INCOMING GOVERNMENT BRIEF

APRA Overview

May 2019

Contents

1 Executive summary

The Australian Prudential Regulation Authority (APRA) is the prudential regulator of the financial services industry. It oversees banks, credit unions, building societies, general insurers and reinsurance companies, life insurers, private health insurers, friendly societies, and most members of the superannuation industry. APRA currently supervises institutions holding $6 trillion in assets for Australian depositors, policyholders and superannuation fund members.

APRA's mandate is to protect the Australian community by establishing and enforcing prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by the institutions we supervise are met within a stable, efficient and competitive financial system. In this way, APRA aims to assure:

- bank depositors that their money is safe;
- insurance policyholders that insurers have the resources to pay valid claims;
- superannuation fund members that their savings will be appropriately managed; and
- the Australian community that the financial system is stable.

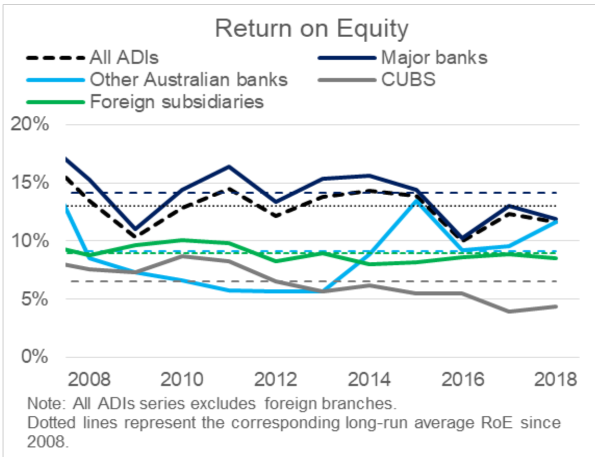
1.1 State of the APRA-regulated industries

Key insights on the current state of the five APRA-regulated industries are provided below.

1.1.1 Authorised deposit-taking institutions (ADI)

The ADI sector is generally financially strong. It is well capitalised, has adequate liquidity and funding and is profitable. Section 47C [redacted]

Section 47C [redacted]



Section 47C [redacted] APRA is also consulting on the removal of the serviceability floor.

Section 47C [redacted]

In recent self-assessments against the findings of APRA's Prudential Inquiry into the Commonwealth Bank of Australia (CBA Prudential Inquiry), it is clear that many of the non-financial risks identified within CBA are not unique to that institution and much work remains to be done across the financial sector to lift standards of governance.

1.1.2 General insurance

The industry is well capitalised and reporting strong profitability despite the increased frequency and severity of natural catastrophe events. Insurers' reinsurance arrangements played a key role in limiting the financial impact of the recent Sydney hail storm (December 2018) and Townsville flooding (February 2019) events. Affordability of cover is an emerging issue, particularly in northern Australia, but is likely to become more widespread over time given the trend in natural catastrophe events.

In recent years, the number of shareholder class actions have increased sharply. This continued in 2018 and early 2019 with actions being filed as a result of the Royal Commission. This trend has increased the number of directors and officers (D&O) claims, which is increasing the cost and limiting the availability of D&O insurance.

Section 47C [redacted]

As a result of the Royal Commission, the industry is facing change on a number of fronts including a shift to a deferred sales model for add-on insurance, a ban on cold calling, and changes to the level of intervention by ASIC in claims handling Section 47E(d) [redacted]

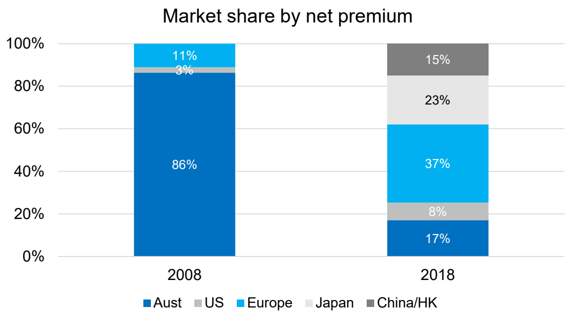
1.1.3 Life insurance and friendly societies

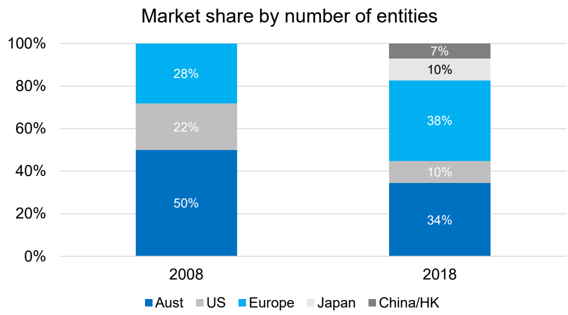
Section 47C [redacted]

APRA has been concerned about disability income insurance (DII), also known as income protection insurance sold to individuals (rather than provided through superannuation in the form of group insurance) due to its ongoing poor performance. The industry has collectively lost $2.5 billion through this product offering over the past five years, with no signs of improvement. APRA has recently published a letter to industry outlining its concerns and issuing a series of requirements for life insurers to address those concerns.

The industry will move from 86 per cent Australian-owned 10 years ago to just 17 per cent shortly. In February 2019, TAL Dai-ichi Life Australia Pty Limited announced the completion of its acquisition of Suncorp's Australian life insurance business. Section 38 [redacted]

Section 38 [redacted]





APRA views this ownership trend as positive for the industry. These large international life insurers bring specialist expertise and knowledge of the insurance cycle, as well as strong capital positions. They tend to take a longer-term view on investment, whereas historically there has been underinvestment by domestic players driven in part by their focus on the profit reporting cycle.

1.1.4 Superannuation

The superannuation sector has grown 9.2 per cent annually over the last 10 years, and now nearly equals the size of the banking sector at $2.7 trillion.

The Royal Commission, Productivity Commission and APRA's supervisory activities have highlighted examples of significant governance failings across the industry. For example, conflicts of interest leading to poor consumer outcomes were a prominent feature of the Royal Commission's case studies.

Section 47C [redacted]

Section 47C [redacted]

Section 47C [redacted]

Section 47E(d) [redacted]

Section 47E(d) [redacted]

1.1.5 Private health insurance (PHI)

The industry is dominated by five large players (Medibank, Bupa, HCF, NIB and HBF) that represent 80 per cent of total policy market share (6.6 million policies). The industry is well capitalised and continues to report profitability.

Section 47C [redacted]

Section 47C [redacted]

Section 47C [redacted]

1.2 APRA's strategic and policy priorities

In setting its strategic and policy priorities, APRA considers both internal and external drivers including the findings of relevant inquiries and reviews, and legislative reforms. In recent times, these have included:

- the Royal Commission – resulting in 10 direct recommendations, 12 case referrals and a range of other recommendations that will affect APRA ;
- the CBA Prudential Inquiry – articulating expectations in relation to governance, culture and accountability with implications for the broader industry;
- the Productivity Commission's *Review of Efficiency and Competitiveness of the Australian Superannuation System*;
- legislative reforms covering the Banking Executive Accountability Regime (BEAR) and crisis management powers;
- the IMF's Financial Sector Assessment Program review of the Australian regulatory system;
- APRA's Enforcement Strategy Review – resulting in the adoption of a more forceful enforcement approach; and
- the APRA Capability Review – due to report to the Government by end June 2019.

In response to the Royal Commission and other recent legislative reforms, APRA has some significant initiatives underway. APRA has publicly committed to implementing quickly the 10 recommendations of the Royal Commission that require APRA's direct attention. This year APRA should also be in a position to determine whether court (or other enforcement) action is warranted for most of the 12 cases referred by the Royal Commission.

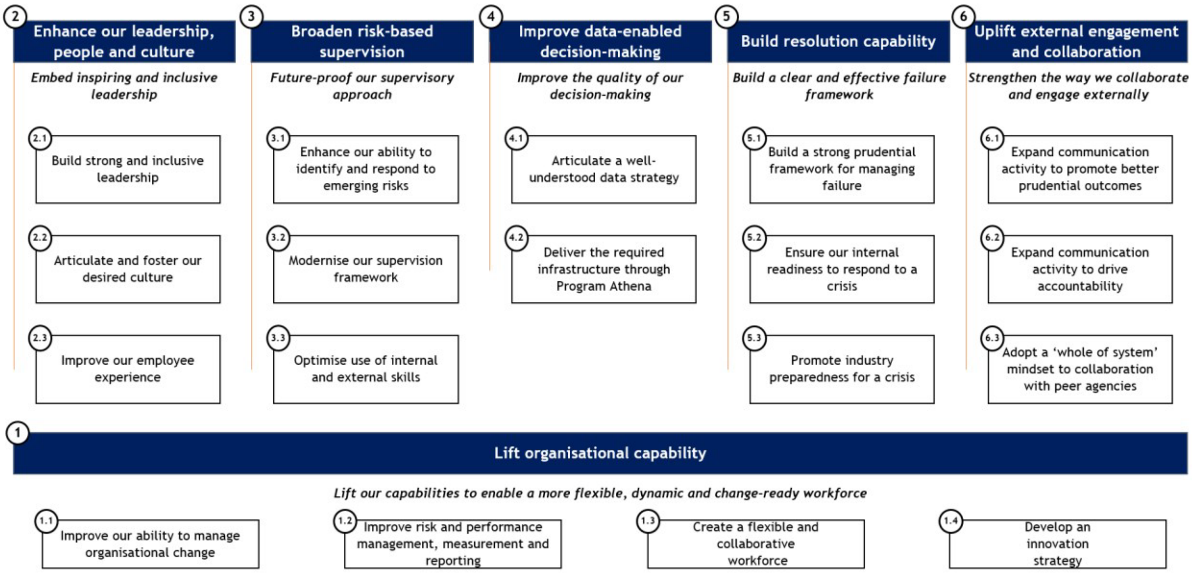
1.2.1 Strategic priorities

APRA's 2018-2022 Strategic Plan was the product of a robust process that involved:

- looking externally (what is happening in the environment);
- looking internally (what is happening within APRA);
- soliciting external input (particularly from Government and industry)

Insights from the strategy development process led to a set of strategic choices for APRA, which will change the way APRA operates in the future. These shifts will, however, require APRA to develop new or enhanced capabilities. The work to achieve this has been set out under six broad strategic initiatives, each with an underlying program of work over the four year period of the plan. The six strategic initiatives are summarised in the diagram below.

Various internal and external drivers (such as the findings of the Capability Review) will reshape aspects of these strategic initiatives. However, given the Strategic Plan sets out a four year program of work, APRA expects many of these to continue to form the basis of APRA's strategic priorities.



1.2.2 Policy priorities

APRA undertakes a program of regular policy review to ensure that the regulatory framework on which its prudential supervision is based remains fit for purpose.

