

Banking (prudential standard) determination Nos. 5 and 6 of 2020

EXPLANATORY STATEMENT

Prepared by the Australian Prudential Regulation Authority (APRA)

Banking Act 1959, section 11AF

Under subsection 11AF(1) of the *Banking Act 1959* (the Act), APRA has the power to determine standards (prudential standards), in writing, in relation to prudential matters to be complied with by authorised deposit-taking institutions (ADIs) and authorised non-operating holding companies (authorised NOHCs). Under subsection 11AF(3) of the Act, APRA may, in writing, vary or revoke a prudential standard.

On 8 December 2020, APRA made the following determinations (the instruments):

- (1) Banking (prudential standard) determination No. 6 of 2020, commencing upon registration on the Federal Register of Legislation, which
 - (a) revokes, effective upon registration, Banking (prudential standard) determination No. 2 of 2020, including *Prudential Standard APS 115 Capital Adequacy: Standardised Measurement Approach to Operational Risk* made under that Determination;
 - (b) revokes, effective 1 January 2023, Banking (prudential standard) determination No. 8 of 2012, including *Prudential Standard APS 115 Capital Adequacy: Advanced Measurement Approaches to Operational Risk* made under that Determination; and
 - (c) determines, effective 1 January 2022, a new *Prudential Standard APS 115 Capital Adequacy: Standardised Measurement Approach to Operational Risk*;
- (2) Banking (prudential standard) determination No 5 of 2020, commencing upon registration on the Federal Register of Legislation, which:
 - (a) revokes, effective upon registration, Banking (prudential standard) determination No. 1 of 2020; and
 - (b) revokes, effective 1 January 2023, Banking (prudential standard) determination No. 7 of 2012, including *Prudential Standard APS 114 Capital Adequacy: Standardised Approach to Operational Risk* made under that Determination.

1. Background

APRA's mandate is to ensure the safety and soundness of prudentially regulated financial institutions so that they can meet their financial promises to depositors, policyholders and fund members within a stable, efficient and competitive financial system. APRA gives effect to its mandate by establishing minimum expectations for prudentially regulated financial institutions. The Act enables APRA to issue legally binding prudential standards that set out specific prudential requirements with which ADIs and authorised NOHCs must comply.

APRA's prudential standards are often informed by developments in international standards. In the banking industry, the primary international standard setting body is the Basel Committee on Banking Supervision (Basel Committee). As a member of the Basel Committee, APRA's prudential requirements are expected to be consistent with those set by the Basel Committee. To facilitate an international level playing-field, APRA is also expected to align its domestic implementation of prudential requirements with the internationally agreed timetables.

In March 2020 in response to the COVID-19 outbreak, the Basel Committee announced the deferral by 12 months of the Basel III capital standards, which includes capital requirements for operational risk. The revised international commencement date is 1 January 2023. APRA gives effect to operational risk capital requirements through *Prudential Standard APS 115 Capital Adequacy: Standardised Measurement Approach to Operational Risk* (APS 115). APS 115 requires ADIs to calculate and hold regulatory capital commensurate with their operational risk profile.

2. Purpose and operation of the instruments

APS 115 was revised by Banking (prudential standard) determination No. 2 of 2020, which made a version of APS 115 that implements the operational risk capital requirements of the Basel III capital standards. That determination was made prior to the announcement by the Basel Committee of the deferral, and was due to commence on 1 January 2021. APRA has decided to revise the commencement date of the standard from 1 January 2021 for ADIs that use an advanced measurement approach (AMA ADIs) to operational risk, and 1 January 2022 for all other ADIs, to 1 January 2022 for AMA ADIs on an opt-in basis, and 1 January 2023 for all other ADIs. The purpose of Banking (prudential standard) determination No. 6 of 2020 is to revoke Banking (prudential standard) determination No. 2 of 2020 prior to it commencing. The effect is that the current version of APS 115 will not be replaced on 1 January 2021. It will continue to have effect until revoked on 1 January 2022, when it will be replaced with a new version of APS 115 containing the operational risk capital requirements of the Basel III capital standards. In this way, Banking (prudential standard) determination No. 6 of 2020 gives effect to the 12 month deferral announced by the Basel Committee.

