# Banking, Insurance and Life Insurance (prudential standard) determinations Nos. 3 and 4 of 2014

# EXPLANATORY STATEMENT

# Prepared by the Australian Prudential Regulation Authority (APRA)

# *Banking Act 1959,* subsections 11AF(1) and 11AF(3)

# *Insurance Act 1973*, subsections 32(1) and 32(4)

# *Life Insurance Act 1995,* subsections 230A(1) and 230A(5)

APRA may, in writing, vary or revoke a prudential standard that applies to an APRA-regulated institution under:

* subsection 11AF(3) of the *Banking Act 1959* (Banking Act), in relation to authorised deposit-taking institutions (ADIs) and authorised non-operating holding companies (authorised banking NOHCs);
* subsection 32(4) of the *Insurance Act 1973* (Insurance Act), in relation to general insurers and authorised non-operating holding companies (authorised insurance NOHCs); and
* subsection 230A(5) of the *Life Insurance Act 1995* (Life Insurance Act), in relation to life companies (including friendly societies) and registered non-operating holding companies (registered life NOHCs).

APRA may, in writing, determine a prudential standard that applies to an APRA-regulated institution under:

* subsection 11AF(1) of the Banking Act, in relation to ADIs and authorised banking NOHCs;
* subsection 32(1) of the Insurance Act, in relation to general insurers and authorised insurance NOHCs; and
* subsection 230A(1) of the Life Insurance Act, in relation to life companies (including friendly societies) and registered life NOHCs.

On 1 December 2014, APRA made the following determinations (the instruments) under the relevant provisions of the Banking Act, Insurance Act and Life Insurance Act:

1. Banking, Insurance and Life Insurance (prudential standard) determination No.3 of 2014, which revokes *Prudential Standard GPS 220 Risk Management* made on 30 November 2012 and *Prudential Standard LPS 220 Risk Management* made on 30 November 2012, and determines *Prudential Standard CPS 220 Risk Management* (CPS 220); and
2. Banking, Insurance and Life Insurance (prudential standard) determination No.4 of 2014, which revokes *Prudential Standard CPS 510 Governance* (old CPS 510) made on 30 November 2012 and determines a new *CPS 510 Governance* (new CPS 510).

The instruments commence on 1 January 2015.

# Background

APRA is committed to harmonising and consolidating its prudential standards across APRA-regulated industries, where appropriate. APRA has already consolidated a number of its ‘behavioural’ prudential standards, relating to outsourcing, business continuity management, governance, and fitness and propriety. These prudential standards apply equally to ADIs, general insurers and life companies (‘insurers’) and authorised NOHCs (collectively ‘regulated institutions’).

However, APRA’s requirements with regards to risk management were spread across multiple prudential standards, creating a number of issues:

* similar risks were treated in different ways depending on whether the institution was an ADI or insurer;
* the existing risk management prudential standards did not reflect recent improvements in local and global risk management practices; and
* without harmonisation, there could have been four near-identical industry-specific prudential standards, where one cross-industry standard would be more efficient.

To address these issues, APRA undertook a project to harmonise and enhance its risk management requirements to ensure that:

* similar risks are treated in a similar way, whether the institution is an ADI or insurer, or is a stand-alone entity or part of a group;
* consistent regulatory language is used in the prudential standards and compliance with risk management requirements is simplified, particularly for groups that operate across regulated industries; and
* ADIs and insurers are required to have sound risk management frameworks that reflect domestic and international best practice, ultimately to strengthen the interests of stakeholders and enhance the protection afforded to Australian depositors and/or policyholders.

# Purpose and operation of the instruments

The purpose of making these instruments is to harmonise and enhance risk management and governance requirements for regulated institutions.

One instrument revokes existing industry specific risk management prudential standards for general insurers, authorised insurance NOHCs, life companies and registered life NOHCs and determines CPS 220, a new a cross-industry prudential standard with respect to risk management. CPS 220 consolidates APRA’s existing risk management requirements for general insurers, authorised insurance NOHCs, life companies and registered life NOHCs and replaces and consolidates ADI risk management requirements that were previously included in a number of ADI prudential standards.