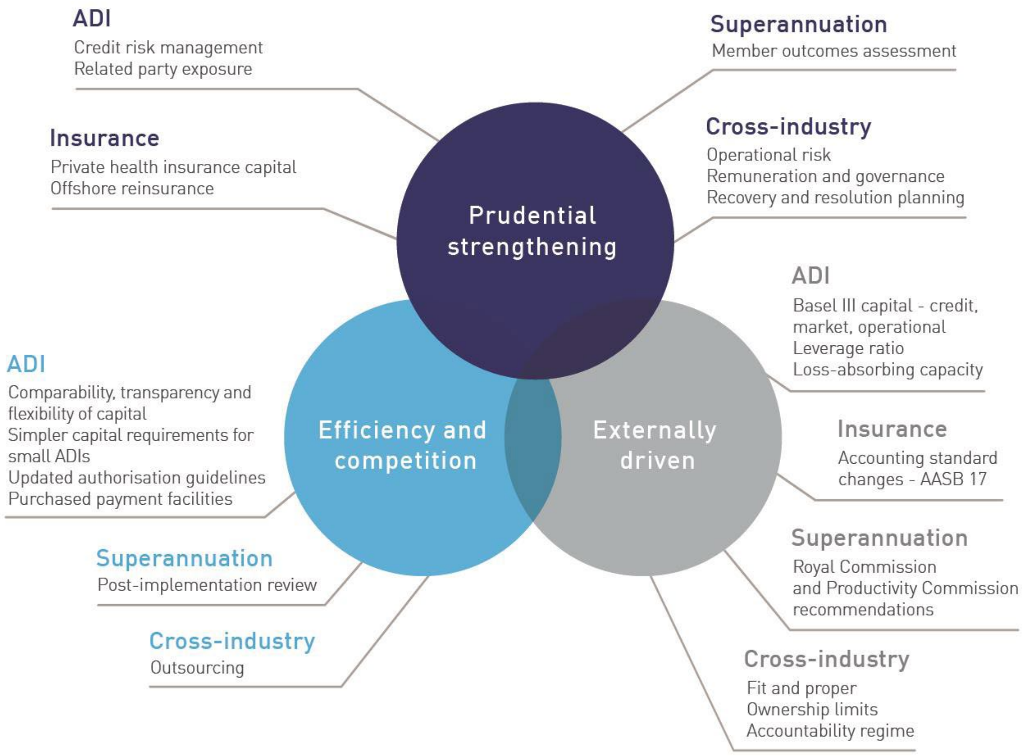
A key priority is APRA's policy work program on governance, remuneration and accountability within financial institutions. In particular, APRA will be revising its cross-industry prudential standards to reflect the findings of the Royal Commission and the CBA Prudential Inquiry. APRA will also work with the Government and ASIC to extend the accountability model set out under the BEAR to the insurance and superannuation industries, and to address misconduct.

In the banking sector, APRA will progress its proposals to implement the Basel III capital reforms and give effect to its expectations for 'unquestionably strong' capital ratios, to take effect in 2022. As part of the reform process, APRA is considering a simplified prudential framework for smaller and less complex ADIs and is assessing the impact of the RBNZ's recent proposals to increase the amount of capital required for the major banks' subsidiaries in New Zealand. Other areas of focus include credit risk management, including for exposures to related parties, finalising loss-absorbing capacity requirements and updates to licensing guidelines and the purchased payment facility regime.

The insurance policy agenda continues the implementation of the next phase of the policy roadmap for private health insurers, where APRA will be developing a proposal for consultation on capital reforms. APRA will continue to work with the insurance industry on understanding the impact and progressing implementation of new insurance accounting requirements (*AASB 17 Insurance Contracts*). APRA is also examining the appropriate prudential treatment of offshore reinsurance in the life insurance industry.

The superannuation policy agenda includes implementation work related to the new member outcomes prudential framework (*Prudential Standard SPS 515 Strategic Planning and Member Outcomes* and related changes to existing prudential standards), including addressing relevant legislative changes. In addition, in 2019 APRA will consider enhancements to the 2013 suite of prudential standards arising from its post-implementation review and will undertake work to implement the recommendations of the Royal Commission. APRA will also commence a major update of superannuation data reporting requirements. APRA awaits the incoming Government's response to the Productivity Commission's review, and will take the necessary action to implement the review's recommendations, where they are accepted by Government.

The diagram below summarises the different streams of APRA's policy development agenda according to the main drivers of change.



1.2.3 Recent Government announcements

As part of the election campaign the Prime Minister committed $100 million to establish the 'Australian Business Growth Fund' (the Fund) to improve equity finance for small- to medium-sized enterprises. Traditionally, APRA requires an ADI's equity investments to be fully funded by shareholders; this would include any equity investment a bank would potentially have in the Fund. APRA notes that a different treatment may be appropriate if the fund can be identified as unique and special circumstances support that treatment. Any alternate capital treatment would also likely be subject to conditions such as a limit on the amount an ADI can invest in the Fund and the Fund having an independent chairperson.

The Prime Minister also announced the First Home Loan Deposit Scheme to assist first home buyers to better access finance without having to save a 20 per cent deposit. We stand ready to work with the National Housing Finance & Investment Corporation, the Government and banks to assist with the development of this scheme.

1.3 Regulatory architecture

1.3.1 Financial stability and macroprudential framework

APRA's role in financial stability is integrated into its mandate – as APRA pursues financial safety within an efficient and competitive financial system, it is explicitly tasked to promote financial system stability. This is complementary to the RBA's role in financial stability and is distinct from the RBA's macroeconomic mandate.

The highest level forum for managing financial system risk is the Council of Financial Regulators (CFR). The CFR is a forum for identifying material risks, discussing appropriate actions and providing advice. Importantly, however, all delegated powers rest with the individual member agencies. As an institutional framework this is relatively informal, but also reflects the regulatory infrastructure chosen following the Wallis Inquiry.

In the 2018 FSAP the IMF explored this regulatory framework in depth and found that whilst informal, it is robust and the framework and practices are comparable to international best practice. As such APRA sees no need to alter the institutional framework, noting this was also the conclusion of the FSI in 2014.

Section 47C [redacted] Section 47C [redacted]

[redacted]

[redacted]

S [redacted]

Section 47C [redacted]

1.3.2 APRA-ASIC coordination

APRA is currently working with ASIC to review cooperation and coordination arrangements between the two agencies, including revising the existing Memorandum of Understanding (MoU). The review is scheduled to be completed in 2019. APRA and ASIC had already significantly increased their engagement in recent times, prior to the Royal Commission, with this initiative to review arrangements underway as part of APRA's Strategic Plan. The work has been given increased priority as part of APRA's response to the Royal Commission's recommendations.

Section 47C [redacted] Section 47J [redacted]

[redacted]

[redacted]

1.4 Accountability

As part of its response to the Royal Commission, APRA committed to implementing BEAR accountability statements and mapping internally. That work will help sharpen accountabilities across the organisation. APRA has commenced the work necessary to put this in place and has committed to complete it by the end of 2019. Any relevant recommendations from the Capability Review will be factored into this exercise.

Section 47C and Section 47J [redacted]

1.5 Funding and resourcing

1.5.1 Funding

During the 2018 Mid-Year Economic and Fiscal Outlook (MYEFO) process and the 2019/20 Budget process, APRA gained government policy approval for two additional funding measures:

- Measure 1: 'New and expanded functions' – This measure (totalling approximately $60 million over 4 years) was approved during MYEFO and is to enhance APRA's supervision across regulated industries by increasing the number of frontline supervisors, enhancing APRA's ability to identify and address new and emerging risks, improving APRA's data collection capabilities, and providing for a review of APRA's enforcement strategy and its use of formal enforcement powers. It provided for an additional 31 full time equivalent (FTE) staff in 2019/20.
- Measure 2: 'Government Response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry' – This measure gained government policy approval during the 2019/20 budget, and is included in the 2019/20 APRA chapter of the Treasury Portfolio Budget Statement. This measure was intended to resource APRA adequately so it could strengthen its supervisory and enforcement activities to respond to concerns raised by the Royal Commission ($150.0 million over four years from 2019-20). It provided for a further 66 FTE. Section 47E(c) and Section 47E(d) [redacted]

[redacted]

1.5.2 APRA resourcing and remuneration

The two measures above would take APRA's total approved FTE to around 740, reflecting the broader responsibilities APRA is expected to take on post the Royal Commission. Section 47E(c) and Section 47E(d) [redacted]

[redacted]

Section 47C [redacted]

Section 47C [redacted]

- Section 47C [redacted]

2.1 Current and emerging risks

Section 47C [redacted]

Section 47C [redacted]

Section 47C [redacted]

Section 47C [redacted]

Cyber risk

Section 47C [redacted]

Cyber risk management is a subset of information security management that is relevant to every regulated entity. Section 47C [redacted]

Section 47C [redacted]

A number of high priority initiatives have commenced to establish a baseline level of capability including finalising *Prudential Standard CPS 234 Information Security* and releasing *Prudential Practice Guide CPG 234 Information Security* for consultation.

APRA participates in a number of local and international forums to keep up to date with industry developments and approaches, and to influence thinking and outcomes. These include the Cyber Working Group of the CFR and the Operational Resilience Working Group of the Basel Committee.

Developments in governance, culture and remuneration (GCR)

Section 47C [redacted]

- [redacted]
- The Royal Commission concluded that the resilience of the Australian financial system would be strengthened by heightened supervisory focus on regulated entities' management of non-financial risks, with specific consideration given to GCR;
- Section 47C [redacted]

[redacted] Section 47C [redacted]

Developments in governance, culture and remuneration (GCR)

- Section 47C [redacted]

APRA recognises the need to lift supervisory intensity on non-financial risks, particularly with respect to GCR issues, to enhance the overall resilience of the financial system. APRA's plan to achieve this centres on developing and embedding a supervisory approach for GCR issues that is:

- Resilient – an approach that is adaptable and flexible, with capacity for supervisory judgement to tailor responses to different issues in different types of entities;
- Scalable – an approach that facilitates risk-based supervision across the prudentially-regulated population; and
- Effective – an approach that prevents and addresses serious prudential risks and holds institutions and individuals to account.

The following actions are planned to build capabilities to enhance supervision of GCR:

- Sharpening supervision practices of GCR issues. APRA is continuing to develop its approach to the ongoing supervision of GCR issues. As part of this, it will consider using a mix of internal and external expertise to increase capability and lift the intensity of supervision of GCR issues.
- Strengthening prudential standards to empower supervisors to pursue appropriate prudential outcomes where GCR concerns are identified in the course of day-to-day supervision. Section 47C [redacted]
- Enhancing transparency by preparing information papers to communicate insights obtained from APRA's supervision of GCR issues to support improvements in industry practice and to inform the public's perception of APRA's role. APRA will release an information paper in May 2019 outlining key insights obtained through the risk governance self-assessments undertaken in response to the CBA Prudential Inquiry.

Section 47C and Section 47J [redacted]

Climate risk

Since 2016, APRA has been raising awareness among regulated entities of the financial nature of climate change risks. In particular, APRA Member Geoff Summerhayes has delivered a number of notable speeches through which APRA has advised that these risks are material, foreseeable and actionable now.

In 2018, APRA surveyed 38 large entities from across the regulated industries to gauge industry maturity related to climate risk governance, assessment and disclosure. The results confirmed industry awareness and understanding of these financial risks has increased since 2016. The thematic results of this survey – as well as an overview of recent developments in relation to climate change risks both domestically and internationally – were published in APRA's March 2019 Information Paper, *Climate change: Awareness to action*.

Climate risk

Section 47C and Section 47J [redacted]

Section 47C [redacted]

2.2 State of the APRA-regulated industries

2.2.1 Authorised deposit-taking institutions

Key insights

- The ADI sector is generally financially strong – well capitalised, has adequate liquidity and funding and is profitable. Section 47C [redacted]
- Section 47C [redacted]
- ADI residential mortgage lending standards have improved as a result of APRA's intervention, with temporary benchmark constraints on investor borrowing growth and interest only lending largely removed.
- Section 47C [redacted]
- In recent self-assessments against the findings of CBA Prudential Inquiry, ADIs largely found themselves to be adequate in relation to governance, culture and accountability but clearly significant work remains to be done in these areas.

