Australian Banking Association

6 December 2022

[redacted]
General Manager, Policy
Australian Prudential Regulation Authority

By email: [redacted]

Dear [redacted],

Strengthening crisis preparedness

The Australian Banking Association (**ABA**) welcomes the release, on 6 September 2022, of the *draft Prudential Practice Guide CPG 190 Financial Contingency Planning* (**CPG 190**) and *draft Prudential Practice Guide CPG 900 Resolution Planning* (**CPG 900**).

Our position

The banking industry is supportive of the Australian Prudential Regulation Authority's (**APRA's**) ongoing crisis preparedness reforms which are aimed at ensuring both entities and APRA are prepared to deal with threats to institutions' viability. This complements the rigorous prudential, legal and regulatory regimes already in place, and banks' strong management and unquestionably strong capital positions.

The APRA-ABA roundtable, on 12 October 2022, further assisted industry's understanding of APRA's intent with the draft standards/guides. Industry appreciates APRA's clarification that institutions are not expected to undertake preparatory work to meet the Prudential Standards CPS 900 Resolution Planning (**CPS 900**) obligations ahead of specific engagement by APRA to commence resolution planning. However, uncertainty remains regarding which institutions are likely to be captured by the requirements under CPS 900 and the additional guidance under CPG 900. Further guidance on how APRA is planning to assess critical functions and the scope of institutions captured by CPS 900 would assist industry, noting that any disclosures on the scope of entities captured by CPS 900 should be carefully managed with impacted entities.

The ABA again notes that the foreign regimes, to which APRA has referred, including in Hong Kong, Singapore, the United Kingdom and the United States, provide considerably more detail on their resolution regimes. This submission highlights specific areas where, in the ABA's view, greater details is appropriate and more likely to lead to consistent implementation with reduced regulatory burden.

The ABA encourages APRA to consider the feedback previously provided on the *draft Prudential Standard CPS 190 Financial Contingency Planning* **(CPS 190)** and draft CPS 900. The feedback provided in this letter builds on that previously provided. Specifically, the ABA provides further feedback for APRA's consideration in Appendix A, regarding CPG 190, and Appendix B, regarding CPG 900.

Finally, the ABA notes the release of the finalised CPS 190 on 1 December 2022. Given the timing of that release, this submission does not seek to make comment on the final CPS 190. Further, any reference to CPS 190 in the submission relates to the draft CPS 190 released on 2 December 2021.

If you require further information or would like to discuss any of the content of this letter, please do not hesitate to contact me on [redacted] or [redacted].

Australian Banking Association

Regards,

[redacted]

[redacted]

Policy Director
Australian Banking Association

About the ABA

The Australian Banking Association advocates for a strong, competitive and innovative banking industry that delivers excellent and equitable outcomes for customers. We promote and encourage policies that improve banking services for all Australians, through advocacy, research, policy expertise and thought leadership.

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Appendix A: Feedback on CPG 190

1. Role of the Board

Review and testing

The draft CPG 190, paragraph 8 states: *"A prudent Board would use simulation exercises to test the effectiveness of the plan in meeting their needs"*. It is unclear to industry if it is APRA's expectation that the Board should be involved in testing of the Plan or if Management should be involved in testing, after which the results are reported to the Board. Additionally, industry seeks clarification, optimally in CPG 190, that the Board is not required to undertake simulation exercises on a yearly basis, rather, only as part of the triennial review.

Industry would benefit from confirmation in the commentary in draft CPG 190, relating paragraphs 17 and 18 of CPS 190, that in the ordinary course the Board's obligations relating to oversight of contingency planning, including holding management to account for keeping the plan current and effective, would be met through management and Board establishing a process for engaging on annual contingency plan updates that includes communicating outcomes of effectiveness testing, and facilitates Board review and feedback on the annual plan update, as part of the Board's annual approval. In addition, clarification on the difference between the role of the Board of a 'head of a group' as compared to an APRA-regulated entity which is not a 'head of a group' would assist industry. Specifically in relation to how paragraph 6 of CPS 190 interacts with paragraphs 17 and 18 of the same.

