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Review of the Australian Prudential Regulation Authority Annual Report 2019 (Second Report)

House of Representatives
Standing Committee on Economics

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Chair's foreword

2020 has been a challenging year for Australians, businesses and our institutions, and APRA has not been exempted.

The COVID-19 pandemic has caused unprecedented disruption to our lives. While the pandemic is primarily a public health issue, it has significantly impacted economies and financial systems around the world. It has led to the closure of our borders; the biggest economic downturn in close to a century; pressure on many small and medium businesses from tough public health measures; and historically low interest rates.

The Australian financial sector and its regulators responded quickly to the pandemic. Financial institutions provided support to Australian families and businesses as they worked to manage their mortgages and debts during a time when income is disrupted. The Morrison government's early release scheme reunited Australians with their own superannuation savings to help them during this difficult time. While some uncertainty remains, it is encouraging that there appears to be a strong economic comeback for Australia against the experience of many other economies.

On the health side, being 'girt by sea' enabled Australia to be one of the few nations that was able to close its international borders and effectively stop COVID-19 entering. Closing our international borders has been the single biggest public health measure taken to protect Australians. The only examples of community transmission have come as a result of a breach of those borders.

On the economic side, when the Australian economy went into this crisis it was better positioned than most to weather the storm. Having a Federal Budget in balance has ensured that lockdown measures could be offset by fiscal support through temporary increases in JobSeeker and the creation of the temporary JobKeeper program. It is a reminder that you are prudent on the 'sunny days' in the hope that 'rainy days' never come, but inevitably do.

The role that APRA has played has also been crucial–particularly in ensuring banks could lend to businesses that faced significant and rapid readjustments in a time of crisis.

The opportunity of Australia's economic comeback is to not simply resuscitate Australia's 20th Century economy but build a forward-looking modern 21st Century economy that provides the foundation for sustainable growth that provides the next generation of Australians with opportunity, employment and home ownership.

However, the economic comeback brings its own challenges. It is essential that governments, regulators, and financial institutions continue to be proactive and work together as the immediacy of the crisis fades and the hard work of economic comeback continues.

The committee notes APRA's proactive and ongoing engagement with peak bodies, superannuation funds, and financial institutions throughout the various stages and changing circumstances of the pandemic. In particular, the committee notes the strong relationship and high level of cooperation and coordination that ASIC and APRA have displayed during this challenging period. The committee notes APRA's progress implementing the Capability Review and the Royal Commission's recommendations, acknowledging the disruption caused by the pandemic and the deferral of implementation of commitments associated with the Royal Commission.

In 2021 the committee will continue to scrutinise APRA's performance; its ongoing implementation of the Royal Commission recommendations and the Capability Reviews recommendations; and the ongoing strengthening of APRA's capability. In particular, the committee will follow APRA's ongoing response to the COVID-19 pandemic as we continue to manage the impacts of the pandemic and begin to focus on the path to recovery.

On behalf of the committee, I thank the Chair of APRA, Mr Wayne Byres, and other APRA representatives for appearing at the public hearings on 5 August 2020 and 23 October 2020.

Tim Wilson MP
Chair

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Chair Mr Tim Wilson MP

Deputy Chair Hon Dr Andrew Leigh MP

Members Dr Anne Aly MP (to 8 October 2020)

Mrs Bridget Archer MP (to 27 August 2020)

Mr Adam Bandt MP

Mr Jason Falinski MP

Ms Celia Hammond MP (from 27 August 2020)

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Ms Peta Murphy MP (from 8 October 2020)

Mr Ted O'Brien MP (to 27 August 2020)

Mr Julian Simmonds MP (from 27 August 2020)

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Terms of reference

The House of Representatives Standing Committee on Economics is empowered to inquire into, and report on, the annual reports of government departments and authorities tabled in the House that stand referred to the committee for any inquiry the committee may wish to make. The reports stand referred in accordance with the schedule tabled by the Speaker to record the areas of responsibility of the committee.

List of abbreviations

ABA	Australian Banking Association
ACCC	Australian Competition and Consumer Commission
ADIs	authorised deposit-taking institutions
AFCA	Australian Financial Complaints Authority
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ASX	Australian Securities Exchange
ATO	Australian Taxation Office
BEAR	Banking Executive Accountability Regime
Capability Review	Australian Prudential Regulation Authority Capability Review
ESG	environmental, social and governance
GCRA	governance, culture, remuneration and accountability
MoU	Memorandum of Understanding
PDC	COVID-19 Pandemic Data Collection
PHIs	private health insurers
RBA	Reserve Bank of Australia
Royal Commission	Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry
RSE	Registrable Superannuation Entity

SMEs	small and medium-sized enterprises
SRI	Supervision Risk and Intensity Model

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Introduction

Background

1.1 The House of Representatives Standing Committee on Economics (the committee) is empowered to inquire into, and report on, the annual reports of government departments and authorities tabled in the House that stand referred to the committee in accordance with the Speaker's Schedule.

1.2 The Australian Prudential Regulatory Authority (APRA) annual reports stand referred to the committee in accordance with this schedule. On 23 October 2019, the committee resolved that it would conduct an inquiry into APRA's 2019 Annual Report.

1.3 APRA is Australia's prudential regulator. It is an independent statutory authority that supervises institutions across banking, insurance, and superannuation and promotes financial system stability in Australia. APRA oversees authorised deposit-taking institutions (ADIs), such as banks, building societies, and credit unions; general insurers, life insurers, and reinsurance companies; private health insurers; friendly societies; and superannuation funds (excluding self-managed funds).[1]

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1 APRA, 'About APRA', <https://www.apra.gov.au/about-apra>, accessed 10 November 2020.

1.4 APRA is tasked with protecting the interests of depositors, policyholders, and superannuation members by establishing and enforcing prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by the institutions it supervises are met within a stable, efficient and competitive financial system.[2]

1.5 APRA's vision is to 'deliver a sound and resilient financial system, founded on excellence in prudential supervision'. Its *Corporate Plan 2019-2023* identifies four areas of strategic focus 'aimed at strengthening outcomes for the Australian community':

- maintaining financial system resilience;
- improving outcomes for superannuation members;
- improving cyber-resilience across the financial system; and
- transforming governance, culture, remuneration and accountability across all regulated financial institutions.[3]

1.6 It also identified key areas where it will focus on uplifting its own capabilities, including:

- improving and broadening its risk-based supervision;
- improving its resolution capability;
- improving its external engagement and collaboration;
- transforming its data-enabled decision making; and
- transforming its leadership, people, and culture.[4]

Scope and conduct of the review

1.7 APRA appeared before the committee at two public hearings held via videoconference on 5 August 2020 and 23 October 2020. Details are provided at Appendix A.

1.8 The proceedings were webcast through the Parliament's website, allowing interested parties to view or listen to the proceedings as they occurred. The transcripts of the hearings are available on the committee's website.[5]

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2 APRA, *Annual Report 2018-19*, p. 18.

3 APRA, *Corporate Plan 2019-23*, August 2019, p. 5.

4 APRA, *Corporate Plan 2019-23*, August 2019, p. 5.

1.9 APRA's responses to the committee's questions on notice and in writing are provided on the committee's website.[6]

1.10 This report focuses on matters raised at the public hearings.

5 House of Representatives Standing Committee on Economics, <https://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/APRAAnnualReport2019-2/Public_Hearings>.

6 House of Representatives Standing Committee on Economics, <https://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/APRAAnnualReport2019-2/Documents>.