State of the industry

There are 147 APRA authorised deposit-taking institutions (ADIs) with total assets of over $4 trillion as at December 2018. Two of these ADIs have restricted licences as part of the new licensing approach. Over recent years there has been a small fall in ADI numbers, mainly as a result of mergers of smaller ADIs.

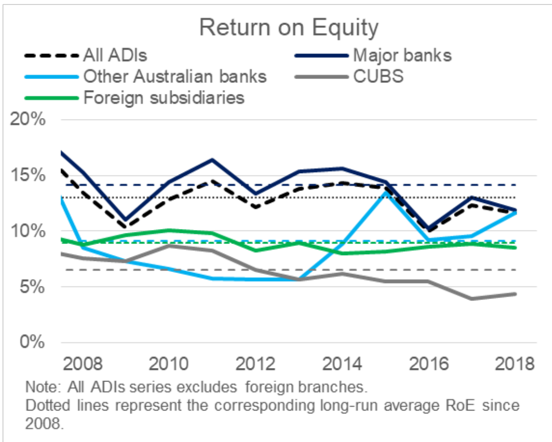
Australia has a relatively concentrated, homogenous banking system with systemic banks reliant on wholesale funding, including from offshore, to fund their lending portfolios. Overall, the industry capital ratio sits comfortably above regulatory minimums. Asset quality remains strong, supported by strong lending standards. The ADI industry is cyclical with likelihood of failure linked to the broader economy. The major banks are highly profitable, well capitalised, relatively simple (traditional banking) and mature. Section 47C [redacted]

Key risks and issues

Financial risks

Profitability

As profits and capital have both steadied, so too has ADIs' return on equity (ROE). ROE is now a few percentage points lower than its historical average but remains high compared with international peers.



Section 47C [redacted]

Section 47C and Section 47J [redacted]

Section [redacted]

Section 47C [redacted]

Section 47C [redacted]

Section 47C [redacted]

Section 47C [redacted]

Non-financial risks

Organisational and cultural resilience

The Royal Commission and the CBA Prudential Inquiry found significant weaknesses in the governance, culture and remuneration practices of large ADIs. As noted above, APRA is reviewing its approach to the supervision of governance, culture and remuneration and is in the process of implementing the Bank Executive Accountability Regime.

Section 47C [redacted]

Section 47C [redacted]

Section 47C [redacted]

Section 47C [redacted]

2.2.2 General insurance

Key insights

- The industry remains well capitalised and in recent periods has reported strong profitability despite the increased frequency of natural catastrophe events.
- In recent years, the number of shareholder class actions have increased sharply. This continued in 2018 and early 2019 with actions being filed as a result of the Royal Commission, increasing the cost and limiting the availability of directors and officers insurance.
- Recent cost of claims pressures in domestic motor vehicle insurance have led to premium rate increases.
- The implementation of the Royal Commission's recommendations will impact the industry on a number of fronts including a shift to a deferred sales model for add-on insurance, a ban on cold calling, changes to the level of intervention by ASIC in claims handling, and the extension of BEAR to the industry Section 47E(d) [redacted]

State of the industry

There are 96 APRA authorised general insurers, and over recent years there has been a fall in numbers largely due to the rationalisation of multiple licences by some insurance groups.

The industry is well capitalised at 1.74 times APRA's prescribed capital amount and is also reporting strong profitability. Insurers' reinsurance arrangements played a key role in limiting the financial impact of the recent Sydney hail storm and Townsville flooding events.

Key risks and issues

Section 47C [redacted]

Section 47C [redacted]

Section 47C [redacted]

Section 47C and Section 47E(d) [redacted]

Shareholder class actions

The number of shareholder class actions have increased sharply in recent years and this continued in 2018 and early 2019 with actions being filed as a result of the outcomes of the Financial Services Royal Commission hearings. This trend has increased the number of D&O claims, which insurers are addressing through the application of large premium increases, changes to terms and conditions, and/or exiting the D&O market. This has increased the cost and limited the availability of D&O insurance.

APRA continues to analyse trends in D&O claims and premiums, and the efficacy of insurers' reinsurance arrangements. Section 47C [redacted]

Section 47C [redacted]

Section 47C [redacted]

Section 47C [redacted]

2.2.3 Life insurance and friendly societies

Key insights

- Growth in individual life insurance policies has slowed. Section 47C [redacted]
- Section 47C [redacted]
- APRA has been concerned about disability income insurance (DII), also known as income protection insurance as the industry has collectively lost $2.5 billion through this product offering over the past five years, with no signs of improvement.
- Section 47C [redacted]
- Section 47C [redacted]
- Section 47C [redacted]

State of the industry

There are 29 life insurers with a combined $222 billion in assets, and a further 12 friendly societies with $7.3 billion. Life insurers' main products are: death cover, permanent disability and income protection (aka DII); these are distributed to retail clients and through superannuation schemes. Friendly societies, which differ from life insurers by the rules that govern them and the products they sell, mainly sell funeral insurance and savings bonds.

Life insurers are well-capitalised at 1.79 times the minimum requirement, and friendly societies have 2.55 times the minimum.

Key risks and issues

Profitability

The life insurance industry is experiencing poor profitability, with adverse claims experience driving loss recognition in key products. Individual DII has experienced persistent losses since 2014, raising questions about its sustainability. APRA is taking action to address these issues.

Section 47C

[redacted]

Consumer outcomes

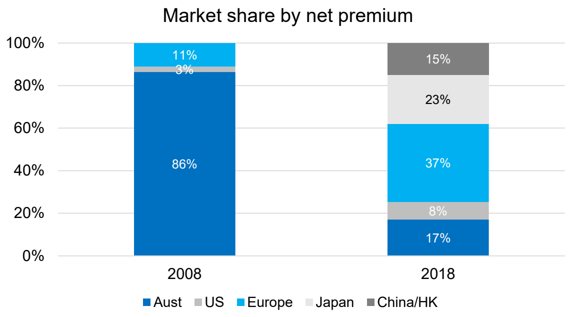
The Royal Commission highlighted a general lack of accountability and a misalignment between professed customer focus and practice, particularly in relation to: aggressive sales tactics; systemic IT issues resulting in clients being overcharged; outdated insurance policy wording; and poor claims management practices resulting in extensive delays and, in some cases, the denial of legitimate claims.

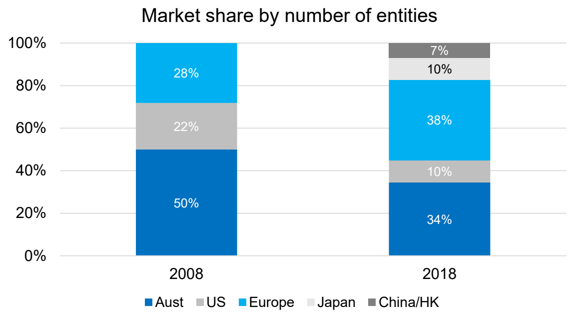
Section 47C

[redacted]

Foreign ownership

Driven in large part by profitability challenges, many Australian owners have sold, or are in the process of selling, their businesses to large overseas life insurance groups. In terms of net premium, the industry will move from 86 per cent Australian-owned 10 years ago to just 17 per cent shortly (reflected in the graphs below). Challenger, Westpac and most small entities remain Australian-owned. To support its supervision of the industry, APRA is stepping up its engagement with the home supervisors of the overseas parent companies.





Section 47C [redacted]

Section 47C [redacted]

2.2.4 Superannuation

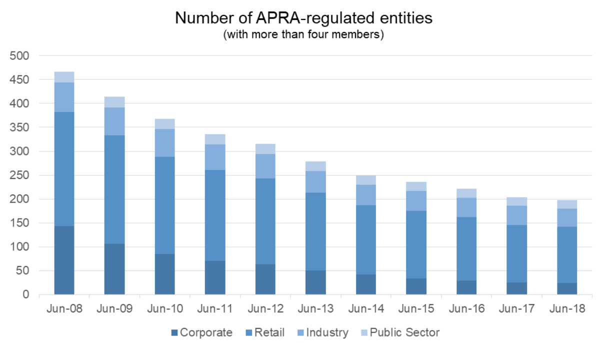
Key insights

- The superannuation sector has grown 9.2 per cent annually over the last 10 years, and now nearly equals the size of the banking sector at $2.7 trillion.
- Section 47C [redacted]

State of the industry

The superannuation has grown 9.2 per cent annually over the last 10 years, and now nearly equals the size of the banking sector at $2.7 trillion.

Section 47C [redacted]



Section 47C [redacted]

Section 47C [redacted]

Key risks and issues

Persistent underperformance in the industry

While overall industry financial performance has been sound, APRA and the PC have identified areas of persistent underperformance in the industry.

APRA will continue to target areas of persistent underperformance across the industry, in an expanded and more intensive manner. APRA will also take steps to enhance transparency through improved data and disclosure on the industry's performance and operations, and increased visibility of APRA's actions to address underperformance.

Section 47C [redacted]

Section 47C [redacted]

Section 47C [redacted]

Section 47C [redacted]

Conflicts of interest

Conflicts of interest leading to poor consumer outcomes were a prominent feature of the Royal Commission's case studies. Section 47C [redacted]

The Royal Commission highlighted specific examples where trustees did not appear to be clearly putting their members' interests first. Thematic supervision focused on conflicts of interest (2014) and related party arrangements (2017) identified that some industry participants have not demonstrated adequate controls around potential conflicts or that all arrangements are entered into on an arms-length basis Section 47C [redacted] Section 47E(d) [redacted]

Member outcomes

APRA expects trustees to clearly articulate and measure their performance across a range of areas including but not limited to investment performance. Trustees should take a holistic approach to assessing the overall outcomes provided to members based on the products, options and services offered including how they meet the needs of members in terms of performance, risk, diversification and fees and costs. Trustees also need to assess on an ongoing basis whether their significant expenditures are consistent with the best interests of members.

Section 47E and Section 47E(d) [redacted] APRA is currently consulting on revisions to its recent prudential standard to reflect these legislative changes.

Parliament also passed the *Protecting Your Super* (PYS) package of legislation, and [redacted] Section 47C and Section 47E(d) [redacted] The legislation bans exit fees, places a cap on the fees that may be charge to low balanced members, requires the cancellation of default insurance on inactive accounts and enables a sweep of low balance inactive accounts to the ATO to ultimately be reunited with an active member account. Section 47C and Section 47J [redacted] APRA wrote to ERF trustees in April 2019 to indicate our expectation that the orderly closure of all ERFs is likely to be in the best interests of members. APRA also recently released a letter to industry and FAQs to provide clarity for industry, where possible, on implementation issues that had been raised in relation to the PYS legislation.

2.2.5 Private health insurance

Key insights

- The industry is dominated by five large players (Medibank, Bupa, HCF, NIB and HBF) that represent 80 per cent of total policy market share (6.6 million policies).
- The industry is well capitalised and continues to report profitability.
- Total participation in private health insurance has been in decline for a sustained period. Affordability is a key driver. Consumers feel the product is too expensive and/or the cover

Key insights

provided is not value for money as premium increases remain higher than both inflation and wage growth.