Assessing recovery capability

The proposed introduction in paragraph 21 of CPS 190 of an express requirement for the Board of an entity to form a view on the sufficiency of recovery capacity to restore financial resilience would benefit from guidance from APRA. In particular, APRA's view of possible markers of sufficiency and/or financial resilience that Boards might apply as a bases for such an assessment would assist. These concepts are subjective and undefined in the standard and the guidance – while draft CPG 190 helpfully addresses the steps that might be taken in the event a view of insufficiency is formed, it would be informative for APRA to also provide examples of criteria or markers that might be used in the Board's assessment when forming its view. For example, a Board could define success measures for recovery capacity as ensuring a bank returns to being financially resilient (in line with its internal trigger frameworks) rather than immediately meeting business-as-usual operating targets following recovery actions.

2. Developing the plan

Recovery options

APRA's guidance suggests that entities should include a list of actions that have been considered but not included. Industry assumes that an end-to-end assessment of these actions is not required until the option is considered in future to be viable or suitable for implementation. The level of assessment and evidence required for an exit action to be demonstrated as credible is also not clear. APRA's guidance on prior engagement with potential transfer partners as an example presents challenges as to the appropriateness and willingness of a potential transfer partner, who would likely also be a competitor, to engage in these discussions sufficiently to prove valuable.

Where APRA identifies a need for the inclusion of additional recovery options, or alternative modifications to an institution's recovery plan, industry requests that sufficient time (that is minimum notice periods) be provided to allow entities to modify financial contingency plans before APRA considers adjusting capital and liquidity requirements.

Credible exit actions

Industry appreciates that the draft CPG 190 has provided some ideas as to APRA's thoughts on credible exit actions. However, banks would appreciate if APRA could further clarify the level of detail

that is expected for these actions. As this is a new requirement, outside of what has been previously communicated as required under Recovery Planning, industry would like to better understand what the expectation is and how this is expected to align with the requirements under CPS 900, especially for significant financial institutions where exit actions for core businesses are limited.

It is industry's understanding that recovery actions are intended to deliver recovery capacity benefits, whereas exit actions are intended to enable orderly and solvent wind-downs rather than delivering a benefit to the bank. Can APRA confirm what metrics an entity would use to assess whether exit actions enable an 'orderly and solvent' wind-down? Secondly, clarification is required as to APRA's expectation for capital and liquidity (ratios/levels) while exit actions are executed, including but not limited to trading and derivatives portfolios.

The ABA notes that other regulators, such as the Single Resolution Board, have provided significantly more detailed information regarding solvent wind down, including on topics such as trading and derivatives portfolios. The ABA encourages APRA to consider developing and publishing a similar level of details regarding its thinking in the Australian context.

Some exit options are unlikely to be viable without intrusive and costly to implement (and unwind) preparatory work. APRA's expectations regarding good practice in relation to taking 'reasonable preparatory steps' for execution is unclear. Given the alignment with CPS 900, the ABA recommends that institutions not be expected to undertake burdensome or difficult to unwind preparatory steps regarding CPS 190 until there is clarity on how such steps would (or would not) assist with any resolution planning options consider appropriate by APRA for the relevant institution. Additionally, industry has concerns regarding the expectation to hold 'prior engagement with potential transfer partners' and the signalling that this may provide.

Given entities are highly likely to have executed recovery actions before entering an 'exit phase', it seems reasonable to assume a reduced size/construct of the book that is being planned for in the exit phase. Can APRA confirm the appropriateness of this approach?

Financial contingency plan

The draft CPS 190, paragraph 13 states: "*An APRA-regulated entity must develop and maintain a financial contingency plan (contingency plan) that sets out how it would respond to a stress that threatens its viability*". Further clarification is provided in CPG 190.

It, however, remains unclear to industry if APRA is expecting that existing Recovery Plans are expanded to specifically include analysis on exit actions and be reframed as a Financial Contingency Plan. Alternatively, would it be sufficient for the Recovery Plan to incorporate by reference (for example, in an appendix to the Recovery Plan) an assessment of plausible exit actions provided in a separate plan?

Scenario analysis

It is unclear to industry how detailed should the scenarios be in terms of modelling when compared, for example, to an enterprise wide stress test. Is there an expectation that the scenarios be reviewed and updated frequently, for example annually? Can the Recovery Planning scenario analysis be merged with ICAAP scenario analysis as long as they meet the requirements of assessing the trigger framework and recovery actions?

