

6 May 2022

Mr Gideon Holland
General Manager - Policy
Policy and Advice Division
Australian Prudential Regulation Authority

Via email: PolicyDevelopment@apra.gov.au

Dear Mr Holland

Strengthening crisis preparedness – CPS 190 and CPS 900

COBA welcomes the opportunity to comment on APRA's proposed CPS 190 Financial Contingency Planning and CPS 900 Resolution Planning prudential standards.

COBA is the industry association for Australia's customer owned banks (mutual banks, credit unions and building societies). Our sector collectively has more than \$150 billion in assets and more than 4.5 million customers. Our members range in size from under \$100 million in assets to over \$15 billion. Our members operate in a market against significantly larger institutions, including some that have been considered to be "too big to fail". Our members' key distinguishing feature is that they are customer-owned rather than investor-owned. The combination of this structure with their relatively smaller size has implications for the recovery options available to mutual ADIs.

Under APRA's proposed standards, most COBA members would be subject to the non-significant financial institution (non-SFI) requirements. However, COBA expects by 2024 that some larger mutual ADIs, through organic growth or merger, will qualify as SFIs under APRA's prudential framework.

Key points

COBA makes the following key points as APRA finalises the prudential standards and develops its prudential guidance:

- APRA should account for the unique customer-owned bank structure in both guidance and supervisory practice,
- we support clearer expectations on ADI contingency planning with our view that these prudential requirements should remain subject to change while consultation is ongoing on APRA's proposed guidance,
- we support proportionality of regulation both in the standards and in practice to deliver meaningful reductions in regulatory burden where appropriate, and
- APRA should clarify the scope of CPS 900 covered entities to reduce the potential burden of resolution planning for the broader system.

We have also provided some more specific comments in Annex A.

Accounting for the unique customer-owned bank structure

Customer-owned banks have a unique mutual structure which, when combined with our smaller size compared to our peers, limits our access to several 'standard' recovery options. For most regulated

entities, recovery options include issuing capital, selling non-essential business lines and assets, selling overseas operations, limiting dividends and reducing executive bonuses.¹

We do not have ordinary shares owned by a separate set of investors which limits the ability to quickly issue equity instruments to recapitalise through this method. We also generally do not pay dividends which limits our sector's ability to restrict capital distributions in a recovery situation. While mutuals are now able to directly issue mutual equity interests under APRA's prudential framework as well as mutual capital instruments under the Corporations Act, instances of mutuals issuing capital instruments are not commonplace notwithstanding that this may be a credible recovery option for some mutual ADIs. APRA has recently noted this publicly:

Given their structure, mutual ADIs, for example, are less likely to have a comprehensive menu of options to raise funds in financial distress, and will be more likely to emphasise preparedness for orderly exit.²

Customer-owned banks typically also have relatively simple business lines with limited non-deposit taking/lending businesses and no overseas businesses to dispose of.

A characteristic feature of mutual ADIs compared to the wider banking sector is the use of mergers as an exit option. Mergers are an opportunity for inorganic growth for mutual ADIs while retaining assets in our sector. Several recent APRA speeches have highlighted this characteristic:

While there may be a range of recovery options available to ADIs, APRA recognises that for smaller ADIs with simple businesses the range of recovery options may be more limited, and that a merger or transfer of business may be the most effective recovery option.³

Under the new draft requirements, entities must have a plan for financial stress. For mutuals, in most cases this means developing feasible, entity-led transfer arrangements to other entities. As this is an entity's last defence ahead of failure, waiting for APRA to step in is not a fall-back option.⁴

The unique characteristics of mutual ADIs must be considered in the development of financial contingency standards, supervisory guidance and the associated guidance. In line with this, we seek more information as to what are considered to be reasonable preparatory steps for credible contingency options as well as further information on getting the balance right between examining recovery vs. exit options, given APRA's recent public commentary.

Supporting clearer expectations on ADI contingency planning

COBA supports APRA's intent to formalise requirements for financial contingency planning (FCP) and introduce a proportionate regulatory framework for these requirements.

The current FCP framework is based upon opaque informal guidance and supervisory expectations. The challenge for APRA and regulated entities is ensuring that sufficient effort is put into contingency planning to meet desired policy objectives in the most efficient and productive way possible so as to not distract from other business activities—many of which also seek to reduce the probability of failure.

COBA's view is that the publication of the standards and subsequent guidance will make it easier for regulated entities to meet and understand APRA's expectations.

¹ See [ECB's Benchmarking of Recovery Plans](#)

² Executive Director Policy and Advice Division Renée Roberts - Speech to Risk Management Institute of Australasia Annual Conference 2022

³ Deputy Chair John Lonsdale - Speech to Customer Owned Banking Association (COBA) 2020 Convention

⁴ APRA Deputy Chair John Lonsdale - Speech to the COBA CEO and Director Forum

For this consultation, while we welcome APRA's introduction of a proportionate and principles-based framework, without accompanying draft guidance it is difficult to provide informed analysis and commentary on the proposed framework.