- Section 47C [redacted]
- [redacted]

State of the industry

There are 37 APRA-authorised private health insurers, of which 24 are not-for-profit, and 12 are restricted access insurers. Section 47C [redacted]

The industry is well capitalised at 1.95 times APRA's capital adequacy requirement, with $13.72 billion in total industry assets. The industry's profitability remains strong, reporting $1.19 billion in profit after tax in the 12 months to December 2018.

Section 47C [redacted]

Section 47C [redacted]

Section 47C [redacted]

Section 47C [redacted]

Section 47C [redacted]

Section 47C [redacted]

Section 47C [redacted]

Section 47C [redacted]

Section 47C [redacted]

2.3 Other developments

Summary

- A number of significant reviews and inquiries have affected APRA's operating environment and priorities. These include the Royal Commission, APRA's Enforcement Review, the Productivity Commission's reports into superannuation and competition in the financial system, and the IMF's FSAP.
- The APRA Capability Review is currently underway and we will seek to build the outcomes into our strategic priorities, as appropriate.

2.3.1 The Royal Commission

The Royal Commission's final report reinforces APRA's core mandate as a prudential supervisor tasked to protect the safety and stability of the financial system for the benefit of the Australian community. In this context, it recommended a strengthening of APRA's prudential and supervisory frameworks and practices in a number of areas. APRA is committed to implementing the recommendations quickly. 10 recommendations require APRA's direct attention. Of the 10, it is expected nine will be completed by the end of 2020, and of those, four are expected to be completed in 2019.[3]

A number of the wider themes emerging from the Royal Commission's Final Report – such as the need to broaden APRA's supervisory focus, enhance inter-agency cooperation and collaboration, and improve performance measurement and accountability – align with APRA's existing program of strategic priorities as set out in its 2018-2022 Corporate Plan, and hence are already in train.

APRA is also examining each of the 12 matters in relation to individual entities that have been referred to it by the Royal Commission. This year we should be in a position to determine whether court action is warranted for most of the 12 cases referred by the Royal Commission.

The Commission's Final Report also contains a number of other recommendations relevant to APRA, such as an extension of the BEAR beyond the banking industry and additional penalties in the *Superannuation Industry (Supervision) Act 1993*, which will require legislative change. APRA is working with the Treasury, ASIC and other stakeholders to ensure these matters can be progressed as quickly as possible.

[3] Media release: APRA update on implementation of Royal Commission recommendations, <http://www.apra.gov.au/media-centre/media-releases/apra-update-implementation-royal-commission-recommendations>, 11 February 2019.

2.3.2 APRA Enforcement Review

APRA completed a review of its enforcement strategy in March 2019. The APRA Members formally commissioned the Review last November in response to a range of developments, including the creation of the Banking Executive Accountability Regime, the Prudential Inquiry into Commonwealth Bank of Australia, evidence presented to the Royal Commission, and proposals to give APRA expanded enforcement powers, particularly in superannuation.

The Review found APRA had, on the whole, performed well in its primary role of protecting the soundness and stability of institutions. However, it could achieve better outcomes in the future by taking stronger action earlier where entities were not cooperative or open, and by being more willing to set public examples.

APRA will be implementing all of the Review's recommendations, including:

- adopting a 'constructively tough' appetite to enforcement and setting it out in a board-endorsed strategy document;
- strengthening cooperation on enforcement matters with ASIC;
- ensuring APRA supervisors are supported and empowered to hold institutions and individuals to account, and strengthening governance of enforcement-related decisions; and
- combining APRA's investigation and legal experts in one strengthened support team, and ensuring resources are available to support the pursuit of enforcement action where appropriate.

Along with the release of the Review report, APRA has now published its new Enforcement Approach, implementing one of the Review's recommendations. The document sets out how APRA will approach the use of its enforcement powers to prevent and address serious prudential risks and to hold entities and individuals to account.

2.3.3 Productivity Commission Reports

Inquiry into Superannuation: Assessing Efficiency and Competitiveness

The PC's final report made 31 recommendations which included a number of recommendations that cover common issues identified in the Royal Commission Final Report as well as issues with some crossover with the implementation of APRA's member outcomes reforms and recent legislative reforms.

The PC recommendations include:

- the 'default once' concept, where default accounts would only be created for members who don't already have an existing superannuation account;
- a 'best in show' shortlist resulting from a competitive process overseen by from which members can choose a default superannuation fund;
- an elevated MySuper and choice outcomes test;
- recommendations relating to the regulation of trustee board directors including further measures relating to performance assessments for boards and directors, board skills matrices and minimum skills for directors;
- a clearer definition of the best interest duty;

- reporting to APRA on merger activity;
- insurance related recommendations including opt out insurance for young and inactive members;
- a capability review of APRA; and
- advice and disclosure related recommendations.

A number of these recommendations are already being progressed. The passing of the *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Act 2019* in April 2019 imposes a number of obligations on RSE Licensees which are consistent with the Commission's recommendations on member outcomes, in particular the newly legislated requirement to undertake an annual outcomes assessment at a product level. APRA's member outcomes reforms also align with the Commission's recommendations in this area by implementing requirements for RSE licensees to undertake a Business Performance Review which takes into account the legislated member outcomes test as well as strengthening RSE licensees' strategic and business planning practices. The *Treasury Laws Amendment (Protecting Your Superannuation Package) Act 2019* commenced in March 2019 and introduces a number of requirements which largely align with the Commissions' recommendations on insurance for inactive members and consolidation of inactive accounts.

Despite the recent progress on some of the recommendations, APRA will await the Government's response before acting on any of the more substantial recommendations that have not already been addressed, many of which would require further legislative change.

Competition in the Australian Financial System

The PC's final report raised concern about a perceived over-emphasis on financial stability by Australia's regulators. The report suggested that APRA's actions with respect to housing lending had negative consequences for competition.

While APRA does not agree with all of the analysis, as evidenced in its public submissions to the PC, APRA is considering the relevant recommendations of the report for future action. In this regard, APRA is already addressing certain recommendations, including improving the granularity of capital requirements for ADIs' exposures to small and medium-sized enterprises, and strengthening its working relationship with the ACCC to establish a stronger competition lens within APRA's regulatory decision-making. In addition, the CFR Working Group on Competition is looking at measures to address the recommendations on interest rate transparency for home loans and the review of regulation for purchased payment facilities.

2.3.4 International Monetary Fund Financial Sector Assessment Program

In 2018, Australia was subject to an objective and diagnostic assessment of financial stability and associated regulatory oversight via the FSAP program conducted by the IMF. The FSAP report on Australia concluded the Australian financial system has been further strengthened since the IMF's previous assessment in 2012. Indeed, the 2018 FSAP underscores the strength and resilience of the Australian financial system.

As part of the review, APRA was subject to a comprehensive assessment of its supervisory approach and capabilities in banking and insurance supervision. The IMF also assessed the adequacy of systemic risk oversight by APRA and other members of the CFR, Australia's crisis preparedness, and financial safety nets.

The IMF concluded:

- Australia benefits from a robust regulatory framework and that prudential supervision shows generally high conformity to international best practices, but with opportunities to strengthen practices further in some areas;
- bank capital requirements have been raised and applied more conservatively than minimum Basel standards, and Australian authorities have taken welcome steps to further strengthen the resilience of banks through stress testing programs;
- bank solvency appeared resilient to stress based on the IMF's own stress testing exercise with the results broadly in line with stress testing undertaken by APRA;
- policy action has lowered financial stability risks in the banking system through the introduction of stronger lending standards, including the temporary restrictions on the growth of investor loans and the share of interest-only mortgages; and
- APRA has undertaken comprehensive reform of prudential regulation for insurance companies, while improving the consistency of the framework between life and general insurers since the IMF's last assessment in 2012.

In addition, the report notes the encouraging progress that has been made in strengthening APRA's resolution powers and expanding banks' recovery planning, as well as strengthening the coordination between Australian and New Zealand authorities in this regard.

Amongst other findings, the report notes the need for additional investment in data and analytical tools to strengthen prudential supervision and systemic risk oversight. APRA has recognised this as part of its 2018-2022 Corporate Plan, which includes a major data transformation program to ensure APRA keeps pace with advancements in data, analytics and technology.

2.3.5 Capability Review

Initially recommended by the 2014 Financial System Inquiry but resulting from a Royal Commission recommendation, a capability review of APRA commenced in mid-March 2019 and is due to report to Government by 30 June. The review is being undertaken by an independent panel, Graeme Samuel AC, Diane Smith-Gander and Grant Spencer, supported by a Treasury Secretariat. The Review aims to provide a forward-looking assessment of APRA's ability to respond to an environment of growing complexity and emerging risks for APRA's regulated sectors. APRA welcomes the review and has a dedicated team to respond to requests for information, presentations and meetings.

3 APRA's priorities

Summary

- APRA's strategic and policy priorities are influenced by both internal and external drivers including the findings of relevant inquiries and reviews such as the Royal Commission and Productivity Commission reports.
- APRA has six strategic priorities including changes to its supervision approach, liftings its capability and enhancing its leadership.
- Over the coming year, APRA will consult on prudential standards related to remuneration, fit and proper requirements, various aspects of operational risk, and recovery and resolution, along with a range of other industry-specific standards.

In setting its strategic and policy priorities, APRA considers both internal and external drivers including the findings of relevant inquiries and reviews, and legislative reforms. In recent times, these have included:

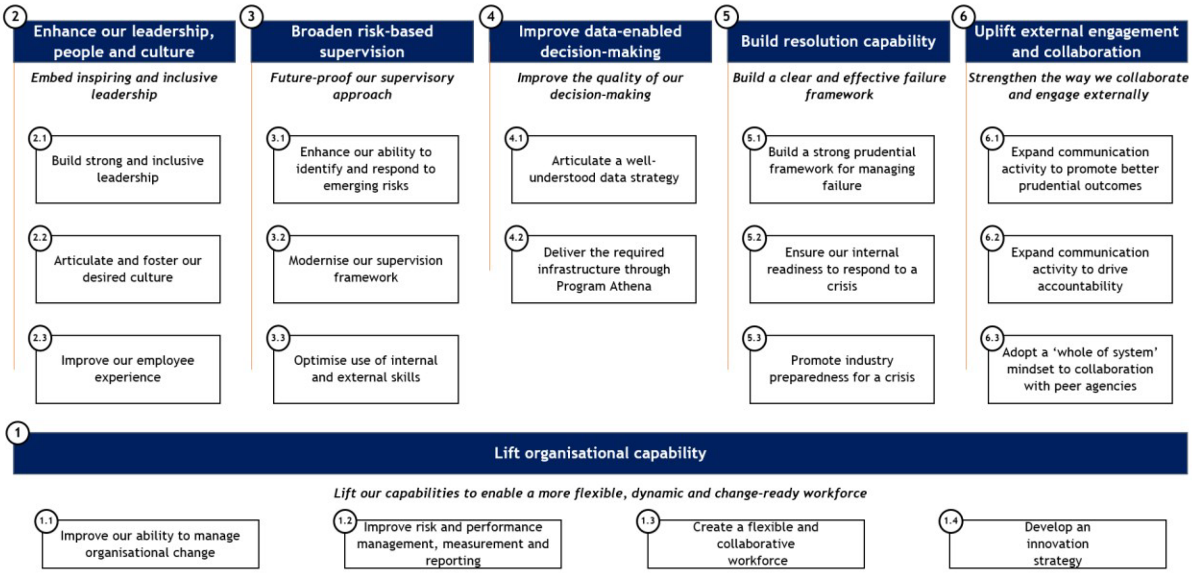
- the Royal Commission – resulting in 10 direct recommendations, 12 case referrals and a range of other recommendations that will affect APRA ;
- the CBA Prudential Inquiry – articulating expectations in relation to governance, culture and accountability with implications for the broader industry;
- the Productivity Commission's *Review of Efficiency and Competitiveness of the Australian Superannuation System*;
- legislative reforms covering the Banking Executive Accountability Regime (BEAR) and crisis management powers;
- the IMF's Financial Sector Assessment Program review of the Australian regulatory system;
- APRA's Enforcement Strategy Review – resulting in the adoption of a more forceful enforcement approach; and
- the APRA Capability Review – due to report to the Government in July 2019.