Recovery capacity

CPS 190 defines recovery capacity as "*the amount of capital and liquidity that can be rebuilt during or following stress*". Conversely, CPG 190 defines it as a summation of only the options, "*combined impact of all recovery actions in the plan*", rather than capital rebuilt during the stress scenario which could include some organic capital generation. Industry seeks clarification on whether recovery capacity can include organic capital generation through during the stress period.

APRA's APS 210 Post Implementation Review acknowledges industry concerns around "how the Liquidity Coverage Ratio (**LCR**) operates during stress". The Bank of England shares a similar view on

the LCR in its 14 July 2022 speech on buffers. Scenarios that are severe enough to trigger recovery or resolution actions would conceivably result in significantly depleted LCR levels, which provides limited direction for management actions. Would it be acceptable for banks to use different measures other than the LCR (such as its net liquidity position) to assess recovery capacity?

3. Preparatory steps

Industry would benefit from CPG 190 in '*Capabilities, monitoring and execution*' on page 16 providing guidance specifically relating to paragraph 26 of the draft CPS 190, such as examples of reasonable preparatory steps and commentary to assist entities to navigate striking a balance between robust and effective implementation planning and unnecessary and potentially wasteful execution of preparatory steps. Specifically, it would be useful for APRA to confirm if the guidance on page 10 of CPG 190 relating to the use of early trigger warnings is also an appropriate way to approach the timing at which identified preparatory steps are mobilised, to support the timely and effective implementation of the contingency plan.

4. APRA 2017 guidance letter

The requirements and guidance in CPS 190 and CPG 190 contain clauses that are different to APRA's 2017 letter on recovery planning. Should it be assumed that the guidance provided by APRA in its 2017 letter will be superseded by CPS/G 190 when they come into effect?

APRA's 2017 Letter providing guidance on Recovery Planning suggests it is "advisable to conduct regular (for example, at least annual) dry-runs and training exercises focusing on internal escalation processes, functioning of crisis management teams and determination of communication plans". This annual testing is not referenced in CPS/G 190. Can APRA confirm this now covered by CPS 232?

5. Foreign Owned ADIs

The ABA also notes that foreign banking groups can in principle draw on resources from the entire group to help local operations that have suffered a shock. As such, the ability of an Australian branch to withstand shocks depends ultimately on the solvency and resilience of the group as a whole.

The ABA agrees with the Australian Financial Market Association's assessment that the financial contingency planning requirements for branches are unlikely to be meaningful, given branches do not have stand-alone capital requirements and liquidity is typically managed centrally at a parent level. The ABA also agrees that it is also inconsistent with the approach taken in other international jurisdictions (for example, the UK, US and the EU) where branches are not required to provide stand-alone recovery plans.

Given that foreign ADIs in Australia predominantly have home authorities with equivalent resolution regimes and requirements for crisis preparedness planning, relevant recovery and resolution planning information can be provided to APRA through presentation of such home authority report /plans, such as the US law Title I plans submitted to the Federal Reserve, the Federal Deposit Insurance Corporation and the Federal Systemic Oversight Council.

6. Testing and review

Industry understands that testing of the plan through 'live' simulation is expected to occur on a 3 yearly basis as part of the comprehensive review. Can APRA confirm this?

With regards to paragraphs 29 and 30 of CPS 190, industry seeks clarification on the definition of "operationally independent, appropriately experienced and competent persons". In particular, on whether this definition could include internal functions (internal audit, risk management etc.) as well as external parties. In addition, further guidance on would be helpful on whether an operationally independent party is expected to run the testing, or if it is able to provide oversight and review of the testing. In particular, industry expects it to be practically challenging for an external party to run this form of testing.

7. Compliance cost estimates

Industry estimates that the annual cost of ongoing compliance with CPS 190 to be $7-9 million.

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Appendix B: Feedback on CPG 900

1. Preparatory work

Industry notes APRA's confirmation that institutions are not expected to undertake preparatory work, including setting up management/oversight structures, ahead of APRA approaching an entity to commence resolution planning, and that sufficient time will be provided for banks to increase internal capabilities ahead of being required to conduct any detailed resolution work. Given the lack of domestic expertise in resolution planning, it may take entities longer to acquire and imbed these resources, compared to other regulatory change initiatives. Industry asks that APRA be mindful of these challenges when setting timelines for its resolution work with entities.