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Current issues in prudential regulation

Overview

2.1 The Australian Prudential Regulation Authority (APRA) appeared before the House of Representatives Standing Committee on Economics (the committee) at two public hearings held via videoconference on 5 August 2020 and 23 October 2020 as part of its review of the APRA Annual Report 2019.

2.2 Issues raised at the hearings focused on APRA's response and regulatory approach to the COVID-19 pandemic including loan repayment deferrals, guidance to banks, and the early release of superannuation scheme. The committee also scrutinised APRA's supervisory approach to superannuation, including the valuation of unlisted assets, as well as the risks facing the private health insurance sector.

2.3 Other topics discussed included APRA's progress in implementing the recommendations arising from the APRA Capability Review (Capability Review) and the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission).

Improving APRA's capability

2.4 The Royal Commission raised questions regarding regulators' ability to anticipate and deal forcefully with the widespread misconduct that it uncovered. It made several recommendations regarding APRA's remit and regulatory approach. The Government and APRA agreed to implement the recommendations.[1]

2.5 The Capability Review concluded that 'variability in leadership, a conformist culture, and aversion to transparency are constraining APRA'. It emphasised that 'in matters of traditional financial risk APRA is an impressive and forceful regulator'. However, it observed that:

> …APRA's tolerance for operating beyond quantifiable financial risks has been low. APRA appears to have developed a culture that is unwilling to challenge itself, slow to respond and tentative in addressing issues that do not entail traditional financial risks. In combination with APRA's organisational structure, these factors limit its ability to deliver on the breadth of its mandate and adapt to new challenges.[2]

2.6 The Government and APRA agreed to implement the Capability Review's recommendations.[3]

Update on progress since previous report

2.7 To date, APRA has released four updates (in February and August 2019 and February and March 2020) on its progress implementing the changes recommended by the Royal Commission and Capability Review. APRA told the committee that 'of the 10 recommendations directed at APRA, three are complete, and a further six will be completed in 2020-21'.[4] Details of the status and actions taken to date by APRA in relation to the recommendations contained in the Final Report of the Royal Commission are at Table 2.1.

1 APRA, 'APRA's response to Royal Commission recommendations', <https://www.apra.gov.au/apras-response-to-royal-commission-recommendations>, accessed 14 September 2020.

2 Treasury, *APRA Capability Review*, July 2019, p. xviii.

3 Treasury, *Government Response to the APRA Capability Review*, July 2019, <https://treasury.gov.au/publication/p2019-395827>, accessed 3 November 2020; APRA, *APRA's response to the Capability Review report*, <https://www.apra.gov.au/apras-response-to-capability-review-report>, accessed 3 November 2020.

4 APRA, 'Opening Statement to the House of Representatives Standing Committee on Economics – August 2020', 5 August 2020, <https://www.apra.gov.au/news-and-publications/opening-statement-to-house-of-representatives-standing-committee-on-1>, accessed 18 November 2020, p. 6.

Table 2.1 APRA's actions on the Royal Commission recommendations

Recommendation	Status and APRA's action
1.12 Valuations of land	**Completed**. APRA amended APS 220 Credit Risk Management which provided a stronger set of requirements in relation to the independent valuation of collateral, as well as additional specification of issues that should be considered in valuations, particularly of agricultural land.[5]
1.17 BEAR product responsibility	**Incorporated into the Financial Accountability Regime work under the Government's Royal Commission implementation roadmap.** In December 2019, APRA released its Governance and Senior Executive Accountabilities that describes APRA's internal governance and accountability arrangements and is supported by individual accountability statements for senior executive roles and an accountability map.[6]
4.14 Additional scrutiny for related party engagements **4.15** Status attribution to be fair and reasonable	**In progress.** In November 2019, APRA released for consultation its proposed revisions to SPS 250, which are aimed at improving superannuation member outcomes by helping trustees select the most appropriate policies for their members. In August 2020, APRA stated it expects SPS 50 to be finalised in the first half of 2021.[7]
5.1, 5.2 Supervision of remuneration — principles, standards and guidance, aims **5.3** Revised prudential standards and guidance	**In progress.** In July 2019, APRA released a discussion paper and draft prudential standard to strengthen remuneration practices across all APRA-regulated entities. In August 2020, APRA stated it will recommence consultation in the latter part of 2020, with a view to finalising new requirements in mid-2021.[8]

5 APRA, *Twelve months on: APRA's progress on the Royal Commission recommendations*, 28 February 2020, <https://www.apra.gov.au/twelve-months-on-apra%E2%80%99s-progress-on-royal-commission-recommendations>, accessed 26 October 2020.

6 APRA, *Twelve months on: APRA's progress on the Royal Commission recommendations*, 28 February 2020, < https://www.apra.gov.au/twelve-months-on-apra%E2%80%99s-progress-on-royal-commission-recommendations>, accessed 26 October 2020; APRA, 'Opening Statement to the House of Representatives Standing Committee on Economics – August 2020', 5 August 2020, <https://www.apra.gov.au/news-and-publications/opening-statement-to-house-of-representatives-standing-committee-on-1>, accessed 18 November 2020, p. 6.

7 APRA, 'Consultation on Prudential Standard SPS 250 Insurance in Superannuation', November 2019, <https://www.apra.gov.au/consultation-on-prudential-standard-sps-250-insurance-superannuation>, accessed 18 November 2020; APRA, 'Opening Statement to the House of Representatives Standing Committee on Economics – August 2020', 5 August 2020, <https://www.apra.gov.au/news-and-publications/opening-statement-to-house-of-representatives-standing-committee-on-1>, accessed 18 November 2020, p. 6.

8 APRA, 'Discussion Paper: Strengthening prudential requirements for remuneration', 23 July 2019; APRA, 'Opening Statement to the House of Representatives Standing Committee on Economics – August 2020', 5 August 2020, <https://www.apra.gov.au/news-and-publications/opening-statement-to-house-of-representatives-standing-committee-on-1>, accessed 18 November 2020, p. 6.

Recommendation	Status and APRA's action
5.7 Supervision of culture and governance	**In progress.** In November 2019, APRA published its information paper *Transforming governance, culture, remuneration and accountability: APRA's approach*.[9] In August 2020, APRA stated that some aspects of its program have had to be deferred or slowed as a result of COVID-19.[10]
6.10 Co-operation memorandum	**Completed.** APRA and ASIC issued a revised Memorandum of Understanding (MoU) on 29 November 2019.[11]
6.12 Application of the BEAR to regulators	**Completed.** In December 2019, APRA published its *Governance and Senior Executive Accountabilities*. The publication was updated in May 2020.[12]

2.8 The committee asked APRA about its response to the Capability Review's recommendation that it should revise its organisational structure. APRA advised that in October 2019 it had 'moved to an industry aligned structure' and restructured its supervision divisions along industry lines—banking, insurance and superannuation.[13]

2.9 APRA explained that it had also 'significantly increased' its resourcing in superannuation. It told the committee that 30 per cent of additional resources are 'focused on superannuation supervision' and added that it has extra capacity and capability in superannuation support areas such as 'policy, legal, enforcement and risk'.[14]

Enforcement

2.10 The Royal Commission and Capability Review criticised APRA's approach to enforcement—one of its core functions as a financial regulator. The findings of the Royal Commission prompted APRA to conduct an

9 APRA, 'APRA sets out stronger, more transparent approach to regulating and supervising GCRA risks', *Media Release*, 19 November 2019.

10 APRA, 'Opening Statement to the House of Representatives Standing Committee on Economics – August 2020', 5 August 2020, <https://www.apra.gov.au/news-and-publications/opening-statement-to-house-of-representatives-standing-committee-on-1>, accessed 18 November 2020, p. 6.