3.1 Strategic priorities

APRA is currently preparing its 2019-2023 Corporate Plan. APRA's 2018-2022 Corporate Plan was the product of a robust process that involved:

- looking externally (what is happening in the environment);
- looking internally (what is happening within APRA);
- soliciting external input (particularly from Government and industry).

Insights from the strategy development process led to a set of strategic choices for APRA, which will change the way APRA operates in the future. These shifts will, however, require APRA to develop new or enhanced capabilities. The work to achieve this has been set out under six broad strategic initiatives, each with an underlying program of work over the four year period of the plan. The six strategic initiatives are summarised in the diagram below.



3.2 Policy priorities

APRA undertakes a program of regular policy review to ensure that the regulatory framework on which its prudential supervision is based remains fit for purpose.

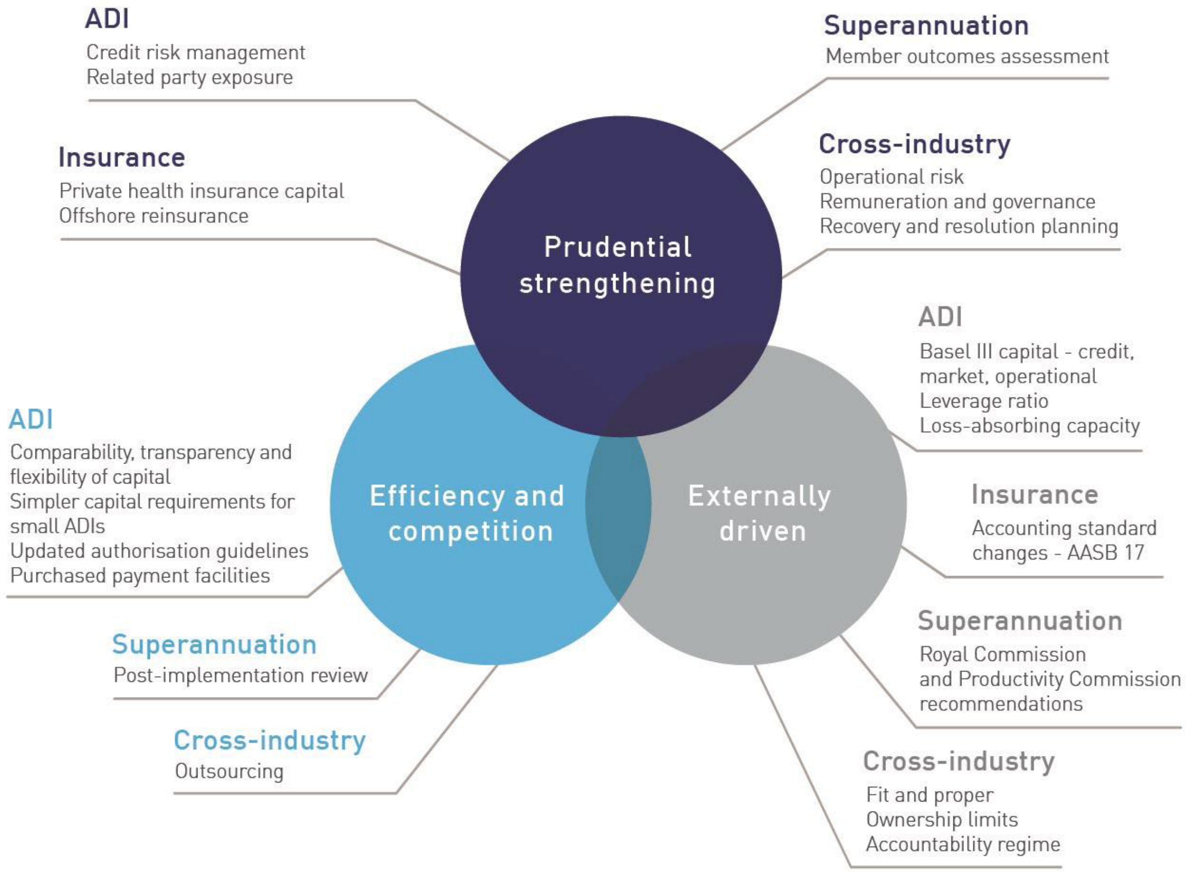
A key priority is APRA's policy work program on governance, remuneration and accountability within financial institutions. In particular, APRA will be revising its prudential standards applicable across financial industry sectors in order to reflect the findings of the Royal Commission and APRA's Prudential Inquiry into the Commonwealth Bank of Australia. This will include findings relating to executive remuneration and non-financial risk management, among other things. APRA will also work with the Government and the Australian Securities and Investments Commission to extend the accountability model set out in the Banking Executive Accountability Regime (BEAR) to the insurance and superannuation industries and to address misconduct.

In the banking sector, APRA will progress its proposals to implement the Basel III capital reforms and give effect to its expectations for 'unquestionably strong' capital ratios for authorised deposit-taking institutions, to take effect in 2022. As part of the reform process, APRA is considering a simplified prudential framework for smaller and less complex ADIs and is assessing the impact of the Reserve Bank of New Zealand's recent proposals to increase the amount of capital required for the major banks' subsidiaries in New Zealand. Other areas of focus include credit risk management, including for exposures to related parties, finalising loss-absorbing capacity requirements and updates to licensing guidelines and the purchased payment facility regime.

The insurance policy agenda continues the implementation of the next phase of the policy Roadmap for private health insurers, where APRA will be developing a proposal for consultation on capital reforms. APRA will continue to work with the insurance industry on understanding the impact and progressing towards implementation of new insurance accounting requirements (*AASB 17 Insurance Contracts*). APRA is also examining the appropriate prudential treatment of offshore reinsurance in the life insurance industry.

The superannuation policy agenda includes implementation work relating to the new member outcomes prudential framework (*Prudential Standard SPS 515 Strategic Planning and Member Outcomes* and related changes to existing prudential standards), including addressing relevant legislative changes. In addition, in 2019 APRA will consider enhancements to the 2013 suite of prudential standards arising from its post-implementation review and will undertake work to implement recommendations of the Royal Commission. APRA will also commence a major update of superannuation data reporting requirements and will await the incoming Government's response to the PC's review, and will take any corresponding action to implement the review's recommendations, where they are accepted by Government.

The diagram below summarises the different streams of APRA's policy development agenda according to the main drivers of change.



4 APRA's role and structure

Summary
• APRA's role is to protect the Australian community by ensuring that, under all reasonable circumstances, financial promises made by the institutions we supervise are met within a stable, efficient and competitive financial system. • APRA currently employs over 680 staff across six offices (Sydney (two offices), Melbourne, Brisbane, Adelaide and Canberra) across six divisions. • APRA is governed by an executive group of four APRA Members (Executive Board) who collectively are responsible and accountable for APRA's operation and performance. • APRA has three core functions (supervision, policy, resolution) supported by three core capabilities (people and culture, risk intelligence and frameworks, organisational effectiveness and infrastructure). • Prudential supervision involves an ongoing cycle in which supervisors identify prudential risks, assess their potential impact and determine an appropriate risk response, including escalating risks and taking enforcement action, where necessary.

4.1 APRA's role

APRA is an independent statutory authority established for the purpose of prudential supervision of financial institutions and for promoting financial system stability in Australia. APRA also acts as a central statistical agency for the Australian financial sector, plays a role in preserving the integrity of Australia's retirement incomes policy and administers the Financial Claims Scheme (FCS).

APRA's mandate[4]	APRA's vision[5]
To protect the Australian community by establishing and enforcing prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by the institutions we supervise are met within a stable, efficient and competitive financial system.	To deliver a sound and resilient financial system, founded on excellence in prudential supervision

4.1.1 Legislative underpinnings

Under the *Australian Prudential Regulation Authority Act 1998* (the APRA Act), APRA's main purposes are to regulate the banking, insurance and superannuation institutions under five 'Industry Acts' and to administer the FCS for depositor and insurance policyholders.[6] The

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[4] APRA's purpose and objectives are formally set out in s. 8 of the *Australian Prudential Regulation Authority Act 1998*, and are reflected in the mandate set out in the *APRA Corporate Plan 2018-2022*, <http://www.apra.gov.au/corporate-plan>.

[5] *APRA Corporate Plan 2018-2022*, < https://www.apra.gov.au/corporate-plan>, p2.

[6] The industry Acts are *Banking Act 1959*, *Insurance Act 1973*, *Life Insurance Act 1995*, *Private Health Insurance (Prudential Supervision) Act 2015* and *Superannuation Industry (Supervision) Act 1993*.

APRA Act provides that, in performing and exercising its functions and powers, APRA must 'balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and, in balancing these objectives, is to promote financial system stability in Australia'[7]

The Industry Acts provide for licensing and regulatory oversight of:

- authorised deposit-taking institutions (ADIs, including banks, credit unions and building societies);
- general insurers;
- life companies and friendly societies;
- private health insurers; and
- registrable superannuation entity (RSE) licensees.

APRA also has responsibilities under other Acts:

- data collection from regulated and non-regulated entities under the *Financial Sector (Collection of Data) Act 2001 (FSCOD Act)*; and
- *Financial Sector Shareholdings Act 1998*.