CPS 220 also includes a number of enhancements to APRA’s existing prudential requirements to reflect and make more explicit its heightened expectations in this area. In some respects, the enhancements underpin the improvements that have been made in risk management practices, locally and globally, in response to lessons learned in the global financial crisis.

The other instrument revokes the old CPS 510 and determines a new CPS 510 that reflects new governance requirements resulting from the amended risk management requirements.

The key aspects of the consolidation and enhancement of APRA’s risk management and governance requirements are:

* the requirement that regulated institutions have a Board Risk Committee that provides the board with objective non-executive oversight of the implementation and on-going operation of the regulated institution’s risk management framework. This requirement is located in the new CPS 510;
* the requirement that regulated institutions designate a Chief Risk Officer (CRO) who is involved in, and provides effective challenge to, activities and decisions that may materially affect the risk profile of the regulated institution; and
* enhancements to the prudential standards that clarify the role of the board and senior management with regards to risk management requirements.

# Consultation

# APRA undertook consultation on the proposed changes to the risk management and governance requirements between May 2013 and November 2014, including four rounds of consultation.

# May 2013 - Discussion Paper ‘Harmonising cross-industry risk management requirements’ – initial consultation on cross-industry risk management requirements, setting out APRA’s proposed approach to harmonising, consolidating and enhancing a number of risk management requirements. This consultation was paired with drafts of CPS 220 and CPS 510;

# January 2014 – Response to Submissions ‘Harmonising cross-industry risk management requirements’ – APRA’s response to submissions received on the proposed cross-industry risk management requirements, combined with final versions of CPS 220 and CPS 510. APRA also released draft CPG 220 for consultation;

# May 2014 – Letter to industry ‘Risk Management’ – letter clarifying APRA’s intent regarding specific aspects of draft CPG 220 that also resulted in consequential changes to the final version of CPS 220. APRA requested comments on the proposed refinements to be considered in the finalisation of CPG 220;

# August 2014 – Response to Submissions ‘Supervision of conglomerate groups – 3. Prudential standards and draft guidance’ – APRA’s response to submissions received on the draft Level 3 framework prudential standards, including an updated version of CPS 510 incorporating Level 3 specific aspects;

# October 2014 – Letter to industry ‘CPS 220 Risk Management / CPG 220 Risk Management’ – APRA’s response to submissions received on draft CPG 220, including the aspects detailed in the May 2014 letter. A revised version CPS 220 and CPG 220 were released for consultation.

# December 2014 – Letter to industry ‘CPS 220 Risk Management / CPG 220 Risk Management’ – APRA’s response to submissions on the revised version of CPS 220 and CPG 220. Final versions of CPS 220 and CPG 220 were also released, for implementation from 1 January 2015.

# APRA has considered both formal and informal feedback from all relevant industries throughout the consultation process. As a result, a number of amendments to the initial consultation documents have been made. These amendments sought to address industry feedback, while ensuring that APRA maintained its objectives of having harmonised and robust risk management requirements.

# 4. Regulation Impact Statement

# The Office of Best Practice Regulation has informed APRA that a Regulation Impact Statement (RIS) is required for the cross-industry risk management requirements and the changes to the governance requirements. An RIS has been prepared and is provided at Attachment B to this Explanatory Statement as supporting material.

# 5. Statement of compatibility prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

# A Statement of compatibility prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* is provided at Attachment A to this Explanatory Statement.

# Attachment A

# Statement of Compatibility with Human Rights

# *Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011*

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The Legislative Instruments are compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* (HRPS Act).

**Overview of the Legislative Instrument**

The Legislative Instruments revoke GPS 220, LPS 220 and CPS 510, while determining a new cross-industry prudential standard CPS 220 and a new CPS 510 to replace the existing CPS 510. These changes introduce harmonised and enhanced risk management and governance requirements.

**Human rights implications**

APRA has assessed these Legislative Instruments and is of the view that they do not engage any of the applicable rights or freedoms recognised or declared in the international instruments listed in section 3 of the HRPS Act. Accordingly, in APRA’s assessment, the instruments are compatible with human rights.

**Conclusion**

These Legislative Instruments are compatible with human rights because they do not raise any human rights issues.