how the costs of compliance can potentially be reduced.</li></ul>	<ul style="list-style-type: none"><li>• Changes to primary legislation.</li><li>• The overall calibration of the prudential framework. APRA’s modernisation agenda will not involve changes that materially strengthen or relax existing prudential requirements.</li><li>• Changes to reporting forms and data collections, which are within the scope of</li></ul>

In scope	Out of scope
<ul style="list-style-type: none"> <li>The use of technology to improve the way in which entities access, navigate and consume the framework, and APRA manages it.</li> <li>APRA's approach to the regulation of new risks and the prudential perimeter.</li> </ul>	<p>another APRA strategic initiative, <i>Enabling better data-driven decisions</i>.</p> <ul style="list-style-type: none"> <li>International equivalence, given that many Australian entities operate in global markets. The framework will continue to meet international standards and best practice.</li> <li>The principles-based approach that underpins the framework, to ensure standards do not limit innovation, and allow for a diverse range of entities and practices.</li> </ul>

In addition, it is important to note that there are also constraints (or guardrails) that APRA operates within, and which APRA will continue to operate within in the years ahead. These guardrails are useful to be clear on, providing certainty to regulated entities that APRA's purpose, legislative basis and consultative approach will be maintained.

Guardrails for modernisation	
<b>APRA's purpose and objectives</b>	APRA's purpose is set out in the <i>APRA Act 1998</i> . It is also guided by its Statement of Expectations. Modernisation of the architecture will be consistent with the overarching direction provided for APRA by the Parliament and Government.
<b>Legislative basis and process</b>	Prudential standards are delegated legislative instruments, and have the force of law. As such, they are subject to due process, governance and consultation, and follow Parliamentary processes. This will not change, and nor will APRA's strict governance and approach to developing standards.
<b>Office of Best Practice requirements</b>	APRA acts in accordance with regulatory best practice and the Office of Best Practice (OBPR) requirements for all regulatory proposals. This includes measuring the impact of regulation on business and the community, and costing proposals before they are introduced.
<b>Industry consultation</b>	APRA announces its policy priorities at the beginning of each calendar year and is committed to consulting with industry and other stakeholders on all new and revised standards and guidance. APRA undertakes a program of regular policy reviews to ensure standards and guidance are fit for purpose.

# Chapter 3 - Key initiatives

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## Getting started: the foundations

Over 2022, APRA has been building the foundations for modernising the prudential architecture. APRA is conducting an internal review of the framework to identify and assess potential complexities within it, establishing an advisory panel to provide an independent, external perspective on key initiatives, and consulting with other regulators domestically and internationally who are facing very similar challenges.

Many regulators internationally are also examining ways in which they can improve their approach to policy development, including design and digitalisation. To share ideas and lessons learned, APRA is engaging with the Prudential Regulation Authority in the UK (PRA), the Office of the Superintendent of the Financial Institutions in Canada (OSFI), and the Monetary Authority of Singapore (MAS). APRA is also collaborating with the Australian Securities and Investments Commission (ASIC), to coordinate on common areas.

## Better regulation

APRA's focus through *better regulation* is on improving the design of the framework. The aim is to ensure the framework is cohesive, easy to understand, simple to update, and quick to access. This will involve consolidation and simplification in the structure and approach to standards and guidance, and rationalisation in requirements where possible.

APRA will be delivering initiatives aimed at:

- Simplifying the structure of the framework, with a clearer hierarchy across standards and more proportionate requirements for smaller entities;<sup>4</sup>
- Changing the way policy is developed and explained, to ensure requirements are clear, and guidance is targeted and outcomes-focused;<sup>5</sup> and
- Transforming how the framework can be accessed, by presenting standards, guidance and advice in a way that is more intuitive to users.

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<sup>4</sup> Early examples include the streamlined draft *Prudential Standard CPS 230 Operational Risk* (CPS 230) which rationalises five standards into one, and the alignment of the definition of Significant financial institutions (SFIs) so that entities are classified once for the whole framework rather than in individual standards.

<sup>5</sup> A recent example is the draft integrated PPGs for *Prudential Standard CPS 190 Financial Contingency Planning* (CPS 190) and *Prudential Standard CPS 900 Resolution Planning* (CPS 900). These integrated PPGs more closely link specific requirements in the standards with the associated guidance, to help enable regulated entities understand how the two connect.