4.1.2 Statements of Expectations and Intent

The Government's Statement of Expectations sets out its key expectations for APRA in undertaking its role. APRA responds with a Statement of Intent outlining its intended approach to fulfilling its role. These documents are published, with the most recent being finalised in 2018.[8]

The statement of expectations provides important information, such as that the Government:

- recognises the importance of having sound and strong financial institutions for the ongoing health of the financial system and its ability to support sustainable economic growth;
- expects APRA to focus on preventative aspects to safeguard Australia's financial system;
- acknowledges that, in performing its role, APRA is required to balance several objectives and that, at times, this may not be straightforward and the appropriate balance will require professional judgement;
- regards competition in the system as a key Government policy priority and expects APRA to facilitate an environment where innovation and competition are encouraged and barriers to entry are minimised;
- expects APRA to publicly communicate how it has balanced its regulatory responsibilities and objectives in acting to promote financial system stability in Australia; and

[7] Section 8, APRA Act

[8] The 2018 statement of expectations is available at: https://www.apra.gov.au/statement-expectations-2018

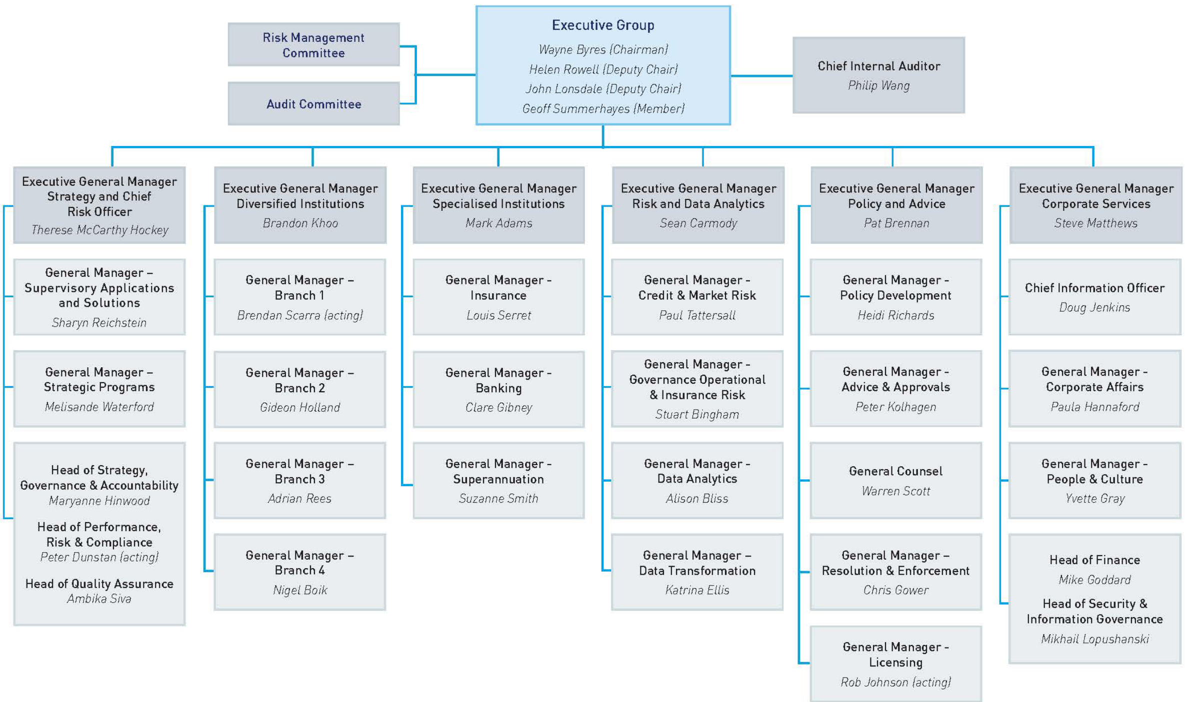
- recognises that prudential regulation cannot and should not seek to guarantee a zero failure rate of prudentially regulated institutions or provide absolute protection for market participants.

It also outlines key Government priorities for the financial system, which in the current statement are to:

- improve accountability and risk culture within financial institutions;
- strengthen the resilience and stability of the financial system, while stimulating innovation and competition within it;
- improve the efficiency and transparency of the superannuation system;
- empower consumers of financial products and ensure they are treated fairly; and
- strengthen regulator capabilities and accountability.

4.2 Organisational structure

APRA's organisational chart is set out below.



APRA is governed by an executive group of four APRA Members (Executive Board) who collectively are responsible and accountable for APRA's operation and performance. The Executive Board is supported by six Executive General Managers and six governance committees – the Executive Committee, Supervision Oversight Committee, Prudential Policy Committee, Resolution and Enforcement Committee, Audit Committee and Risk Management Committee. The latter two are chaired by one of two independent committee members.

APRA currently employs over 680 staff across six offices (Sydney (two offices), Melbourne, Brisbane, Adelaide and Canberra), with the head office based in Sydney. It has six divisions as follows.

Diversified Institutions Division and Specialised Institutions Division

DID and SID are the 'frontline supervision' divisions that directly supervise regulated institutions. DID supervises the approximately 122 functionally diversified financial institutions. These include large financial conglomerates, banks, insurance companies and superannuation firms. SID supervises more than 340 smaller entities, including regional banks, credit unions, building societies, friendly societies, insurers and RSE Licensees.

Policy and Advice Division

Policy and Advice Division works closely with Treasury on legislative issues and develops prudential standards and industry guidance material. This division provides technical advice, interpretations and approvals. It includes APRA's crisis management and investigations specialists, APRA's licensing team and the legal team that provides legal advice across all APRA activities.

Risk and Data Analytics

RDA provides specialist expertise across credit, investment, liquidity, market, governance, culture, remuneration, operational and insurance risks. It includes data analytics teams that perform industry analysis, and also manage APRA's data collection and publications. RDA has responsibility for Project Athena, a major program of work to transform APRA's data analytical capabilities by modernising the way APRA collects, stores and provides access to data.

Enterprise Performance Division

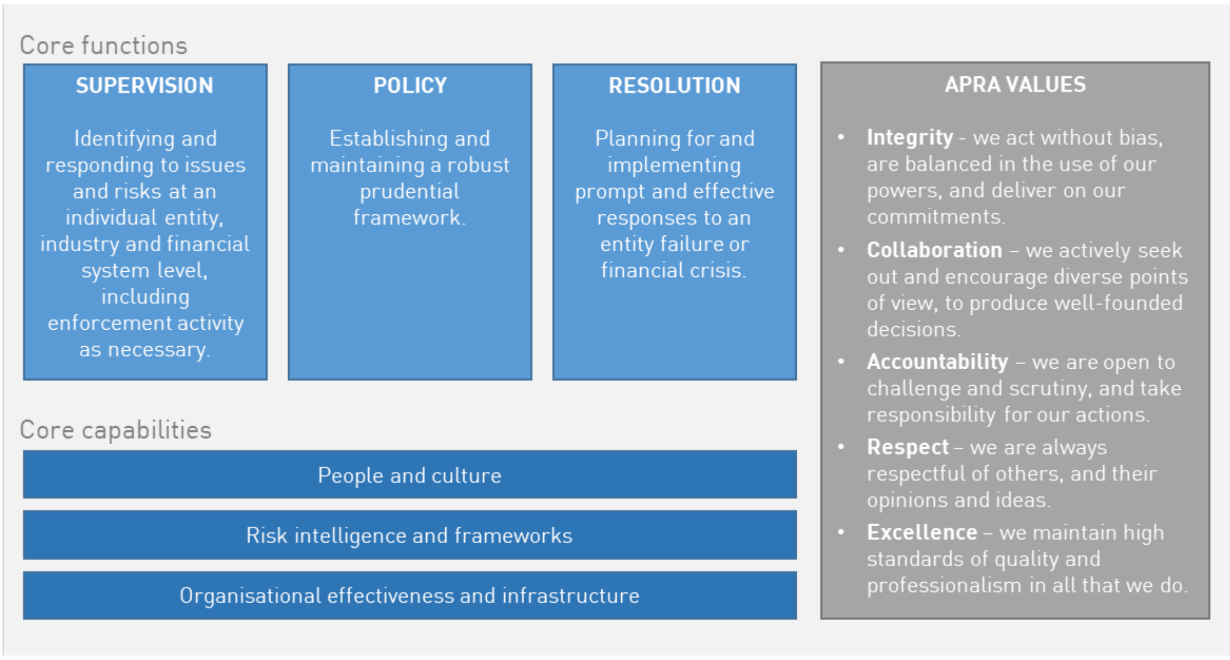
EPD supports the development and maintenance of APRA's enterprise-wide strategy, internal governance structure, and organisational performance reporting. It is responsible for the development of APRA's supervisory approach and framework, guidance materials, supervisory training and supervisory IT systems. EPD includes the risk management and compliance function, the quality assurance function and manages organisation-wide strategic projects.

Corporate Services Division

CSD provides corporate support services including handling internal and external communications, web services and development, project and change management. It includes the finance, people and culture, information technology, security and information governance, portfolio and project management, property, procurement and facilities management functions.

4.3 APRA's operating model

APRA's organisational structure supports APRA's operating model, which is designed to harness the diverse range of skills and experience necessary to fulfil APRA's mandate. APRA's operating model (depicted below) consists of three core functions supported by three core capabilities, underpinned by five organisational values critical to APRA's success.



4.3.1 Core functions

Supervision

Licensing

Supervision of regulated entities is APRA's core business. This starts with licensing entities under the relevant industry Acts. In 2017, APRA established a separate licensing team to provide more consistent and efficient engagement with entities seeking to be authorised by APRA, including those with innovative or non-traditional models. In 2018, APRA finalised a phased licensing framework for ADIs. This aims to provide a pathway to assist entities navigate the licensing process, including the introduction of restricted banking licences which allows new entrants to conduct some business while they build resources and capabilities. These measures have seen a considerable increase in new entrants, particularly in the banking sector.

Supervision

Once licensed, entities are subject to supervision, which accounts for the majority of APRA's activities. Every supervised entity is assigned a responsible supervisor. For larger entities, this may be a team of supervisors. For smaller entities, a responsible supervisor may cover a number of entities.

Day-to-day supervision is the responsibility of teams in APRA's frontline divisions, supported by risk specialists who provide in-depth risk assessments at an entity and industry level; identify emerging risks; and offer horizontal risk insights across industries. Further intelligence is gathered through statistical and industry analysis. Supervisors are also supported by technical advice, legal, resolution and investigation specialists.

APRA's supervisory approach

APRA's supervisory approach is:

- risk-based – supervisory resources and activities are directed to areas of greatest risk or impact;
- outcomes-focused – considers substance over form, looks to the achievement of a supervisory outcome rather than merely following a process;
- principles-based – allows flexibility, where appropriate, in terms of the means by which prudential outcomes are achieved rather than prescribing the exact method/approach.

Supervision involves an ongoing cycle in which supervisors identify prudential risks, assess their potential impact and determine an appropriate risk response, including escalating risks and taking enforcement action, where necessary.

Risk identification

APRA uses a range of tools to identify prudential risks, focusing on both current risks and those that could plausibly arise in the future. This work includes analysing financial data to identify early warning indicators, and stress test results to identify potential vulnerabilities in an entity's business model. Entities' policies and procedures, such as capital plans and strategy documents, are also reviewed (Lodgement Analysis). APRA also undertakes onsite analysis, visiting entities and meeting with relevant staff to understand how risks are being managed (Prudential Review).

Risk assessment

As supervisors form judgments, they update their risk assessment in APRA's risk rating tool (PAIRS). PAIRS provides a common methodology to assess an entity's overall risk of failure based on inherent risk, management and controls, and capital support. This informs the degree of supervisory intensity (SOARS stance) under the following categories: normal, oversight, mandated improvement or restructure.

Risk response

APRA sets a supervisory action plan (SAP) for each regulated entity at least annually. The SAP includes a baseline level of supervisory activity to ensure supervisors maintain an up-to-date assessment of an entity's risk profile. Higher risk and more systemic entities are subject to more intensive plans.

Supervisors can respond to potential prudential risks by undertaking in-depth reviews together with APRA's specialist risk teams, where appropriate (Prudential Review). Where APRA identifies weaknesses, it requires or recommends an entity improve their practices, depending on the seriousness of the issue.

APRA also meets with executives and Board members to communicate its risk assessment and expectations, and seeks commitment to addressing any identified issues (Prudential Consultation).

APRA regularly updates its risk assessments as entities progress their risk responses. APRA generally lowers the risk rating if an entity is effective in addressing risks.

APRA's supervisory approach

For key industry risks, APRA pursues coordinated, thematic actions across multiple entities (Thematic Review). This includes, for example, APRA's work to strengthen ADI residential mortgage lending standards in recent years.