11 APRA, 'ASIC and APRA issue updated MoU', *Media Release*, 29 November 2019.

12 APRA, *Governance and Senior Executive Accountabilities*, 18 May 2020, <https://www.apra.gov.au/governance-and-senior-executive-accountabilities>, accessed 30 October 2020.

13 Mrs Helen Rowell, Deputy Chair, APRA, *Transcript*, 5 August 2020, p. 21; APRA, 'APRA announces new executive roles', *Media Release*, 3 October 2019.

14 Mrs Helen Rowell, Deputy Chair, APRA, *Transcript*, 5 August 2020, p. 21.

Enforcement Strategy Review and APRA acknowledged that it needed to take stronger action earlier when it is appropriate.[15]

2.11 The Enforcement Strategy Review final report concluded that 'APRA's appetite to use enforcement "primarily…as a last resort and mainly where financial promises or stability are at risk" has been too low' and provided seven recommendations to 'strengthen APRA's enforcement approach and ensure it remains sustainable and effective into the future'.[16]

2.12 In addition, the Capability Review stated that APRA needed to 'respond more quickly and effectively and increase its appetite to prosecute concerns in areas such as operational risk and [governance, culture and accountability] risks'.[17]

2.13 In April 2019, APRA launched its new Enforcement Approach. It acknowledged that, 'much of APRA's work is achieved through using non-formal approaches and working cooperatively with entities to identify and rectify problems before they threaten the ability of an entity to meet its financial promises'. However APRA stated that it is 'prepared to take enforcement action to deliver its prudential mandate when appropriate', explaining that:

> …APRA will be prepared to use enforcement to prevent and address serious prudential risks and to hold entities and individuals to account. APRA may do this well before the risks (whether financial, operational or behavioural) present an imminent threat to financial viability. Where entities or individuals are failing to meet prudential obligations, APRA will act quickly and forcefully, and be willing to set public examples to deter unacceptable practices from occurring in the future. APRA will also use enforcement where appropriate to ensure that the data it collects remains fit for purpose for its users.[18]

2.14 The Enforcement Approach includes a framework outlining the criteria that APRA uses to identify matters for potential enforcement action and

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15 APRA, *Enforcement Strategy Review Final Report*, 29 March 2019, <https://www.apra.gov.au/sites/default/files/apra_enforcement_strategy_review_-_final_report_web.pdf>, accessed 18 November 2020, p. 7.

16 APRA, *Enforcement Strategy Review Final Report*, 29 March 2019, <https://www.apra.gov.au/sites/default/files/apra_enforcement_strategy_review_-_final_report_web.pdf>, accessed 18 November 2020, pp. 7-9.

17 Treasury, *APRA Capability Review*, July 2019, p. 113.

18 APRA, *APRA's Enforcement Approach*, 3 September 2019, <https://www.apra.gov.au/sites/default/files/apras_enforcement_approach_-_final.pdf>, accessed 18 November 2020, p. 7.

the principles guiding 'APRA's strategic decisions on when and how to take enforcement action'.[19]

Matters arising from the Royal Commission

2.15 APRA told the committee that it received 12 direct referrals on 10 entities from the Royal Commission. It explained that its approach is to first gather information on each of the entities, look critically at the case, and then seek independent legal advice (in addition to its own legal advice) to determine the course of action it will follow.[20]

2.16 APRA advised that 'for all of these referrals, no actual penalty applies' and that this has 'driven a lot of the thinking on how we proceed'. It told the committee that, for eight of the 10 entities, APRA has 'a firm course of action'. APRA explained that the 'course of action may have involved a thematic review'. APRA explained that, in these cases 'the actual issues that have been identified have raised other issues more broadly within industry, so we're doing a deeper dive'. [21]

2.17 APRA told the committee that it can also apply license conditions or utilise its new directions power, noting that it has 'done that several times'.[22] APRA advised that it is undertaking a formal investigation for four of the entities, explaining that it has determined that 'there's enough there to actually have a statutory investigation'. APRA told the committee that the formal investigations are currently underway.[23]

Supervision

2.18 In January 2020, APRA released an information paper outlining its supervisory priorities over the banking, insurance, and superannuation industries supported by an increased focus on recovery and resolution planning and stress testing. APRA's planned supervisory activities cover four core priorities:

- maintaining financial system resilience;
- improving cyber resilience;

19 APRA, *APRA's Enforcement Approach*, 3 September 2019, <https://www.apra.gov.au/sites/default/files/apras_enforcement_approach_-_final.pdf>, accessed 18 November 2020, p. 7.

20 Mr John Lonsdale, Deputy Chair, APRA, *Transcript*, 5 August 2020, pp. 20-21.

21 Mr John Lonsdale, Deputy Chair, APRA, *Transcript*, 5 August 2020, pp. 20-21.

22 Mr John Lonsdale, Deputy Chair, APRA, *Transcript*, 5 August 2020, pp. 20-21.

23 Mr John Lonsdale, Deputy Chair, APRA, *Transcript*, 5 August 2020, pp. 20-21.

- transforming governance culture, remuneration and accountability; and
- improving outcomes for superannuation members.[24]

2.19 In addition, APRA recently finalised its new Supervision Risk and Intensity (SRI) Model, which replaced its older risk rating and response tools. The model is a new system to assess risk and determine supervisory intensity and enables APRA supervisors to make robust and timely risk assessments of an entity and develop appropriate supervision strategies.[25]

2.20 In March 2020, APRA announced the temporary suspension of part of its policy and supervisory agenda to focus on the disruption caused by the COVID-19 pandemic. APRA stated that its 'primary supervision focus will be on monitoring the impact of COVID-19 on the financial and operational capacity of regulated institutions'. It explained that:

> APRA's refocused supervision effort will involve frequent communication with entities, monitoring key financial settings, such as capital and liquidity, and responding accordingly. These engagements will be conducted virtually, unless absolutely necessary, and will continue as long as necessary.[26]

Competition

2.21 The Capability Review panel stated that APRA should 'take a more structured approach to competition and other balancing considerations, including in cooperation with the ACCC' and recommended that APRA create a competition champion, to ensure there is sufficient analysis of competition, and to regularly report on competition developments.[27]

2.22 The committee asked for an update on APRA's implementation of this recommendation. APRA advised the committee that it is implementing not one, but four competition champions. It explained that it is a 'core requirement of APRA's mandate to balance stability and resilience in the system with competition neutrality', which is a responsibility for all APRA members and the agency.[28]

24 APRA, *Information Paper: APRA's Supervision Priorities*, January 2020.

25 APRA, *Guide: Supervision Risk and Intensity Model*, 6 October 2020.

26 APRA, 'APRA adapts 2020 agenda to prioritise COVID-19 response', *Media Release*, 23 March 2020.

27 Treasury, *APRA Capability Review*, July 2019, pp. 72-73.

28 Mr John Lonsdale, Deputy Chair, APRA, *Transcript*, 23 October 2020, p. 61.

2.23 APRA pointed to its *Information Paper: APRA's objectives*, published in November 2019. In it, APRA outlines its approach to balancing its objectives:

> It is sometimes considered that there must be a trade-off between safety and stability, on the one hand, and competition and efficiency in the financial system on the other. APRA is of the view that, with the right balance, the goals can be mutually reinforcing. Stability can support a competitive environment, with competition bringing increased efficiency, welcoming innovation and enhancing outcomes for customers…Good regulatory settings can deliver financially strong competitors, creating both financial stability and a dynamic and innovative marketplace for financial services.[29]