2. Overseas operations

CPG 900 states "Where an entity has overseas operations, CPS 900 requires the entity to support the development and maintenance of cross-border components of a resolution plan. APRA may establish a working group to facilitate the consideration of cross-border resolution issues with overseas regulators." Affected institutions would appreciate further insight into how and when such working groups are likely to be formed and the involvement expected of institutions. Additionally, affected institutions would also benefit from understanding APRA's role in facilitating cross-border resolution issues, including any actions they may take with overseas regulators in an actual resolution event.

3. Resolution plan scope

Clarification is required regarding the scope of resolution plans in terms of regulatory consolidation. For example, does APRA expect them to cover the consolidated group (at Level 3) or are plans to be limited to Level 2 entities?

4. Role of the Board

In the ABA's submission to APRA on CPS 190 and CPS 900, the ABA raised concerns with the Board of an entity having ultimate responsibility for ensuring resolvability in circumstances where resolution occurs under an APRA owned plan and given the myriad of internal and external variables that impact resolvability, many of which the Board may have little or no control over. In addition, responsibility for ensuring a particular outcome (that is 'resolvability') is at odds with other regulatory and legislative expressions of duties and obligations of directors which are centred on responsibility for ensuring sufficiency of processes, effectiveness of oversight and decision making, in the steps taken towards achievement of a particular outcome. The ABA re-states the view that it would be more aligned with the established role of a Board, and with the formulation of the role of the Board in paragraph 17 of draft CPS 190, to express the obligation in paragraph 17 of CPS 900 as responsibility for effective oversight of resolution planning and preparedness to support enaction by APRA of the resolution plan.

Industry also seeks clarification on whether the oversight and approval of a resolvability assessment and pre-positioning plan can be delegated by the Board to a relevant Board Committee.

Furthermore, industry seeks APRA's clarification on the role of the Board in approving the resolvability assessment. For example, is Board approval required in relation to the initial resolvability assessment institutions are required to conduct, as well as the triennial review (as per paragraphs 31 and 32 of CPS 900)?

Industry also seeks clarification on the difference between the role of the Board of a 'head of a group' as compared to an APRA-regulated entity which is not a 'head of a group'. Specifically in relation to how paragraph 5 of CPS 900 interacts with paragraphs 17 and 18 of the same.

5. Systemic assumptions

A key assumption or factor in assessing resolvability would be availability of funding and capital in the system. In undertaking a resolvability assessment, would banks be able to assume that there is no system-wide stress to enable transfers or winding down of businesses?

6. Dependence on regulatory actions

Where certain resolution options are dependent on regulatory action, will APRA provide standard timelines for entities to consider in its resolvability assessment for paragraph 20(b) of CPS 900?

The ABA encourages APRA to continue its work with relevant agencies to reduce potential legal and regulatory barriers to (recovery and) resolution options.

7. Independent review

With regards to paragraph 31 of CPS 900, the ABA submits that:

1) Further explanation be provided as to who is considered "operationally independent, appropriately experienced and competent persons". Industry seeks clarification on whether this definition could include internal functions (internal audit, risk management etc.) as well as external parties.
2) CPG 900 is an appropriate place for APRA to provide further guidance on the term "conduct" with respect to the resolvability assessment review. That is, to clarify whether the term relates to an operationally independent party running the testing, or alternatively, providing oversight and review of the testing (in line with other prudential standards, for example CPS 220 and APS 110). In particular, industry expects it to be practically challenging for an external party to run this form of review.

8. Sufficient capital and liquidity and the use of buffers

It is unclear to industry what APRA considers maintaining “sufficient capital to absorb losses and liquidity to continue meeting financial obligations” for resolution purposes. For example, for capital, is this maintaining a capital ratio above PCR and for liquidity, surplus liquids.

The ABA notes discussion in the global regulatory community regarding the use of buffers (in crises), in particular on market expectations/implications of the use of buffers and the role of regulators in response to those expectations. Industry would welcome further dialogue on the issue of buffer use and market expectations.

Loss absorbing capacity

It would be helpful to industry if APRA could clarify what prior engagement and/or notice it would provide to entities if it was considering imposing additional capital requirements on an entity where APRA is of the view that material barriers to resolution have not been addressed or where capabilities to support a resolution plan are insufficient. In particular, it would be useful to understand if APRA envisages a period of rectification to be available to entities to address concerns and avoid additional capital requirements.