Escalation and enforcement

Where entities are not cooperative or constructive, or there are other serious prudential risks, APRA increases its supervisory intensity. This involves requiring remediation action, revising the supervisory strategy, escalating engagement with entities and individuals, and taking enforcement action.

Policy

APRA's policy function is responsible for establishing and maintaining a fit-for-purpose prudential framework that reflects all elements of APRA's mandate. APRA's prudential framework aims to protect beneficiary interests by requiring prudent practice from institutions and enabling prompt, effective and proportionate supervisory response to significant risks. APRA aims to set requirements that are clear and well understood by institutions and supervisors. Where appropriate, requirements are principles-based and allow a range of prudent practices to achieve an outcome.

Prudential framework

Underpinning supervision is the prudential framework, which provides the overarching set of requirements and expectations applying to regulated institutions through legislation, prudential standards, reporting standards and guidance. Prudential standards are made under the Industry Acts. The framework also includes Reporting Standards made under the FSCOD Act. As delegated legislation, prudential and reporting standards are legally enforceable and may be disallowed by Parliament, although none have been.

Where appropriate, APRA's prudential framework is 'principles-based', which means that regulatory requirements are not highly prescriptive but instead set out expectations of prudential outcomes that allow regulated entities to take different approaches to achieve those outcomes. APRA's prudential framework and supervision focus on the underlying principles to be met (such as in relation to robust risk management), although there are areas where a high degree of prescription is required (such as minimum capital requirements).

Historically, APRA's prudential standards were industry-specific; indeed, APRA's power to make prudential standards for superannuation entities only dates from 2012 and from 2015 for the private health industry. Reflective, however, of the underlying premise of an integrated regulator such as APRA—that like risks should be treated in a like manner—in recent years, APRA has sought to harmonise these standards where possible. There are some impediments to doing so for superannuation, such as the statutory requirement for equal representation on the Boards of some funds, and some areas where the explicit focus on members' best interest within APRA's prudential mandate requires a different approach.

Prudential and reporting standards are developed taking account of changes in industry practice, matters identified through supervision, identified risk areas and international standards.

Resolution

APRA aims for institutions to be appropriately prepared to recover from severe adversity, supported by credible plans for effective resolution at the point of failure (where necessary). This involves working with institutions to ensure they are prepared for the effective implementation of resolution plans and, working with domestic and international counterparts, to ensure readiness for cooperation if needed.

The operational capability to resolve failures and near-failures in an orderly manner, and the ability to identify any potential threats to the viability of institutions early enough so that corrective action can be promptly initiated or orderly exit achieved, is key. It is also important to have sound operational processes for communications, enforcement activity, maintaining or applying resolution strategies and readiness to administer the FCS, which protects individuals' deposits and ability to claim on their insurance policy in the event of an institution failing.

APRA is continuing a large body of work to develop its resolution capabilities following the passage of major legislative reform in 2018.

4.3.2 Core capabilities

People and culture

Integral to achieving its objectives are APRA's people and the culture that it fosters. APRA has a strong focus on its people and a program of work aimed at developing capabilities, leadership and high performing teams. Attracting and engaging a talented workforce is always an area of high priority.

Over the years, APRA has built up a strong cadre of supervisory expertise, primarily built around the importance of APRA's mandate to protect the community. APRA requires staff with a diverse set of skills and a broad range of educational backgrounds, including actuarial, financial, legal and economics.

Section 47E(c) and 47E(d) [redacted]

APRA's recent workplace initiatives have focused on inclusion and diversity and the importance APRA places on living its values. Last year, it introduced a Values Award program, which provides staff the opportunity to nominate those whom they believe have demonstrated an APRA value, supported by quarterly and annual awards by the Members.

[redacted] Section 47E(c) and Section 47E(d) [redacted]

Risk intelligence

Access to timely, relevant and reliable information is integral to APRA producing well-founded, risk-based decisions. APRA relies heavily on the skills and knowledge of its people and expects them to exercise professional judgment in their roles. Insightful analysis of institutions, industries, the financial sector and the broader economy enhances APRA's ability to identify and respond to risks and emerging vulnerabilities.

APRA Data

APRA uses data to provide insights into individual entities, industry level risks and trends, enabling effective decision-making, driving risk-based supervisory action plans and supporting policy initiatives.

APRA collects financial data from over 4500 financial institutions, regulated and unregulated, under the *Financial Sector (Collection of Data) Act 2001*. As well as for its own purposes, APRA also collects data on behalf of other agencies including the RBA and ABS. Upon request, APRA also collects and publishes data to meet specific needs. For example, the National Claims and Policies Database (NCPD) was developed at the request of the Government to provide insurers and the community with a better understanding of public liability and professional indemnity insurance.

APRA publishes regular statistical publications, covering key data and information across all the industries it supervises. In addition to regular statistical publications, APRA also responds to requests for data from members of the financial services industry and the broader community, subject to confidentiality privileges and appropriate delivery timeframes.

Data transformation initiatives

APRA is undertaking a major data transformation initiative (Project Athena) to keep pace with advancements in data, analytics and technology. Project Athena will build the platform and infrastructure required to modernise the way APRA collects, stores and accesses data.

APRA has recently selected a software system developed by Irish company Vizor Software to replace its existing data reporting system, Direct to APRA (D2A). Australia's Dimension Data has been selected to deliver the new solution. Vizor will provide a modern, efficient, web-based system, improving APRA's core data collection capabilities, which is due to come online in March 2020.

Alongside the data collection solution, Program Athena also delivers new data warehousing capabilities, new analytical tools and capabilities, and a data lab environment to explore new ways of working with data.

To drive ongoing value from the platform and technology initiatives, APRA is also undertaking an initiative to develop a Data Strategy that will support data enabled decision making in APRA. It is anticipated the Strategy will include not only APRA's internal approach to sourcing, sharing, using, managing and governing our existing data, but will also reassess the data APRA collects to best fulfil our approach and ultimately APRA's mandate.

Confidentiality of an individual entity's data is a consideration in compiling publicly released data and can limit the data APRA is able to release through its statistical publications. APRA is currently working with Data61 at CSIRO as part of the Platforms for Open Data (PfOD) initiative to investigate

APRA Data

ways of de-identifying confidential data with the goal of achieving greater availability of high-value data for industry and public consumption.

APRA also participates in a number of cross agency committees and initiatives around data with a focus on maximising the sharing of data and only collecting data once. APRA also chairs the Triparty Data Committee (TDC) which is currently reviewing future data needs across the CFR agencies on a five year time horizon.

Organisational effectiveness and infrastructure

As with any business, efficient and effective organisational frameworks and processes are the backbone of core operations. Of specific importance to APRA are:

- appropriate standards for its workplaces, and technology that is robust, effective and secure;
- encouragement of flexible working arrangements;
- presenting and publishing information and data in a timely and efficient manner; and
- effective governance arrangements.

5 Funding, resourcing and accountability

Summary

- APRA is funded primarily from appropriations, for which the Commonwealth is substantially reimbursed through levies collected from regulated financial institutions. Changes to APRA's operating budget are met with a corresponding change to the levies recovered from industry, and therefore the majority of funding for APRA does not impact the Commonwealth Budget 'bottom line'.
- During the 2018 MYEFO process and the 2019/20 Budget process, APRA gained government new policy proposal (NPP) approval for two additional funding measures, which would enable APRA to grow to about 740 FTE.

Section 47C and Section 47E(d)

[redacted]

5.1 Funding

APRA is part of the Treasury portfolio of agencies. APRA's annual budget is subject to the usual government agency review and approval processes. APRA is in turn funded primarily from appropriations,[10] for which the Commonwealth is substantially reimbursed through levies collected from regulated financial institutions. In addition to levies, APRA directly charges certain institutions fees for services and there is a small appropriation in lieu of interest on funds held within the APRA Special Account.[11] Changes to APRA's operating budget are met with a corresponding change to the levies recovered from industry, and therefore the majority of funding for APRA does not impact the Commonwealth Budget 'bottom line'.

Levy-recovered appropriation accounts for approximately 95 per cent of APRA's total funding. Levy recoveries are raised according to the legislative framework established by the *Financial Institutions Supervisory Levies Collection Act 1998* (FISLC Act) and a suite of imposition Acts that apply to regulated institutions. Prior to the beginning of each financial year, and following consultation with industry and Treasury, the Minister is required under

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[10] In addition to appropriation funding recovered from industry through levies, APRA also charges various fees for services. These take the form of cost recoveries for statistical work provided to the RBA and ABS, charges to a small number of large banks and insurers for the work necessary to allow them to utilise internal models for capital adequacy purposes, gain access to the RBA's Committed Liquidity Facility, and licence and other miscellaneous fees. In 2017/18 APRA recovered approximately $6.5 million of one-off prudential inquiry costs from the Commonwealth Bank of Australia (CBA).

[11] From 1 July 2007, when APRA became a *Financial Management and Accountability Act (1997)* (FMA Act) agency, a Special Account was established into which all fees and appropriations are credited. This arrangement has been maintained under the *Public Governance,* Performance *and Accountability Act 2013* (PGPA Act), in which APRA is classified as a non-Corporate Commonwealth entity.

legislation to make a determination as to certain matters such as the levy percentages for the different levy components, maximum and minimum levy amounts for applicable industries, and the date at which the regulated institutions' levies are to be calculated.

The potential for over or under-collection of levies is implicit in APRA's levies model, in which levies are determined on the basis of estimates of the number of industry entities and growth in asset values.[12] Variations in levy collections are allowed for when setting future period levies such that, over time, there is a net zero impost on industry beyond government-agreed APRA costs. Periodically, Treasury consults with industry on the overall Financial Industry Supervisory Levy methodology. The government's response to the most recent methodology review, including recommendations for changes, was released in April 2014. The overall levy methodology was considered again in 2016 as part of a Treasury Portfolio Charging Review, and no changes to the current method was proposed.

Historically, and again more recently, the levies collected under the FISLC Act were predominantly for the purposes of funding APRA – in 2011/12 almost 80 per cent of funds collected were for APRA's budget and as a result the levies were commonly known as 'APRA levies'. However, the levies collected by APRA after then were used to recover certain additional regulatory costs of ASIC, the Department of Human Services (DHS), and the ATO, including from July 2012 to June 2018 the *SuperStream* initiative, taking APRA's portion of the levies as low as 42 per cent in 2012/13. Following the completion of the *SuperStream* collection and the recent implementation of the ASIC user-pays funding model, in 2019/20 it is estimated that the APRA portion of the levy will return to close to 80 per cent.

The following table outlines the actual, and budgeted levy collections:

Table 2: Financial Institutions Levy Collections

	2011/12 Actual ($m)	2012/13 Actual ($m)	2013/14 Actual ($m)	2014/15 Actual ($m)	2015/16 Actual ($m)	2016/17 Actual ($m)	2017/18 Actual ($m)	2018/19 Budget ($m)	2019/20 Budget ($m)
APRA	99.2	112.9	115.6	116.9	117.5	122.1	136.1	141.6	186.1
Other agencies	27.9	32	43.9	40.1	50.7	93.1	76.4	71.8	49.9
Super Stream	-	121.5	99.5	71.7	61.8	35.5	35.5	-	-
Total	**127.1**	**266.4**	**259.0**	**228.7**	**230.0**	**250.7**	**248.0**	**213.4**	**236.0**

	2020/21 Forward Estimate ($m)	2021/22 Forward Estimate ($m)	2022/23 Forward Estimate ($m)
APRA	182.7	188.3	192.7
Other agencies	45.5	44.5	41.9

[12] The exception is the private health insurers levy model, under which levies are collected annually based on policy numbers.