2.24 APRA told the committee that it has 'taken a number of steps in recent years with a competition perspective firmly in mind'. It explained that this includes 'facilitative measures to promote more active competition and simplification efforts aimed at lifting the burden on smaller ADIs'.[30]

2.25 APRA told the committee that it has revised its Memorandum of Understanding (MoU) with the Australian Competition and Consumer Commission (ACCC). It explained that APRA has been 'strengthening our work with the ACCC', noting that, 'we meet regularly with them…I personally meet with Sarah Court and her people every quarter'.[31]

Deferral of implementation of commitments

2.26 In May 2020, the Government announced a six-month deferral of the implementation of commitments associated with the Royal Commission as a result of the significant impacts of COVID-19. The announcement explained that:

> The deferral will enable the financial services industry to focus their efforts on planning for the recovery and supporting their customers and their staff during this unprecedented time.
>
> Under the updated timetable, those measures that the Government had indicated would be introduced into the Parliament by 30 June 2020, will now be introduced by December 2020. Similarly,

29 APRA, *Information Paper: APRA's Objectives*, 11 November 2019, pp. 14-15.

30 APRA, *Response to question on notice*, APRA11QW, p. 1.

31 Mr John Lonsdale, Deputy Chair, APRA, *Transcript*, 23 October 2020, p. 61.

> those measures originally scheduled for introduction by December 2020 will now be introduced by 30 June 2021.[32]

Response to the COVID-19 pandemic

2.27 On 23 March 2020, APRA announced the suspension of 'the majority of its planned policy and supervision initiatives in response to the impact of COVID-19'.[33] APRA stated it has pivoted 'quickly and proactively' from its agenda in December 2019 'to one that is focused on ensuring the financial system remains financially and operationally sound in very trying circumstances'.[34]

2.28 During this time, APRA advised that it has:

- reduced its operational burden on the industry by postponing a range of activities;
- provided targeted and temporary concessions to assist in facilitating the broader package of economic and financial support being offered by the government, the RBA, and the industry itself; and
- made clear that the financial strength it has required the industry to build up over the past four to five years is now available to be used to absorb losses and support customers.[35]

2.29 APRA told the committee that prudential guidance regarding pandemic risk has been in place for the last 13 years. It advised that stress-testing for pandemics are a current and ongoing requirement, which is 'built into the capital standards of firms'. APRA explained that it conducts 'stress tests across a basket of risks for banks and insurers on a very regular basis, and a pandemic scenario and a pandemic capital requirement provision is included in those stress tests'.[36]

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32 Treasury, 'Update on the implementation of the Banking, Superannuation and Financial Services Royal Commission', *Media Release*, 8 May 2020.

33 APRA, 'APRA adapts 2020 agenda to prioritise COVID-19 response', *Media Release*, 23 March 2020.

34 Mr Wayne Byres, Chair, APRA, *Transcript*, 5 August 2020, p. 20.

35 APRA, 'Opening Statement to the House of Representatives Standing Committee on Economics – August 2020', 5 August 2020, <https://www.apra.gov.au/news-and-publications/opening-statement-to-house-of-representatives-standing-committee-on-1>, accessed 18 November 2020, p. 1.

36 Mr Geoff Summerhayes, Executive Board Member, APRA, *Transcript*, 5 August 2020, p. 26.

2.30 APRA advised that the stress-tests are 'why we feel somewhat reassured in the resilience of the APRA-regulated entities at this point in an incredibly challenging crisis'.[37] It explained that:

> …we would regard the fact that the industry has withstood this period of significant disruption as evidence that actually that has had effect. It folds into a broader resilience, an operational resilience—with business continuity planning—of the industry. That has been something that has had regular supervisory engagement. As I said, the proof of the pudding is that the industry thus far has stood up very, very well to a period of significant disruption.[38]

2.31 APRA told the committee that 'financial firms and APRA regulated firms have done, comparatively, very well through this pandemic so far and have been there to support the community'.[39]

2.32 However, APRA noted that it is preparing itself for 'what happens as the government support mechanisms start to fade or are gradually wound down and we see the full economic impacts of the virus flowing through'.[40] APRA explained that for the remainder of 2020 and into 2021, it will be 'keeping a very close look on credit quality and the impact that that will have on the banks' balance sheets'.[41]

Regulatory relief

2.33 APRA told the committee that it had received 'a large number of applications for concessions or relief from different aspects of the prudential framework and/or reporting requirements'.[42] It reported that it had received 266 applications for regulatory relief from financial institutions related to COVID-19 prior to the end of the financial year. As at 25 August 2020, a total of 248 applications were assessed, of which 224 were granted and 24 were declined. The remaining 18 applications remained under consideration.[43]

37 Mr Geoff Summerhayes, Executive Board Member, APRA, *Transcript*, 5 August 2020, p. 26.

38 Mr Geoff Summerhayes, Executive Board Member, APRA, *Transcript*, 5 August 2020, pp. 26-27.

39 Mr Geoff Summerhayes, Executive Board Member, APRA, *Transcript*, 23 October 2020, p. 60.

40 Mr Wayne Byres, Chair, APRA, *Transcript*, 23 October 2020, p. 54.

41 Mr John Lonsdale, Deputy Chair, APRA, *Transcript*, 23 October 2020, p. 54.

42 Mr Wayne Byres, Chair, APRA, *Transcript*, 23 October 2020, p. 53.

43 APRA, *Annual Report 2019-20*, p. 24.

2.34 When asked to explain its basis for declining 24 regulatory relief applications, APRA told the committee that 'there were instances where we thought it was still reasonable, notwithstanding the COVID environment, that the bank, insurance company or super fund should still be able to adhere to the prudential obligations that they had'. It explained that these entities 'didn't really have a valid basis for receiving a waiver, a concession or a deferral of the obligation, so we said no'.[44]

Temporary suspension of licensing

2.35 APRA told the committee that it had suspended licencing of any new entities for six months in response to COVID-19, as it believed that 'it was better for competition and stability to have those entities come in when there was a little bit more certainty in the system'.[45] APRA advised that it has recently recommenced licensing of banking, insurance, and superannuation businesses in two phases:

- the first phase will 'concentrate on branches or subsidiaries, where the parent might be well capitalised with strong established systems'; and
- the second phase, which will be implemented in early 2021, will be 'for new or very small players'.[46]

2.36 APRA added that it has a team of staff who 'deals specifically with newly licenced entities or entities who would like to be newly licenced' to try and facilitate the process 'as best we can'.[47]

Loan repayment deferrals

2.37 In March 2020, the Federal Government announced two economic support packages totalling $189 billion to 'keep Australians in work and businesses in business'. The packages included support for households, and regulatory protection and financial support for businesses to retain staff and stay in business.[48]

2.38 After the announcement, the Australian Banking Association (ABA) encouraged businesses and individuals that were financially impacted by

44 Mr Wayne Byres, Chair, APRA, *Transcript*, 23 October 2020, p. 53.

45 Mr John Lonsdale, Deputy Chair, APRA, *Transcript*, 23 October 2020, p. 56.

46 Mr John Lonsdale, Deputy Chair, APRA, *Transcript*, 23 October 2020, p. 56.

47 Mr John Lonsdale, Deputy Chair, APRA, *Transcript*, 23 October 2020, p. 56.

48 Prime Minister and Treasurer, 'Supporting Australian workers and business', *Media Release*, 22 March 2020.

COVID-19 to contact their financial institutions. The ABA told customers that the assistance offered from banks could include:

- a deferral of scheduled loan repayments;
- a six-month deferment of all loan repayments attached to a small business through the SME Guarantee Scheme;
- waiving of fees and charges;
- interest free periods or no interest rate increases; and
- debt consolidation to help make repayments more manageable.[49]

2.39 In March 2020, APRA announced a temporary capital treatment for bank loans with repayment deferrals, under which 'banks that offered borrowers impacted by the COVID-19 pandemic an option to defer repayments for a period of up to six months need not treat the repayment deferral period as a period of arrears for capital adequacy and regulatory reporting purposes'. APRA will also 'provide an adjustment to the normal regulatory treatment of loans that are restructured'.[50]

2.40 In July 2020, APRA extended its temporary capital treatment for bank loans to a 'maximum period of 10 months from the start of a repayment deferral, or until 31 March 2021, whichever comes first'.[51]

2.41 APRA explained that, given the volume of deferrals, it 'considers it reasonable to provide authorised deposit-taking institutions (ADIs) more time to determine the best approach for each borrower'. It noted that, 'while some customers are able to return to making normal payments in the near future, for others it may be preferable for an ADI to restructure or renegotiate the loan to provide a revised repayment schedule' and that 'in some cases, banks will need to recognise that loans are permanently impaired'.[52]

2.42 APRA advised that these measures are 'designed to incentivise ADIs to continue to support their customers through an extended period of

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49 Australian Banking Association, 'Economic stimulus package will help keep economy strong', *Media Release*, 12 March 2020; Australian Banking Association, 'Second stimulus package will help support small business', *Media Release*, 22 March 2020.

50 APRA 'APRA updates regulatory approach to loans subject to repayment deferral', *Media Release*, 8 July 2020.

51 APRA 'APRA updates regulatory approach to loans subject to repayment deferral', *Media Release*, 8 July 2020.

52 APRA 'APRA updates regulatory approach to loans subject to repayment deferral', *Media Release*, 8 July 2020.

uncertainty, while at the same time facilitating the restructure of eligible loans in a measured and timely manner'.[53]

2.43 As at 30 September 2020, APRA reported that $179 billion of loans have been granted temporary repayment deferrals, which is approximately 6.7 per cent of total loans outstanding. It noted that housing loans make up the majority of total loans granted repayment deferrals, but that SME loans have a higher incidence of repayment deferral, with 10.8 per cent of SME loans subject to repayment deferral, compared with 7.4 per cent of housing loans.[54]

2.44 APRA reported that exits from deferral continued to outweigh new entries for the third straight month in September, with $66 billion of loans expiring or exiting deferral and $17 billion of entries approved or extended. It noted that the pace of exits increased significantly over the month, with total exits increasing 169 per cent from $24 billion in August. The majority of these loans have returned to a performing status.[55]

Protecting consumers

2.45 In July 2020, APRA wrote to ADIs outlining the treatment of loans impacted by COVID-19. It advised that 'regardless of the capital treatment, it is the responsibility of ADIs to determine the most appropriate response when borrowers encounter a period of financial hardship'. The letter set out APRA's approach, explaining that:

> APRA expects ADIs to proactively engage with affected borrowers between now and the end of the current deferral period to determine whether to grant an extension on the deferral period, to restructure or to recognise a loan as impaired. ADIs should be encouraging borrowers that can restart repayments to do so, and to identify, monitor and manage those loans where this is not possible. APRA will be engaging closely with ADIs on their credit risk management practices for affected loans.[56]

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53 APRA 'APRA updates regulatory approach to loans subject to repayment deferral', *Media Release*, 8 July 2020.

54 APRA, *Temporary loan repayment deferrals due to COVID-19, September 2020*, <https://www.apra.gov.au/temporary-loan-repayment-deferrals-due-to-covid-19-september-2020>, accessed 18 November 2020.

55 APRA, *Temporary loan repayment deferrals due to COVID-19, September 2020*, <https://www.apra.gov.au/temporary-loan-repayment-deferrals-due-to-covid-19-september-2020>, accessed 18 November 2020.

56 APRA, 'Letter: Treatment of loans impacted by COVID-19', 9 July 2020, <https://www.apra.gov.au/sites/default/files/2020-07/Letter%20to%20authorised%20deposit-taking%20institutions%20-

2.46 In September 2020, APRA wrote to ADIs again, advising that it had received and completed its review of all ADI comprehensive plans for the assessment and management of loans with repayment deferrals. APRA noted that 'successful implementation of these plans remains a critical risk for both ADIs and borrowers' and that APRA 'expects that ADIs will exercise appropriate governance and monitoring over all aspects of the plan's implementation, in order to identify and respond to any material issues that may arise'.[57]

2.47 APRA told the committee that it is 'in very close discussions with the banks'. APRA advised that it is working closely with the Australian Securities and Investments Commission (ASIC) 'seeking assurances from the banks' regarding how they are processing loan deferrals as well as how banks are contacting customers and the types of discussions that are occurring.[58]

After the deferral period ends

2.48 The committee asked about the protections for consumers who may not be able to resume mortgage payments after the deferral periods ends. APRA acknowledged that it is 'a very difficult issue'. It explained that:

> At the end of the day, there will be some loans that are impaired; there will be some loans where customers will not be able to pay back the loan. And that happens now, so there are established hardship provisions and established mechanisms where that works its way through the system. But it is a very difficult set of issues…there is a whole process that would then follow through hardship.[59]

2.49 APRA confirmed that it considers its current hardship provisions adequate for the pandemic situation and stated that 'at this stage, we haven't seen any reason to question them'.[60]

2.50 The committee asked whether the deferral of loan payments could get borrowers out of the habit of making repayments and, ultimately, exacerbate the problems of bad debt. APRA told the committee that 'this is

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%20Treatment%20of%20loans%20impacted%20by%20COVID-19.pdf>, accessed 24 November 2020.

57 APRA, 'Letter: Review of treatment of loans impacted by COVID-19', 22 September 2020, <https://www.apra.gov.au/review-of-treatment-of-loans-impacted-by-covid-19>, accessed 27 October 2020.

58 Mr John Lonsdale, Deputy Chair, APRA, *Transcript*, 5 August 2020, p. 28.

59 Mr John Lonsdale, Deputy Chair, APRA, *Transcript*, 5 August 2020, p. 28.

60 Mr John Lonsdale, Deputy Chair, APRA, *Transcript*, 5 August 2020, p. 28.

not an approach that is without risk, but doing nothing is also risky'. It acknowledged that this is 'a very difficult set of situations, but we think we've taken the right and prudent course of action'.[61]

2.51 APRA advised that banks are responsible for determining whether to grant a deferral and how repayments will flow, noting that 'these are commercial decisions that banks undertake with their customers'.[62] APRA explained that, while some customers will be able to return to paying full interest and principal repayments after the deferral period ends, it expects that there will be others that are not quite ready to return to paying full principal and interest, as well as a 'group of impaired loans where the loan cannot be paid back'.[63]

2.52 APRA told the committee that, as at October 2020, loan repayment deferrals have 'come down significantly'. APRA explained that originally the deferrals were 'around 10 per cent of the banks' books' and are now 'around 6.6 per cent', which it described as a 'significant reduction'.[64]

2.53 APRA added that it is continuing to work closely with those banks that still have deferrals in place 'to make sure that they have a plan in place, that they're contacting borrowers, that their risk governance is good and that as many people as possible can be contacted and come off deferrals'. APRA noted that loan impairment rates are 'very low' and that most loans are 'coming off deferrals or being restructured in some way'.[65]