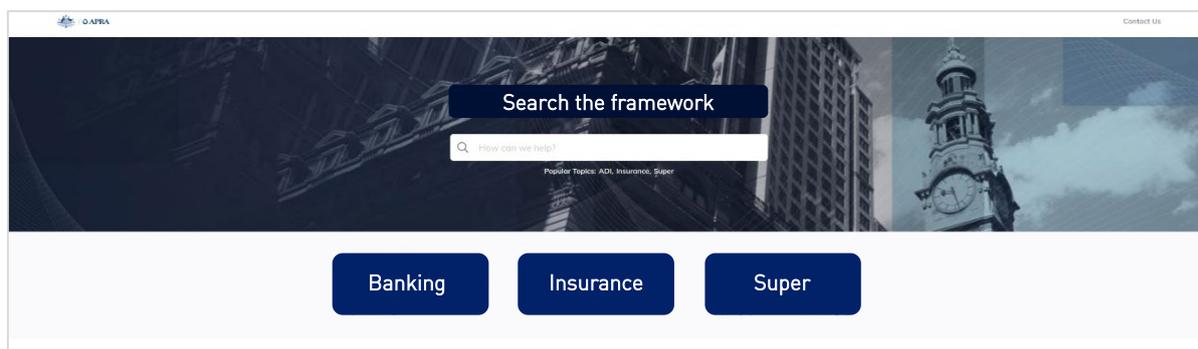
As an initial step, APRA has developed and will pilot a new Guide for ADI directors to support them in understanding their current obligations, which are spread across various standards and PPGs. The Board is ultimately accountable for ensuring that the entity it oversees meets APRA's standards, and is therefore a logical starting point for better regulation. APRA expects that, as the framework simplifies over time, this compendium of Board obligations will also evolve.

## Digital first

Internationally, many jurisdictions are starting to explore how regtech and suptech can be used to support better regulation, such as through developing machine-readable regulation to automate compliance.

In modernising the architecture, APRA intends to take a *digital first* approach: exploring how digital tools can be used to make it quicker and easier to access and navigate the framework, for both readers and coders. This will involve investigating how to draft standards in a way that facilitates regtech solutions and supports entities' governance, risk and compliance (GRC) systems.

As a first step, APRA is planning improvements to its existing website. APRA is also developing an internal prototype digital handbook, with functionality to search, navigate and analyse standards and guidance (an illustrative graphic is presented below).



## New risks, new rules

There are a range of emerging risks which the prudential framework will need to address. These include, for example, the advent of crypto-assets and digital ledger technology, the financial risks associated with climate change, and the increasingly prevalent risks associated with cyber security. In addition, there are innovative business models and changes in group structures that are creating new challenges and accentuating existing risks.

New risks require new thinking, including around APRA's role, the right balance in setting expectations, and the existing framework. Rather than simply add to the standards to cater to these new risks and new business models, APRA intends to develop a more integrated approach: considering how to enhance existing requirements where possible, as opposed to bolting on new standards. APRA also plans to adopt a disciplined approach to guidance and advice, providing clarity on expectations while maintaining cohesion in the framework. APRA

will continue to collaborate and work closely with peer agencies on risks that traverse regulatory mandates to ensure a coordinated approach.<sup>6</sup>

## Next steps

The table below summarises next steps on each of these key workstreams.

Objective	Next steps
<b>Better regulation</b>	<ul style="list-style-type: none"><li>• Publish a new Guide for ADI Board directors</li><li>• Review the design of the framework, and engage with key stakeholders</li><li>• Develop and publish plans for changes to the framework</li></ul>
<b>Digital first</b>	<ul style="list-style-type: none"><li>• Improve the existing APRA website</li><li>• Develop a prototype digital handbook</li></ul>
<b>New risks, new rules</b>	<ul style="list-style-type: none"><li>• Develop a strategic approach to new risks, new rules</li></ul>