	2020/21 Forward Estimate ($m)	2021/22 Forward Estimate ($m)	2022/23 Forward Estimate ($m)
Super Stream	-	-	-
Total	**228.2**	**232.8**	**234.6**

5.1.1 Operating results

Given the growth in the financial sector, APRA's costs relative to the value of assets supervised have generally declined, to approximately 2.3 cents per $1000 of assets supervised in 2017/18 compared to 2.9[13] cents per $1000 of assets supervised in 2011/12. With the approved and expected increase to APRA's funding for 2019/20 a small increase in this measure is expected.

APRA's 2017/18 operating result, 2018/19 forecast, 2019/20 budget and forward estimates are summarised in Table 3:

Table 3: APRA Operating Results

	2017/18 Actual ($m)	2018/19 Forecast ($m)	2019/20 Budget ($m)	2020/21 Forward Estimate ($m)	2021/22 Forward Estimate ($m)	2022/23 Forward Estimate ($m)
Levies and other income	147.5	149.0	192.5	193.1	198.6	203.0
Operating expenses	(144.0)	(156.9)	(184.2)	(187.0)	(197.6)	(202.0)
Surplus/ (Deficit)	**3.5**	**(7.9)**	**8.3**	**6.1**	**1.0**	**1.0**

- For the 2017/18 financial year, APRA had an audited operating surplus of $3.5 million. Section 47E(c) and Section 47E(d) [redacted] The forecast for APRA for 2019/20 is for a deficit of $7.9 million however this is $3.0 million lower than the MYEFO-updated approved deficit of $11.9 million following approval of $14.7 million of additional expenses (with the levy recovery of $10.7 million to occur in 2019/20). The lower forecast deficit arises from an anticipated slower increase in headcount than envisaged at the time of MYEFO; and

- The increase in budgeted expenditure in the 2019/20 financial year and beyond is due largely to additional resourcing provided to APRA from the Government Response to the

[13] It is worth noting that APRA's 2017/18 year's costs are inflated by around $6.5 million for the CBA inquiry, which were separately recovered, removing these one-off costs lowers the above rate to 2.2 cents per $1000 of assets supervised.

Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

- The 2019/20 budget surplus arises from a re-coup from industry of $10.7 million of 2018/19 additional resourcing, plus associated amortisation and a $4.0 million increase to the Contingency Enforcement Fund. This is offset by a deferral of $3.0 million for supervision of the largest and most complex institutions from 2019/20 to 2020/21, $0.9 million of expected over-collected levies in 2018/19 returned to industry plus $2.5 million of unspent 2017/18 project funding deferred to 2019/20.

5.2 Ongoing funding and resourcing

During the 2018 Mid-Year Economic and Fiscal Outlook (MYEFO) process and the 2019/20 Budget process, APRA gained government policy approval for two additional funding measures:

- Measure 1: 'New and expanded functions' – This measure (totalling approximately $60 million over 4 years) was approved during MYEFO and is to enhance APRA's supervision across regulated industries by increasing the number of frontline supervisors, enhancing APRA's ability to identify and address new and emerging risks, improving APRA's data collection capabilities, and providing for a review of APRA's enforcement strategy and its use of formal enforcement powers. It provided for an additional 31 full time equivalent (FTE) staff in 2019/20.
- Measure 2: 'Government Response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry' – This measure gained government policy approval during the 2019/20 budget, and is included in the 2019/20 APRA chapter of the Treasury Portfolio Budget Statement. This measure was intended to resource APRA adequately so it could strengthen its supervisory and enforcement activities to respond to concerns raised by the Royal Commission ($150.0 million over four years from 2019-20). It provided for a further 66 FTE. Section 47E(c) and Section 47E(d) [redacted]

Section 47E(c) and 47E(d) [redacted]

5.2.1 APRA resourcing and remuneration

The two measures above would take APRA's total approved FTE to around 740, reflecting the broader responsibilities APRA is expected to take on post the Royal Commission. [redacted] Section 47E(c) and Section 47E(d) [redacted]

APRA primarily recruits staff from, and loses staff to, the financial services sector – movement between APRA and other public sector agencies is negligible. [redacted]

Section 47E(c) and Section 47E(d) [redacted]

5.2.2 2014 FSI Recommendation 28

The FSI recommended providing APRA with a more stable funding model, increased capacity to pay competitive remuneration, and boosting flexibility in respect of staffing and funding. Prior to the Royal Commission, the Government's response to this recommendation focused on ASIC's operating arrangements, in light of the ASIC Capability Review and revisions to its funding arrangements Section 47C [redacted]

5.3 Accountability

As an independent statutory agency, APRA understands the importance of, and supports, being subject to appropriate external scrutiny. Over the past 20 years, APRA's performance and accountability measures have grown through accretion; most recently, the Government accepted the Royal Commission's recommendation and proposed establishing an independently chaired oversight body to report on the performance of APRA and ASIC.

Section 47C [redacted]

Section 47C [redacted]

Section 47C [redacted]

Section 47C [redacted]

6 Interagency collaboration

Summary

- APRA has strong working relationships with Australia's key financial regulatory agencies, including the RBA, ASIC and the Commonwealth Treasury. Together with APRA, these four agencies cooperate on a multilateral basis through their membership of the CFR towards a 'whole of system' approach to financial regulation.
- APRA also collaborates with international agencies and standard-setting bodies. Liaison with overseas home and host supervisory agencies facilitates a deeper understanding of the activities of internationally active firms supervised by APRA.

6.1 Domestic agencies

APRA has strong working relationships with Australia's key financial regulatory agencies, including: the RBA, ASIC and the Commonwealth Treasury. Together with APRA, these four agencies cooperate on a multilateral basis through their membership of the CFR towards a 'whole of system' approach to financial regulation.

The CFR has no statutory authority or regulatory functions of its own but operates as a valuable high-level forum for sharing information and views and discussing regulatory issues, with a particularly emphasis on matters impacting financial stability. It also advises the Government on the adequacy of the regulatory architecture of the Australia's financial system in light of ongoing developments.

Financial system stability and macroprudential policy

APRA's role in financial stability is integrated into its mandate – as APRA pursues financial safety within an efficient and competitive financial system, it also promotes financial system stability. APRA has an explicit mandate under both the APRA Act and the industry legislation to promote financial system stability.

Financial system stability is achieved through the stability and resilience of financial institutions that make up the system, as well as through the combined interactions between those institutions, their customers, the central bank and the financial system infrastructure. Financial system stability, in turn, is affected by and affects the overall macro-economy, although macroeconomic management clearly is not part of APRA's mandate.

In addition to being the domestic regulatory authority with explicit authority and mandate for financial stability, APRA also maintains most of the tools and levers that can help control it. Many of these are also traditional 'microprudential' tools, such as minimum capital and liquidity requirements, which help to maintain the resilience of the key institutions supporting the financial system.

Policy tools that are sometimes called 'macroprudential' are those that operate at a system level (although applied to individual financial institutions) in order to influence or respond to the financial cycle. APRA's exercise of its authority to constrain residential mortgage lending to

Financial system stability and macroprudential policy

investors, for example, has been described as a macroprudential policy action, as concerns related to the overall rate of loan growth in higher risk segments, rather than identified concerns with particular institutions.

APRA consults closely with its counterparts at the CFR agencies when it considers use of tools to address financial stability concerns. With the Reserve Bank, APRA actively monitors financial stability indicators and risks, which are considered on a regular basis by the CFR.

In its 2018 FSAP, the IMF explored the CFR institutional framework in depth and found that whilst informal, it is robust and the framework and practices are comparable to international best practice. This was also the conclusion of the FSI in 2014.

Section 47C and Section 47J [redacted]

- Section 47C and Section 47J [redacted]

Section 47C and Section 47J [redacted]

APRA and ASIC cooperate and coordinate, where relevant, on policy development and on operational or entity-specific matters. The formal APRA-ASIC relationship is governed by a 2010 MoU, which is currently under review and due to be revised by the end of 2019. This update will include finalising the engagement principles and structures, and the approach to the sharing of financial regulator information recommended by the Royal Commission.

APRA works with the Treasury on the development of legislative changes. Recent examples are the Crisis Management Bill and the Bank Executive Accountability Regime (BEAR).

More generally, APRA interacts with a number of other public sector agencies, including:

- the Australian Bureau of Statistics (ABS), for whom APRA collects considerable data;
- the Australian Transaction Reports and Analysis Centre (AUSTRAC), with whom APRA has an MoU and holds regular co-ordination meetings to promote confidence in the integrity of the Australian financial system;
- the Australian Taxation Office (ATO), with whom APRA has an MoU on superannuation to reflect current activities and arrangements for the exchange of statistical information (the ATO has responsibility for the regulation of self-managed superannuation funds;
- the Department of Health, on whose behalf APRA collects PHI data; and
- other bodies with financial sector interests including the Australian Competition and Consumer Commission (ACCC) and State regulatory bodies that administer compulsory third-party (CTP) insurance.

6.2 International agencies and bodies

APRA collaborates with overseas regulators and standard-setting bodies. APRA has been stepping up its liaison with overseas regulators, including by establishing or participating in supervisory colleges, to improve its knowledge of the offshore operations of Australian institutions and of the home-country supervision and operations of overseas institutions represented in Australia.

APRA's participation in global standard-setting bodies ensures that relevant characteristics of the Australian financial system are taken into account in how international standards evolve. APRA is also engaged in a range of global groups and fora that shape the international financial regulatory architecture, including:

- Basel Committee on Banking Supervision (Basel Committee) - a forum for regular cooperation on banking supervisory matters and is best known for its international standards on capital adequacy and other risk management matters. Since March 2009, Australia, represented by APRA and the RBA, has been a member of the Basel Committee. APRA takes the lead on prudential supervision matters and also participates in a number of sub-committees and working groups;
- International Association of Insurance Supervisors (IAIS) – represents insurance supervisors world-wide and issues global insurance principles, standards and guidance papers, provides training and support on issues related to insurance supervision and organises meetings and seminars for insurance supervisors. APRA has been a member of the IAIS Executive Committee for many years and participates in a number of committees, subcommittees and working groups. APRA is also a signatory to the IAIS multilateral MoU on supervisory cooperation and information exchange; and
- International Organisation of Pension Supervisors (IOPS) - a world-wide forum for policy dialogue and the exchange of information, as well as the standard setting body, promoting good practices in pension (superannuation) supervision. APRA has also been an active participant in IOPS for a number of years.

APRA also monitors the work of the OECD Insurance and Private Pensions Committee, which focuses on liberalisation of insurance markets, governance and regulatory frameworks in insurance and private pensions, publication of cross industry statistics and research on important cross country regulatory, market and other issues.

As part of a whole-of-government approach, APRA plays a continuing role in providing support and technical assistance to regulatory agencies in Indonesia, via the Department of Foreign Affairs and Trade (DFAT) PROSPERA funding facility. The DFAT funding for APRA's technical assistance activities in the Pacific (under the Government Partnerships for Development (GPFD) program) ended on 30 June 2018. APRA has submitted a work plan and funding proposal to DFAT for a continuation of its activities in the Pacific in 2019-20.