Dividends

2.54 In April 2020, APRA wrote to ADIs and insurers advising that it expects entities 'to limit discretionary capital distributions in the months ahead, to ensure that they instead use buffers and maintain capacity to continue to lend and underwrite insurance'. It explained that 'this includes prudent reductions in dividends, taking into account the uncertain outlook for the operating environment and the need to preserve capacity to prioritise these critical activities'.[66]

2.55 APRA advised ADIs and insurers to 'seriously consider deferring decisions on the appropriate level of dividends until the outlook is

61 Mr John Lonsdale, Deputy Chair, APRA, *Transcript*, 5 August 2020, p. 24.

62 Mr John Lonsdale, Deputy Chair, APRA, *Transcript*, 5 August 2020, p. 24.

63 Mr John Lonsdale, Deputy Chair, APRA, *Transcript*, 5 August 2020, p. 27.

64 Mr John Lonsdale, Deputy Chair, APRA, *Transcript*, 23 October 2020, p. 48.

65 Mr John Lonsdale, Deputy Chair, APRA, *Transcript*, 23 October 2020, p. 48.

66 APRA, 'Capital management', <https://www.apra.gov.au/sites/default/files/2020-04/Capital%20management.pdf>, accessed 20 August 2020.

clearer'. APRA explained that 'where a Board is confident that they are able to approve a dividend before this, on the basis of robust stress testing results that have been discussed with APRA, this should nevertheless be at a materially reduced level'.[67]

2.56 In July 2020, APRA updated its guidance on capital management for banks and insurers, easing restrictions around paying dividends. APRA's updated guidance recommended that, for the rest of the calendar year, boards of banks and insurers should:

- seek to retain at least half of their earnings when making decisions on capital distributions (and utilise dividend reinvestment plans and other initiatives to offset the diminution in capital from capital distributions where possible);
- conduct regular stress testing to inform decision-making and demonstrate ongoing lending capacity; and
- make use of capital buffers to absorb the impacts of stress and continue to lend to support households and businesses.[68]

2.57 When asked about its updated guidance to banks and insurers, APRA explained that in April 2020, 'the situation was highly uncertain' and 'there was a lot of concern about the possible depth of the downturn and the shock to the system'. It noted that 'in that period equity markets had fallen 30 per cent' and 'there were some pretty dire forecasts about GDP in Australia and around the world'.[69]

2.58 APRA advised that, since then, APRA and the industry have completed a range of stress testing and have had 'a bit more of an opportunity to understand how the macroeconomic experts in the RBA and the Treasury were seeing things play out'. APRA explained that:

> …the outlook is still obviously a difficult and sobering one, but it's not as severe or as concerning as it was, so we had a bit more certainty that some degree of dividend payment was able to be made without undermining the fundamental strength and resilience of the system.[70]

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67 APRA, 'Capital management', <https://www.apra.gov.au/sites/default/files/2020-04/Capital%20management.pdf>, accessed 20 August 2020.

68 APRA, 'APRA updates guidance on capital management for banks and insurers', *Media Release*, 29 July 2020.

69 Mr Wayne Byres, Chair, APRA, *Transcript*, 5 August 2020, pp. 28-29.

70 Mr Wayne Byres, Chair, APRA, *Transcript*, 5 August 2020, p. 29.

2.59 APRA told the committee that its policy is based on a 'downside scenario'. It explained that it has 'allowed for a significant deterioration in activity in thinking about the right policy settings, for dividends and capital management'. As such, 'if there are some short-term setbacks, they need not change the position we've adopted'. APRA noted that 'the guidance only exists to the end of the year' acknowledging that 'this reflects the uncertainty and volatility of the situation'.[71]

2.60 The committee asked whether its guidance for banks to be 'moderate and modest in their dividends' was consistent with community expectations at a time when banks are receiving significant taxpayer support, noting the guidance in some international jurisdictions advised that banks should not pay dividends. APRA explained that it is an 'on-balance decision' that is 'right for the Australian system and Australian conditions':

> The last thing we'd want to do is have banks disincentivised from taking on board public sector support because it would restrict their dividend practices. We also want to make sure that the industry has a capacity to pay a dividend, because that's important should it need to raise capital in the future. We have had regard to the fact that there are many in the community who rely on some dividend income as part of their normal income flow.[72]

2.61 The committee asked whether APRA had briefed the media about the guidance before the guidance had been provided to the banks. APRA assured the committee that, after markets had closed, it 'briefed the regulated institutions who were most impacted' and then publically announced the guidance. APRA explained that:

> We were very careful to make sure the announcement happened after markets were closed and before they opened. We did what we would usually do for announcements. First of all, the week before, I had flagged in a speech that this was coming, so it was no secret that the announcement was coming. The evening before, but after markets had closed, we advised the major institutions that this was coming out because they needed to be prepared to respond to investor queries et cetera in the morning. Then we made sure we got our announcement out first thing in the morning.[73]

71 Mr Wayne Byres, Chair, APRA, *Transcript*, 5 August 2020, p. 29.

72 Mr Wayne Byres, Chair, APRA, *Transcript*, 5 August 2020, p. 32.

73 Mr Wayne Byres, Chair, APRA, *Transcript*, 5 August 2020, p. 24.

Early release of superannuation

2.62 In March 2020, the Australian Government announced an early release of superannuation scheme as part of its economic support package to 'cushion the economic impact of the coronavirus and help build a bridge to recovery'. Under the scheme, individuals in financial stress as a result of the COVID-19 pandemic could access up to $10,000 of their superannuation in the 2019-20 financial year and a further $10,000 in 2020-21.[74]

2.63 As at 8 November 2020, APRA reported that 3.3 million initial applications and 1.4 million repeat applications for early release of superannuation had been received, totalling $35 billion. The average payment is $7,400 for initial applications and $8,326 for repeat applications. APRA reported that 98 per cent of applications received by funds since inception had been paid.[75]

2.64 The committee asked about the impact of the withdrawals, noting that superannuation funds switching more assets into cash would reduce the return to the system. APRA advised that superannuation funds will 'have to adjust investment portfolios to deal with the current situation and then rebalance', acknowledging that this 'will impact on investment returns'.[76] It explained that:

> Cash does generate a lower return, so, in the short term, there would be an impact on returns. What we've seen, though—particularly through May, June and continuing—is that the level of switching has dropped off. In fact, members that had switched have now switched back. We've had a very significant focus on ensuring equity between different groups of members, and hence funds are rebalancing to strategic asset allocations in an orderly way to minimise the impact on other members of the short-term decision or need to raise cash. I think we would say that at the moment cash levels at a system level are probably higher than they would normally be, and that is likely to continue for a little while, while the current economic environment and continuation of potential drawdowns of cash remain a little bit higher than might be the case normally. It's hard to put a time frame on, but

74 Prime Minister and Treasurer, 'Supporting Australian workers and business', *Media Release*, 22 March 2020.

75 APRA, 'COVID-19 Early Release Scheme – Issue 29', <https://www.apra.gov.au/covid-19-early-release-scheme-issue-29>, accessed 18 November 2020.

