

28 April 2022

General Manager, Policy
Policy and Advice
Australian Prudential Regulation Authority

Email: **Redacted**

Dear Sir/Madam,

Consultation: Strengthening crisis preparedness

The Actuaries Institute ('the Institute') welcomes the opportunity to comment on the following documents released by APRA on 2 December 2021:

- Discussion Paper – Strengthening crisis preparedness;
- Draft Prudential Standard 190 on Financial Contingency Planning (CPS 190); and
- Draft Prudential Standard 900 on Resolution Planning (CPS 900).

The Institute is the sole professional body for actuaries in Australia. It commends APRA for undertaking and consulting on the development of requirements to strengthen crisis preparedness for financial institutions and for the degree of consultation that is being undertaken to understand the views of industry stakeholders, including the actuarial profession.

The Institute has established a Working Group to consider APRA's proposals within the above documents. The Working Group provided a broad cross-section of industry and member representation, with members working in life insurance, general insurance, private health insurance, superannuation and risk management. The Institute notes that there will not be a consensus view among its members on all aspects of this response, however this response is guided by the Institute's [public policy principles](#).

Whilst the Institute is supportive of the intention to strengthen crisis preparedness, a number of feedback points are offered below relating to the proposed prudential standards for APRA's consideration, including outlining areas where potential changes may improve alignment with APRA's stated policy intentions.

Executive summary

The Institute welcomes APRA's focus on entities managing severe scenarios that threaten their financial viability (CPS 190) and in the case of large and complex entities, pre-positioning to minimise the impact of entity failure on beneficiaries and financial system stability via resolution planning (CPS 900). The Institute believes these are useful additions to an entity's overall risk and capital management frameworks.

Institute of Actuaries of Australia

ABN 69 000 423 656

Level 2, 50 Carrington Street, Sydney NSW 2000, Australia

† +61 (0) 2 9239 6100 † +61 (0) 2 9233 3446

actuaries@actuaries.asn.au | www.actuaries.asn.au



The Institute has identified several areas of potential changes to enhance consistency between APRA's stated policy intentions and the proposed prudential standards. In summary, the Institute suggests that APRA:

- 1. Consider the requirements for superannuation funds more holistically rather than applying CPS 190 and CPS 900 narrowly to Registrable Superannuation Entity Licensees (RSEs).** The Institute believes this is critical to achieve APRA's policy objectives in superannuation. The Institute believes RSEs should be excluded from CPS 190 and CPS 900 requirements unless the standards are applied to RSEs and Registrable Superannuation Entities (RSEs) holistically. The comments in this response should be considered alongside the Institute's response to APRA's paper on [Strengthening Financial Resilience in Superannuation](#).
- 2. Provide greater clarity on how the proposed Prudential Standards are to be integrated (and interact) with APRA's current suite of risk and capital management prudential standards, particularly the Internal Capital Adequacy Assessment Process (ICAAP).** Clear definitions on the crisis continuum and articulation of where the proposed prudential standards fit within that continuum will support this understanding.
- 3. Provide more clarity on the inclusion of non-financial risks within the Financial Contingency Plan required as part of CPS 190.**
- 4. For CPS 900, recommence the consultation in the second half of 2022 and consider a staggered implementation starting with the banking industry, before moving onto insurers.** Whilst APRA has made known a resolution plan is not required until being approached by APRA, resolution planning is nonetheless a complex, lengthy and costly process.
- 5. Consider a later implementation date for Private Health Insurers (PHIs).** This is to allow adequate time for insurers to develop Contingency Plans that are appropriately integrated with their ICAAP, which is required for PHIs from 1 July 2023.

The Institute has also outlined some areas where further guidance and clarification will aid financial institutions to meet APRA's policy intentions. These areas include the definition of critical functions for scenario analysis for non-significant financial institutions (non-SFIs), the treatment of conglomerates and the interaction between the ICAAP and Financial Contingency Plan.

Key areas of feedback

This section discusses areas where potential changes may improve alignment with APRA's stated policy intentions.

Application of framework for RSEs

Whilst the Institute is supportive of enhancing the oversight of financial governance within superannuation, the Institute believes the draft CPS 190 and CPS 900 do not achieve this in an optimal manner.