As part of the implementation of the operational risk capital requirements of the Basel III capital standards, *Prudential Standard APS 114 Capital Adequacy: Standardised Approach to Operational Risk*, as made by Banking (prudential standard) determination No. 7 of 2012 (APS 114), was to be revoked on 1 January 2022. The purpose of Banking (prudential standard) determination No. 5 of 2020 is to revoke the instrument that would have effected that revocation, prior to its commencement, so that APS 114 will now continue in operation until 1 January 2023.

Where APS 115 refers to an Act, Regulation, prudential standard or Australian Accounting Standard,¹ this is a reference to the document as it exists from time to time, and which is available on the Federal Register of Legislation at www.legislation.gov.au.

¹ Australian Accounting Standards is defined in *Prudential Standard APS 001 Definitions* as the Australian Accounting Standards issued by the Australian Accounting Standards Board as may be amended from time to time.

APS 115 provides for APRA to exercise various discretions. Decisions made by APRA exercising those discretions are not subject to merits review. This is because these decisions are preliminary decisions that may facilitate or lead to substantive decisions which are subject to merits review.

A breach of a prudential standard is a breach of the Act, as section 11AG of the Act provides that ADIs must comply with prudential standards. However there are no penalties prescribed for breach of a prudential standard. Instead an ADI's breach is grounds for APRA to make further, substantive decisions under the Act in relation to the entity. Those decisions are:

- (a) to revoke an authority to carry on banking business under section 9A of the Act, and
- (b) to issue a direction to the ADI, including a direction to comply with the whole or part of a prudential standard section 11CA of the Act.

It is only at this stage that an ADI is exposed to a penalty: loss of licence or imposition of a penalty if it breaches the direction (50 penalty units each day under section 11CG of the Act). The subsequent substantive decisions of APRA to impose a direction or revoke a licence are subject to merits review. In nearly all cases,² the decisions are preceded by a full consultation with the regulated entity to raise any concerns they may have in relation to the decision.

3. Consultation

APRA did not engage in any formal public consultation prior to amending the prudential standards. The decision-maker is satisfied that no public consultation in this instance was appropriate, given the changes are intended to provide relief to APRA-regulated entities at a time when their resources are more appropriately directed to dealing with the impact of the COVID-19 pandemic on their businesses and on the Australian financial system. Furthermore, the deferrals to commencement dates had been requested by a number of APRA-regulated entities and industry bodies.

4. Regulation Impact Statement

The Office of Best Practice Regulation has advised that no Regulatory Impact statement is required as the changes are minor and machinery.

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.

² The Act specifically provide that APRA does not need to consult where APRA is satisfied that doing so could result in a delay in revocation that would be contrary to the national interest or the interests of depositors with the body corporate (subsection 9A(4) of the Act).

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 Instruments

The purpose of Banking (prudential standard) determination No. 6 of 2020 is to revoke *Prudential Standard APS 115 Capital Adequacy: Standardised Measurement Approach to Operational Risk* (APS 115) and replace it with a new version of APS 115. The changes to APS 115 revise the commencement date of the standard from 1 January 2021 for ADIs that use an advanced measurement approach to operational risk and 1 January 2022 for all other ADIs, to 1 January 2023. This aligns with the revised international commencement date.

The purpose of Banking (prudential standard) determination No. 5 of 2020 is to defer the revocation of *Prudential Standard APS 114 Capital Adequacy: Standardised Approach to Operational Risk* (APS 114) in line with the deferral of the commencement of APS 115.

The deferrals relate to prudential standards that are concerned only with imposing financial obligations on APRA-regulated institutions.

Human rights implications

APRA has assessed the 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

The instruments are compatible with human rights as they do not raise any human rights issues.