76 Mr Wayne Byres, Chair, APRA, *Transcript*, 5 August 2020, p. 25.

> we would expect that to return to typical levels reasonably quickly.[77]

2.65 APRA added that it is 'monitoring investment outcomes across the industry and what changes, if any, trustees are making to their investments'. APRA explained that there are 'a number of factors at play—not just the early release program—that are impacting the way superannuation entities are investing'.[78]

Pandemic Data Collection

2.66 In June 2020, APRA announced that it was releasing a COVID-19 Pandemic Data Collection (PDC) request 'to enable ongoing assessment of the impact of COVID-19 on the superannuation industry and the outcomes being delivered to members'. The purpose of the PDC is to:

- provide APRA with enhanced data surrounding the early release of superannuation, enabling analysis of impacted demographics;
- provide APRA and ASIC with monthly data on complaints, member accounts with insurance that have been cancelled, insurance claim activity and intra-fund advice provided;
- provide APRA with quarterly data on investment options, foreign currency exposure and hedging, and member switching; and
- allow APRA to understand the impact of the COVID-19 pandemic on the superannuation industry and provide reporting to the Government and other agencies.[79]

2.67 APRA told the committee that the PDC gives 'APRA and other relevant government agencies insights and information to understand the impact of the early release scheme and the management of the early release scheme at an industry and at an entity level'.[80]

Fraudulent activity

2.68 APRA told the committee that 'whilst there has been some fraudulent activity in relation to the early-release scheme…it has been at a relatively low level based on the information that has been reported'. It explained

77 Mrs Helen Rowell, Deputy Chair, APRA, *Transcript*, 5 August 2020, p. 25.

78 Mrs Helen Rowell, Deputy Chair, APRA, *Transcript*, 23 October 2020, p. 54.

79 APRA, 'Letter to registrable superannuation entity licensees: COVID-19 Pandemic Data Collection Request', <https://www.apra.gov.au/letter-to-registrable-superannuation-entity-licensees-covid-19-pandemic-data-collection-request>, accessed 18 August 2020.

80 Mrs Helen Rowell, Deputy Chair, APRA, *Transcript*, 5 August 2020, p. 23.

that fraudulent activity has been 'in the order of hundreds out of the four million or so payments that have been made'. Furthermore, APRA noted that there have been 'a number of cases that have been detected and stopped…therefore the amount of money that has gone out in fraudulent payments is also very low'. [81]

2.69 The committee asked whether superannuation funds would be liable for fraudulent activity. APRA explained that it is difficult to give a hypothetical answer, as 'it could potentially rest with the fund; or could potentially rest with another party, depending on where and how the fraud has actually been undertaken'. APRA advised the committee that, while it would need to consider the circumstances of each case, 'on the basis that the trustee had taken reasonable steps and a reasonable approach, it would be unlikely that we would take any action against the trustee'. [82]

Superannuation

2.70 The Capability Review scrutinised APRA's role in superannuation, commenting that it had 'under-resourced superannuation and not approached it with an appropriate regulatory focus' and that 'member outcomes and superannuation have often taken a "back seat"'. The Capability Review panel recommended that APRA 'embed and reinforce its increasing focus on member outcomes, and continue to ensure that trustees prudently manage member funds'.[83]

2.71 APRA told the committee that it had been 'very active in supervising superannuation through the last few months, focused on impact on investment portfolios, liquidity as a result of the early release scheme and generally making sure that member interests are being looked after'.[84]

Unlisted assets

2.72 Unlisted assets are investments that are not traded through exchanges or central clearing agents and do not have readily available prices. They are investments in assets such as airports, toll roads, social infrastructure,

81 Mrs Helen Rowell, Deputy Chair, APRA, *Transcript*, 5 August 2020, p. 24.

82 Mrs Helen Rowell, Deputy Chair, APRA, *Transcript*, 5 August 2020, pp. 23-24.

83 Treasury, *APRA Capability Review*, July 2019, pp. 100, 109.

84 Mr Wayne Byres, Chair, APRA, *Transcript*, 5 August 2020, p. 20.

utilities and assets held by private equity investors.[85] These investments can present valuation challenges due to factors such as multiple management layers; complex investment structures; lack of transaction data; and underlying assets that are opaque in nature or where undertaking frequent valuations is costly and/or time consuming.[86]

2.73 APRA advised the committee that it requires unlisted assets to receive an appropriate valuation. However, it acknowledged that the accounting standard in this area 'is not particularly prescriptive'. APRA explained that:

> …our focus is on understanding the process that the trustees use to come to an appropriate valuation, which often relies—in fact, it almost always relies for significant liquid assets—on independent valuations from at least one party, if not multiple parties, to form a view. Those valuations would be reviewed by the internal staff, and they would also be reviewed by either or both the investment committee and the audit committee, and put to the board for final signoff of the financial statements.[87]

2.74 APRA explained that it examines how superannuation funds are valuing assets and seeks to make sure that assets, listed or unlisted, are being appropriately valued.[88] APRA assured the committee that, if it has any concerns about the valuation process, it 'would either ask the trustee to review its process, make a change to its process, or take whatever action we felt was appropriate to ensure that the basis on which the trustees were assessing the value of assets and the return achieved for members was appropriate'.[89]

2.75 The committee noted that there was a significant market event in early 2020 as a result on the COVID-19 pandemic, during which Australian share prices fell very sharply before beginning to recover.[90] The committee asked whether the lag between this event and the re-valuation of unlisted assets created an opportunity to trade on arbitrage.

2.76 APRA acknowledged that this is a possibility. It explained that superannuation funds generally operate on 'daily unit pricing or striking

85 S Bright, 'GFC puts a spotlight on unlisted asset valuations', *InFinance*, Vol. 124, Iss. 1, March 2010, p. 29.

86 APRA, *Prudential Practice Guide SPG 531 Valuation*, November 2013, p. 5.

87 Mrs Helen Rowell, Deputy Chair, APRA, *Transcript*, 5 August 2020, p. 22.

88 Mr Wayne Byres, Chair, APRA, *Transcript*, 5 August 2020, p. 22.

89 Mrs Helen Rowell, Deputy Chair, APRA, *Transcript*, 5 August 2020, p. 22.

90 Reserve Bank of Australia, *Statement on Monetary Policy – May 2020*, 7 May 2020, p. 59, 73.

of interest rates' that 'covers a whole spectrum of assets that they're managing'. APRA told the committee that unlisted assets 'would typically operate on quarterly valuations, maybe on a rolling basis but certainly on a periodic basis'.[91]

2.77 APRA explained that institutions will usually have policies with a trigger for the investment committee or the investment management team to make an 'out-of-cycle adjustment' to the valuations. APRA told the committee that it has been working with the industry regarding this process:

> One of the things that we have been talking with the industry about is how that works, what triggers and criteria they have in their valuation policies as to when and how quickly they would make out-of-cycle adjustments to the valuation of certain assets, in essence, to narrow that gap and that opportunity that you were talking about.[92]

2.78 APRA acknowledged the importance of integrity measures to ensure that those working within a superannuation fund or invested in a superannuation fund are not able to take advantage of any arbitrage opportunity that may exist.[93] It added that, since March 2020, it has been engaging with investment committees and investment teams:

> …to understand the processes they went through, the nature and size of the adjustments that they made, both in the short term in response to the market movements and then, subsequently, as they moved through their normal end-of-year processes leading up to finalisation of 30 June accounts and unit prices.[94]

2.79 APRA advised the committee that it is currently undertaking a thematic review of evaluation practices and management of assets to assess the range and quality of practices across the industry and where there is need for improvement. It noted that 'there was room to improve some of those processes, and in particular the triggers and criteria used to determine when out-of-cycle valuation adjustments should be made, how they should be made and what the process was then for reverting back to a normal cycle of valuation adjustments'.[95]

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91 Mrs Helen Rowell, Deputy Chair, APRA, *Transcript*, 5 August 2020, p. 31.