CPS 190 as it applies to superannuation covers the financial resilience of the RSEL. It does not consider the financial resilience of the RSE itself, despite the greater significance of the RSE to its members. The Institute believes that an appropriate approach to financial resilience within the superannuation industry should recognise the inter-connectivity of RSEs and their RSEs, and consider the financial resilience of a superannuation fund and trustee holistically.



If CPS 190 is maintained at the RSEL level for superannuation, then for many RSEs financial contingency plans will be centered on the financial impact of potential fines and penalties to the extent these cannot be met by insurance policies. The indicators of financial stress for these RSEs will be limited to monitoring impending potential penalties that cannot be met from RSE assets or insurance.

Further, even if there is a financial stress causing the RSEL to be in financial difficulty, the remediation would likely be replacement of the RSEL, with the RSE continuing to operate. This will have limited impact on beneficiaries (whose benefits are under trust), would not disrupt the financial system, or impact on continuity of functions critical to the economy. In the event an RSEL is in financial difficulty as a consequence of fines and penalties, then the likely worst-case scenario is the inconvenience and cost of replacing the trustee. This could be managed through an operational contingency plan for RSEL replacement rather than a broader financial contingency plan. For this reason, the Institute believes that RSEs should be excluded from CPS 190 and CPS 900 requirements unless the standards are applied to RSEs and RSEs holistically.

The Institute also notes the proposed CPS 190 contemplates heightened requirements for RSEs identified as SFIs through the asset sizes of their RSEs. The contingency plans will be largely identical for a RSEL regardless of whether it is deemed a SFI under CPS 190. The only difference by RSE asset size is the number of RSE members affected, and as observed above the worst-case impact is likely not significant to the members. The Institute's view is that the contingency plan contemplated for RSEL SFIs appear disproportionate to the financial risks to members given the very limited financial stress events. Therefore, if CPS 190 is applied to RSEs, the Institute believes all RSEs should be treated as non-SFIs for the purposes of CPS 190 compliance.

If CPS 190 is extended to include RSEs as well as RSEs, then whilst there will be other potential sources of financial stress (e.g. impact financially of operational risk events), stresses will still be substantially more limited than for insurers or banks. This is because in RSEs, except defined benefit arrangements (which are carefully monitored under SPS 160), assets are largely matched with liabilities. A financial stress such as a market downturn, changing interest rates, impacts of COVID, unexpected additional expenses, etc. will impact liabilities the same as assets, not the financial strength of the RSEL and RSE. Further, members' monies will remain secure as they are in a separate trust from the RSEL.

Consequently, the Institute believes the inclusion of superannuation entities in CPS 190 will result in relatively narrow financial contingency plans of limited benefit to the financial resilience of the RSEL. Instead, the Institute suggests APRA consider the broader feedback obtained from its discussion paper *Strengthening Financial Resilience in Superannuation* dated November 2021 and uplift financial resilience requirements in a more holistic manner for superannuation.

Integration and interaction between CPS 190 and other Prudential Standards

The Institute appreciates that CPS 190 is focused on stresses that threaten the viability of the entity and recovery/exit strategies from such stresses. However, the Institute believes there could be a significant overlap between the current ICAAP and the proposed Financial Contingency Plan requirements.

Many of the financial contingency planning aspects as defined in CPS 190 should largely already be covered in the ICAAP, albeit with a focus on entities being in a viable state. These include trigger frameworks, stress testing and monitoring.



The consultation documents do not make reference to the ICAAP and the Institute believes it is not always clear to what extent a requirement in CPS 190 differs to one for the ICAAP. For example, the Institute expects that the trigger framework in CPS 190 should be aligned to the ICAAP and at most an extension of it, and that monitoring should also be aligned and complementary. There are also significant advantages to considering a stress testing and trigger framework across the full crisis continuum.

The Institute believes the industry would benefit from guidance on whether there are different expectations for overlapping requirements between the ICAAP and CPS 190.

Based on the Institute's understanding of the intention of CPS 190, an alternative solution that may be more proportionate and may limit additional regulatory related costs imposed by the requirements of CPS 190, is that entities are given the option to implement the requirements of CPS 190 as part of the ICAAP. For example, additional section(s) could be included as part of the ICAAP Summary Statement and ICAAP Report to:

- identify stresses that may threaten the viability of the entity;
- define the point of non-viability;
- identify recovery/exit strategies from such stresses;
- outline the efficacy of the identified recovery/exit strategies given the particular stress that resulted in the company being in that state; and
- include other information that is pertinent and consistent with APRA guidance and requirements.