At a high level, it is hard to disagree with proportionate and principles-based requirements but, as usual, the devil remains in the detail when these prudential requirements are accompanied by APRA's guidance and supervisory expectations.

Given APRA's proposed cross-industry standard and expected cross-industry guidance, a level of detail in both this guidance and prudential standards may also be lost given these requirements need to apply to all regulated entities and not just ADIs. COBA's view is that it would be helpful for ADIs to have specific guidance on these matters to minimise any misunderstandings around meeting APRA's expectations.

Recent comments from APRA Deputy Chair John Lonsdale have noted that there is a "lack of understanding of APRA's expectations" by smaller ADIs:

APRA observed that the general quality of recovery plans amongst smaller ADIs was weaker than we would like it to be, and that there was a lack of understanding of APRA's expectations.⁵

To promote understanding of APRA expectations, APRA must ensure that there is sufficient information available about these expectations, including those that relate to ADIs and in particular smaller and mutual ADIs.

While the release of the prudential standard outlines high-level requirements, it is hard to comment on them or prepare to meet them in the absence of guidance that provides more context and information on these requirements. This is important given APRA continues to highlight deficiencies in plans whilst the draft standards outline the need for 'trigger frameworks', 'credible options' and 'crisis communication strategies'.

Recent APRA reviews of plans in this cohort identified that most had weak or insufficient trigger frameworks that did not meet APRA's expectations. Additionally, at least half of the reviewed plans required either remediation of their crisis communication strategies or additional preparatory measures taken for contingency options to be credible. It is clear that there is work that needs to be done.⁶

COBA also notes that these requirements exist as minimum standards, with some expectations based on best practices seen in other entities that are not be visible to their competitors (noting that an entity's FCPs are only visible to itself and APRA at this point).

APRA is agnostic as to how these objectives are achieved by institutions, but in the course of supervising CPS 190 APRA will form views of what represents better practice and communicate this to institutions via the supervisory process.⁷

While COBA supports improvements in practices, the increasing expectation that ADIs should continually implement best practice does not recognise the limited resources of regulated entities. Ultimately, improving practices in one area can detract resources from others area that support similar objectives (for example, general risk management, financial claims scheme preparedness and, if applicable, resolution planning). The challenge for APRA is ensuring that this balance is right in the context of regulated entities having limited resources but expanding prudential expectations.

⁵ APRA Deputy Chair John Lonsdale - speech to Customer Owned Banking Association (COBA) 2020 Convention

⁶ APRA Deputy Chair John Lonsdale - Speech to the COBA CEO and Director Forum

⁷ Executive Director Policy and Advice Division Renée Roberts - Speech to Risk Management Institute of Australasia Annual Conference 2022

Supporting proportionality in standards and in practice

COBA supports APRA's approach to embed proportionality into the prudential framework both in general and in the specific context of financial contingency and resolution planning. However, COBA notes that the actual application of the requirements by APRA's supervisory teams determines whether they lead to the lower regulatory burden intended.

Between SFIs and non-SFIs

The CPS 190 and CPS 900 clearly delineate the requirements between the two groups. However, COBA notes that there are some aspects of proportionality that may currently be applied to ADIs and be proportionality only in name rather than in practice. For example, the 'relevant risk frameworks' integration requirement differences for SFIs and non-SFIs.

In addition, there may also be existing supervisory practices that exceed the minimum standards outlined for non-SFIs. While COBA's view is that any existing practices above the non-SFI minimum should be removed or relaxed with the introduction of the new standards, if they are not, then it should be clear to regulated entities that these are expectations despite the non-SFIs prudential standard not reflecting these requirements. This is important to ensure that non-SFIs can easily understand and meet APRA's expectations.

Within SFI and non-SFI groups

COBA notes that the standards refer to proportionality by "size, business mix and complexity". Given APRA's standard practices of benchmarking entities,⁸ some members question how APRA expects to benchmark each individual ADI. Given the wide variation in size, even within the mutual ADI cohort, we are interested in how APRA determines peers in its benchmarking process.

Reducing potential burden of resolution planning for the system

Under CPS 900, APRA's prudential requirements only apply to critical non-SFIs or SFIs at the point where APRA approaches an institution to commence the resolution planning process.

As noted earlier, COBA expects some COBA members to qualify as SFIs by 1 January 2024. We seek more information about what point (if at all) that these mutual ADIs SFIs would be subject to resolution planning given they are likely to remain simple albeit larger entities. We consider this clarity to be critical given the potential burden compared to the benefit of resolution planning in these cases. APRA has acknowledged this potential burden noting that "Given the resource intensity involved in resolution planning, it is likely that APRA will only be able to maintain a handful of resolution planning exercises annually across all industries, and some of these exercises will be multi-year exercises."⁹ If mutual ADI SFIs are captured, we would assume that if they are subject to these requirements that it would be several years after the 2024 start date as APRA undertakes resolution planning for the much larger ADIs. However, COBA's view is that APRA must consider the relative benefit against the cost of putting all possible SFIs through the resolution planning process (i.e. in practice not all SFIs will be required to do resolution plans).