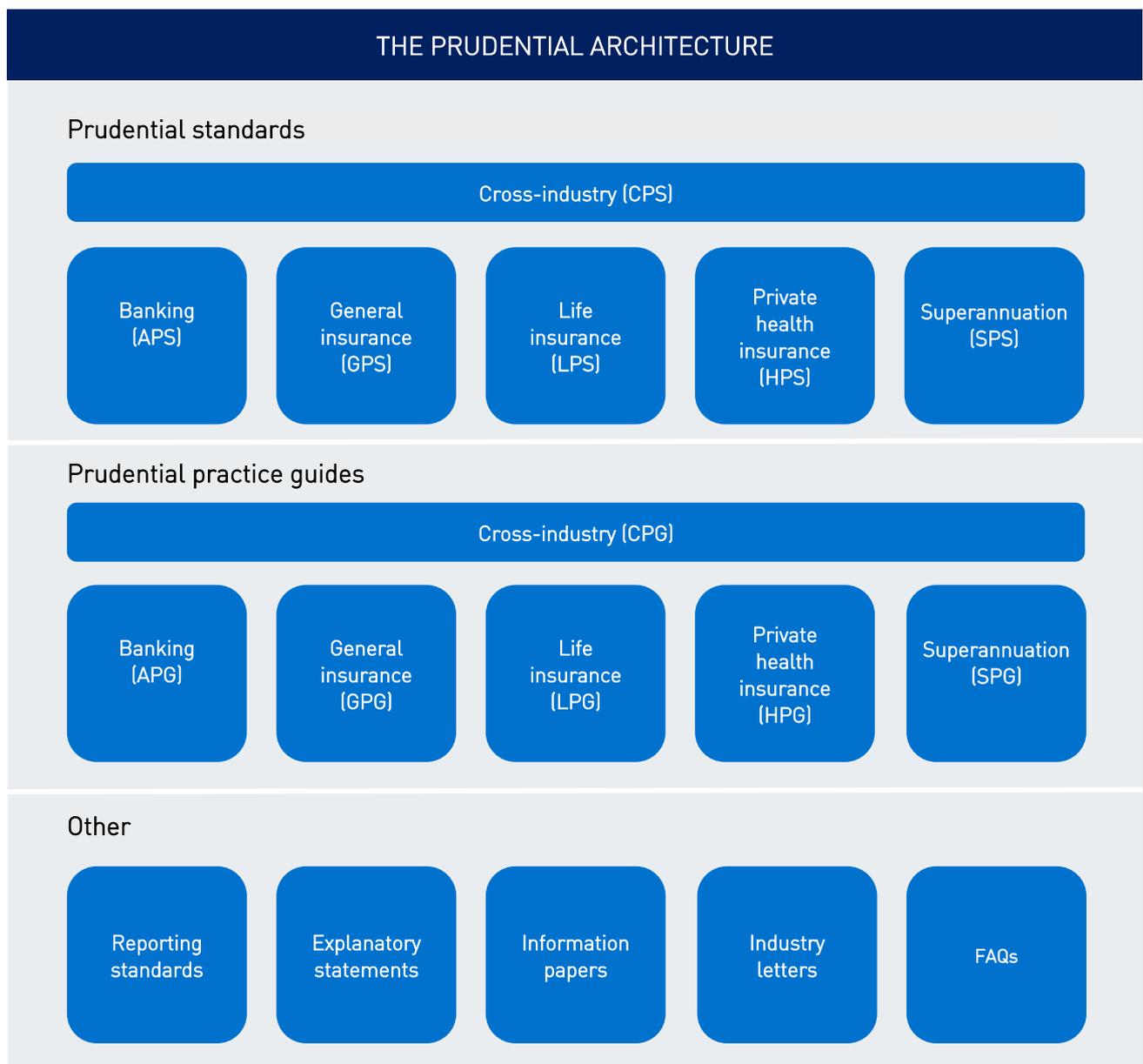
Over the next 6-12 months, APRA plans to engage with regulated entities, industry associations and other key stakeholders through targeted workshops and a broad survey, to understand any pain points with the current framework and identify opportunities for improvement. In 2023, APRA intends to publish more detailed plans for changes to the framework that will be implemented over the period ahead.

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<sup>6</sup> APRA's industry letter on crypto-assets in April 2022 was in line with this integrated approach. It set out risk management expectations referenced to existing standards where relevant and a roadmap for policy reform, and was developed in consultation with ASIC.

# Annex A – Map of the architecture

The map below outlines the current prudential architecture. It covers the prudential framework of prudential standards, PPGs, reporting standards and a range of supporting advice. In addition, there is a range of enabling legislation, as outlined on APRA’s website, which is out of scope for the program ahead.<sup>7</sup>



<sup>7</sup> See [Enabling legislation | APRA](#).



APRA