This, or a similar, approach may reduce significant duplication as outlined above and would also be simpler for Management and Boards to understand the linkages between the ICAAP and CPS 190 requirements.

The Institute understands APRA is open to companies using pragmatic approaches such as the one outlined above. However, it was not clear in the consultation material and the Institute believes the industry would benefit from additional guidance on whether a combined document approach can be used to cover all requirements for ICAAP and CPS 190 holistically.

Similarly, the Institute believes the industry would benefit from additional guidance on how Financial Contingency Planning is intended to link with the Risk Management Framework, Business Continuity Planning and other related prudential standards. The Institute observed only a minor reference to other prudential standards in paragraph 15 of CPS 190.

In addition, the Institute believes that guidance would be useful as to the operation of the adjustments APRA may make to the prudential requirements under paragraphs 23 and 40 of CPS 190, versus what is done with respect to supervisory adjustments under LPS110, GPS 110 and HPS110. For example, it would be useful to know whether the adjustment under CPS 190 is non-disclosable as is the case under the various 110 prudential standards.

The Institute understands through discussion with APRA that APRA has considered the new standards in the context of a supervisory crisis continuum ranging from stable conditions through to recovery and resolution. The Institute suggests APRA sets out this crisis continuum in the Prudential Standards or within the supporting Practice Guides. As part of setting out the crisis continuum, the Institute believes it will be useful for APRA to outline where the existing and proposed Prudential Standards fit on the continuum, as well as the linkages between different requirements and documents.



Inclusion of non-financial risks

Through a discussion with APRA, the Institute understands that APRA's intention is for entities to consider financial and non-financial risks that could result in adverse financial outcomes as part of their Financial Contingency Plans. Further, the Institute understands that while non-financial risks are to be considered, the recovery plans under CPS 190 are to be focused on improving the entities financial position rather than its operations or business continuity, which are intended to be covered under CPS 232 Business Continuity Management.

The Institute believes APRA's intention in respect of non-financial risks could be made clearer either within CPS 190 or the related Practice Guide. In addition, the Institute notes the term 'Financial Contingency Plan' could be inferred to suggest that non-financial risks are not covered under these plans.

Implementation timeline

CPS 900

Whilst APRA has made known a resolution plan is not required until being approached by APRA, resolution planning is a complex, lengthy and costly process. The Institute therefore suggests:

1. that APRA recommence the consultation in the second half of 2022 by either reissuing an expanded or more detailed CPS 900 or consult on the CPS 900 and related guidance concurrently; and
2. that APRA consider a staggered implementation starting with the banking industry, before moving onto insurers.

Private Health Insurance

As part of APRA's review of the Private Health Insurance capital framework, insurers are required to develop an ICAAP by 1 July 2023. Given the potential significant overlap between Financial Contingency Plan with the ICAAP, the proposed implementation of 1 January 2024 may not allow adequate time for insurers to develop Contingency Plans that are appropriately integrated with their ICAAP. The Institute believes that a later implementation date for CPS 190 will achieve a better outcome for PHIs.

Areas for further guidance

In addition to the items noted above, the Institute is of the view that the following areas could benefit from further guidance from APRA.

Scenario analysis for non-SFIs

The draft CPS 190 requires the Financial Contingency Plan for SFIs to include scenario analysis to assess the effectiveness of the trigger framework and the recovery (and exit) actions and to assist the entity in forming a view on recovery capacity. In comparison, non-SFIs are not required to perform scenario analysis or form a view on recovery capacity as part of their Financial Contingency Plans.

The Institute is of the view that having scenario analysis capabilities and forming a view on recovery capacity is equally important for non-SFIs. The Institute understands that most non-SFIs in the life and general insurance industries have developed these capabilities to support their annual ICAAP reporting, as well as general risk management.



Through a discussion with APRA, the Institute understands that the requirements for non-SFIs set out in CPS 190 represent a minimum standard and APRA would expect non-SFIs to perform scenario analysis if this is needed to demonstrate that the actions outlined in the Financial Contingency Plan are credible. The usage of scenario analysis for non-SFIs in the Financial Contingency Plan could be clarified within CPS 190 or the related Practice Guide. The Institute notes, however, by applying the principles of proportionality it may be appropriate for non-SFIs to perform fewer, simpler scenarios within their Financial Contingency Plans.