COBA is concerned about applying resolution planning practices for much larger ADIs to our members, who may only be marginally above the SFI thresholds at this point, given that the resolution planning process is a significant unknown for most ADIs. COBA questions the value to the overall financial system of these entities being subject to resolution planning compared to focusing resources on much larger, more complex and systemically important entities.

⁸ Deputy Chair John Lonsdale - speech to Customer Owned Banking Association (COBA) 2020 Convention
"The review included the benchmarking of peer group recovery plans to identify areas for further improvement."

⁹ Executive Director Policy and Advice Division Renée Roberts - Speech to Risk Management Institute of Australasia Annual Conference 2022

Similarly, we question the example put forward of a critical function which notes that “An example of a critical function could be a very large deposit book that would impact large parts of the community if access was disrupted.”¹⁰ Under CPS 900, a non-SFI can be subject to resolution planning requirements if APRA judges it to have critical functions. A critical function is defined as “any function provided by an APRA-regulated entity that is important to financial system stability or the availability of essential financial services to a particular industry or community”. We note that many COBA members historically have industry or community bonds which could be captured in this definition if deposit-taking is an essential financial service. An overly expansive definition may lead to a lack of clarity regarding non-SFIs being caught in the resolution planning net. We do not believe it is APRA’s intention to capture these entities.

APRA should provide more certainty on when and if entities will be subject to resolution planning given the potential resourcing requirements. COBA’s view is that smaller ADIs have more economically beneficial prudential regulatory priorities than preparing for resolution planning.

Application of APRA’s current expectations and proposed expectations in the interim period

COBA members also seek clarity on how these proposed requirements apply in the context of current expectations during the interim period (i.e. now and when these requirements are in force) given APRA has potentially relaxed some requirements in the incoming non-SFI framework (examples such as stress testing and annual review requirements).

If you wish to discuss any aspect of this submission, please contact Mark Nguyen (mnguyen@coba.asn.au) or Luke Lawler (llawler@coba.asn.au).

Yours sincerely



MICHAEL LAWRENCE
Chief Executive Officer

¹⁰ APRA Discussion Paper: Strengthening crisis preparedness, December 2021

Annex A – Specific comments on CPS 190

Paragraph	Topic	Comments
CPS 190 15 & 35	Integration with other risk management frameworks	We note that there may be little practical difference between this SFI clause and the equivalent non-SFI clauses for ADIs given that the capital and liquidity frameworks are “relevant frameworks”.
CPS 190 19b & 39a	Trigger frameworks	<p>COBA questions whether there is difference between the non-SFI and SFI requirements for ADIs despite the less prescriptive wording for non-SFIs given APRA’s recent comments on our sector’s trigger frameworks.</p> <p>We also request more guidance on expectations around the content of trigger frameworks given APRA’s public comments on mutual ADI trigger frameworks. We note that calibration of trigger levels are specific to individual ADIs so should not be set prescriptively.</p>
CPS 190 19c & 19d 38c & 38d	Preferred contingency options Credibility of contingency options	<p>Some COBA members have indicated a preference that APRA provide preferred contingency options. COBA notes that any list would need to consider a number of elements such as size and industry.</p> <p>We seek more information as to what is considered to be “credible” and the role of preparatory measures in credibility. COBA notes that in previous guidance that the requirements in para 20 (only applying to SFIs) do form a key part of the ‘credibility’ definition.</p>
CPS 190 19f	Scenario analysis	While not explicitly a non-SFI requirement, COBA notes that if this is ever applied to non-SFIs, we would appreciate more guidance/APRA provision of these scenarios so ADIs focus on the analysis rather than scenario construction.
CPS 190 19h & 39e	Communications plans	We request more guidance on expectations around communications plans given APRA’s public comments on mutual ADI communication strategies.
CPS 190 26 & 43	Preparatory steps	<p>For both non-SFIs and SFIs, this clause notes that the “APRA-regulated entity must take reasonable preparatory steps...”.</p> <p>We seek more clarity on what APRA considers these preparatory steps as well as how this is materially different from para 20c.</p>
CPS 190 28 & 45	Plan updates	<p>We welcome APRA’s change to reduce the frequency of the annual plan review to every three years for non-SFIs.</p> <p>However, we seek clarity about whether the second line acts as a trigger to update the plan – i.e. non-SFIs must update plans every three years but also update it when there are changes in legal or organisational structure, business mix, strategy or risk profile.</p>

		If this is the case then this should have a 'material' or 'significant' qualifier.
CPS 190 30	Testing	We support APRA not including this requirement for non-SFIs given this testing may be burdensome relative to any perceived benefit.