In addition, the Institute notes APRA's previous guidance on recovery planning issued to life and general insurance entities required entities to include three types of scenarios within the Recovery Plan (i.e. an idiosyncratic scenario, a systemic scenario and a combination scenario). The Institute believes it would be useful for APRA to clarify any expectations on the types of scenarios to be considered in the Financial Contingency Plan as part of the CPS 190 Practice Guide.

Application of CPS 190 and CPS 900 for conglomerates

Guidance on how the requirements of the proposed standards apply to conglomerates would be useful, noting the interaction between different entities. The Institute suggests APRA considers clarifying whether each entity in the Group needs a separate Financial Contingency or Resolution Plan or whether Group level plans (with sufficient detail on each subsidiary) would meet APRA's expectations.

Definition of critical functions under CPS 900

The proposed CPS 900 states that it will apply to non-SFIs determined by APRA to provide functions that are critical to the economy. Whilst there is some discussion of critical functions in the Discussion Paper, additional guidance on the type of functions likely to be designated as critical functions would be useful. For example, the Institute understands through a discussion with APRA (and consistent with the Discussion Paper) some of the criteria that may be considered in determining whether a company operates a critical function are:

- Contagion risk: consideration of whether failure of the entity could materially impact the stability of the financial system; and
- Ability to replace the entity: if the entity operates a line of business that is not easily substitutable or may require government intervention.

Consultation questions

The Institute's views on some of the consultation questions raised by APRA are covered in Appendix A. Overall, the Institute is broadly supportive of the items raised in APRA's questions.

Further discussion

The Institute would be pleased to discuss the contents of the submission further with APRA.

If you would like to do so, please contact Chief Executive Officer of the Actuaries Institute on **Redacted**,

Yours sincerely,

Annette King
President



Appendix A – Answers to Consultation Questions

The Institute's answers to the consultation questions are as follows.

a) Framework Design

Is the approach to proportionality well-balanced and appropriate?

The Institute views that larger and more complex companies should be subject to higher requirements than smaller companies, so that the requirements are fit for purpose. From this perspective, the approach to proportionality is appropriate.

Further, the Institute views that SFIs or entities that APRA considers provide critical functions to the economy provides a reasonable basis of application of CPS 900.

However, there are aspects of CPS 190 which could be extended to non-SFIs, albeit at a lower level of complexity e.g. scenario analysis as noted above.

A more proportionate approach for the implementation of CPS 190 is that entities are given the option to implement the requirements of CPS 190 as part of the ICAAP. In particular, this would be a more proportionate approach for smaller and less complex entities.

In addition, the concept of proportionality is less relevant for RSEs (if this structure is maintained) as noted above.

b) Financial Contingency Planning (CPS 190)

Should APRA indicate preferred contingency options?

The Institute does not believe that CPS 190 should cover preferred contingency options as this will vary by company, with effectiveness also varying based on the scenario under consideration.

Further, the Institute notes the Discussion Paper states that an assessment of the effectiveness of contingency plans is required: *'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.'*

Further guidance on how this assessment is conducted may be helpful to foster a consistent standard across the industry, as opposed to guidance on options themselves.

Are the proposed contents of the financial contingency plan comprehensive?

As noted above, the Institute believes that the proposals for the financial contingency plan should be clarified to explain that non-financial risks are included as part of these plans. Changing the name from 'Financial Contingency Plan' to 'Contingency Plan' for example may assist in this regard.

It would be useful to issue prudential guidance on CPS 190 to capture elements which the Institute believes APRA covered in its letters on 'Recovery Plans for insurers' that have been sent to a number of insurers.

**Are the frequency and type of reviews appropriate?**

The Institute believes that an annual review with a more comprehensive review every three years is appropriate for SFIs. It is also appropriate that a less frequent review is adopted for non-SFIs (once every three years).

c) Resolution Planning (CPS 900)

Is the scope of entities subject to CPS 900 appropriate?

The Institute believes that CPS 900 should apply to entities whose failure can have an impact on financial stability. From that perspective, it is appropriate that it applies to SFIs and non-SFIs that provide critical functions as defined under CPS 900. However, given the nature of superannuation funds, the Institute believes that it should not apply to RSEs as noted above.

Is the frequency and type of review appropriate?

The frequency and type of reviews should be driven by the extent of change in the organisation and the external environment. On balance, the Institute believes a review every three years or as required by APRA is appropriate. The content of the review covered in paragraph 32 is also appropriate.