92 Mrs Helen Rowell, Deputy Chair, APRA, *Transcript*, 5 August 2020, p. 31.

93 Mrs Helen Rowell, Deputy Chair, APRA, *Transcript*, 5 August 2020, p. 31.

94 Mrs Helen Rowell, Deputy Chair, APRA, *Transcript*, 23 October 2020, p. 48.

95 Mrs Helen Rowell, Deputy Chair, APRA, *Transcript*, 23 October 2020, p. 49.

2.80 APRA advised the committee that, in early 2021, it is intending to release better practice guidance and a review of its prudential standard around investment governance with a 'particular focus on lifting practice within this area'.[96]

Potential for 'quasi insider trading' during market downturn

2.81 During March and April 2020, there was significant market volatility due to the economic downturn caused by the COVID-19 pandemic. Superannuation funds were impacted by this downturn not only in their holdings with listed assets such as shares in the ASX, but with their unlisted assets.

2.82 Some members of the committee raised concerns regarding actions by executives and employees of superannuation funds during this downturn. The Chair outlined his concerns to APRA:

> This is a concern around quasi insider trading where, during the period at the start of the COVID-19 pandemic, there was of course a point where the ASX bottomed out. But there was obviously a lag until unlisted assets were revalued in light of the circumstances and the potential that money could be moved between different funds to effectively game and gain the benefits of the highs and lows in both sectors based on the delay between the two. I raised this with ASIC as well and I'm providing it to you.[97]

2.83 A number of responses to questions on notice received by the committee from superannuation funds were forwarded to APRA and ASIC for consideration.[98] APRA advised that it will examine these responses and undertake investigations, if necessary, in accordance with its usual practices.[99]

MySuper Product Heatmap

2.84 In December 2019, APRA published a MySuper Product Heatmap (the heatmap). The heatmap is 'designed to lift industry practices and enhance member outcomes by publicly identifying which MySuper products are

96 Mrs Helen Rowell, Deputy Chair, APRA, *Transcript*, 23 October 2020, p. 49.

97 Mr Tim Wilson MP, Chair, *Transcript*, 23 October 2020, p. 49.

98 APRA, *Response to question on notice*, APRA12QON, pp. 1-3; ASIC, *Response to question on notice*, ASIC28QON, pp. 1-2.

99 APRA, *Response to question on notice*, APRA12QON, pp. 1-3.

underperforming and the areas they need to improve'.[100] APRA advised the committee that, as at 5 August 2020, the heatmap has been accessed 33,738 times (see Table 2.2).[101]

Table 2.2 APRA heatmap activity, December 2019 to August 2020

Page Name	Page views*	Unique page views**
MySuper Product Heatmap	33,738	28,327
MySuper Product Heatmap FAQs	2,527	2,299

* Page views record all visits to the page, including when a user reloads the page or returns to the page multiple times.

** Unique page views aggregate page views that are generated by a single user. For example, if one user visits the page six times, it is recorded as six page views but only one unique page view.

Source *APRA, Response to question on notice, APRA04QON, p. 1.*

2.85 The heatmap uses a colour overlay to provide stakeholders with a visual illustration of the outcomes provided by MySuper products relative to peers and appropriate benchmarks. The colour overlay is a continuous colour gradient of 'heat' (from white to amber to crimson) to emphasise areas of material underperformance across 21 metrics covering investment performance, fees, and sustainability.[102]

2.86 APRA told the committee that the heatmap is a 'game changer', that has 'delivered very good outcomes' for members of superannuation funds. APRA advised that, since its release in December 2019, it had seen 'a very significant response from the industry to the heatmap'. APRA explained that its June 2020 update to the heatmap showed that there has been a 'significant reduction in fees'. In the six months from December 2019 to June 2020, 42 per cent of MySuper members received a reduction in fees. APRA added that there has also been 'a number of products that have either closed or are in the process of closing because of being identified as underperforming in the heatmaps'.[103]

Expanding the heatmap

2.87 APRA told the committee that it is looking into two areas of potential expansion of the heatmap: insurance coverage and claims and costs; and choice products. APRA noted that the timing of the release of the

100 APRA, 'APRA publishes MySuper heatmap', *Media Release*, 10 December 2019.

101 APRA, *Response to question on notice*, APRA04QON, p. 1.

102 APRA, 'Information Paper: Heatmap – MySuper products', November 2019, <https://www.apra.gov.au/sites/default/files/Information%20paper%20-%20Heatmap%20-%20MySuper%20products.pdf>, accessed 28 October 2020.

103 Mrs Helen Rowell, Deputy Chair, APRA, *Transcript*, 23 October 2020, p. 47.

expanded heatmap will be dependent on the quality and veracity of the data it collects during its consultation with the sector, which is expected to take place in September 2020.[104]

2.88 APRA advised that it is still determining which portion of the choice products will be the focus of the expansion in the first instance. APRA explained that the choice heatmaps will aim to 'address and put out in the public domain transparency of where most of the assets sit or where there are particular underperformance issues that we feel need to be highlighted'.[105]

2.89 APRA acknowledged that there are challenges when producing a heatmap for choice products, considering the volume of products. APRA assured the committee that it is working on addressing these challenges, noting that 'if we are going to produce a heat map, we want it to be reliable and informative, and that means looking at the enhancements that are appropriate and how you can appropriately draw conclusions from it'.[106]

Your Future, Your Super

2.90 In October 2020, the Federal Government announced its 'Your Future, Your Super' package. The package, which commences on 1 July 2021, will implement a number of key recommendations from the Productivity Commission review into superannuation and the Hayne Royal Commission. In particular, it aims to:

- prevent the creation of unintended multiple superannuation accounts;
- make it easier for people to choose a well-performing product that meets their needs;
- hold funds to account for underperformance; and
- increase transparency and accountability.[107]

2.91 APRA told the committee that it is 'working very closely' with Treasury, ASIC and the Australian Taxation Office (ATO) on the implementation of the measures. APRA advised that its 'primary involvement will be with the underperformance measure and also the increasing transparency and

104 Mrs Helen Rowell, Deputy Chair, APRA, *Transcript*, 5 August 2020, p. 30.

105 Mrs Helen Rowell, Deputy Chair, APRA, *Transcript*, 5 August 2020, p. 30.

106 Mrs Helen Rowell, Deputy Chair, APRA, *Transcript*, 5 August 2020, p. 30.

107 Treasury, *Your Super, Your Future: Reforms to make your super work harder for you*, October 2020, p. 7.

accountability measure'. It will also be 'working with the tax office around the data needed for the YourSuper tool'.[108]

2.92 The committee asked if there is a risk that the measures could lead to the prioritisation of passive, secure investments, which are likely to deliver an income return, over more active management. APRA advised that it would 'need to see how the measure is finalised in implementation', noting that the legislation has not been finalised. However, APRA commented that it expects that trustees will think about what changes may be needed, if any, to their investment strategies:

> …if trustees are confident that they have a good active investment strategy that can deliver better outcomes to members than a passive, low-cost strategy, then we would think they would continue to pursue them. If their strategy isn't delivering returns that are better than a passive investment strategy, then they need to revisit whether that is the right investment strategy.[109]

Private health insurance sector

2.93 On 4 February 2020, APRA gave private health insurers (PHIs) the 'blunt' message that 'on current trends, APRA predicts that we're only a few years away from seeing private health insurers forced to merge or fold, with the small insurers…likely to be the most vulnerable'. APRA stated that over the past two years, the factors threatening the sustainability of PHIs have become more acute. It explained that:

> The decline continues to be driven by an exodus of younger, healthier policyholders: another 127,000 policyholders in the crucial 20-34 age group have left the private system in the past two years. The fact that's been offset by an ongoing rise in policyholders in the 70-84 age group makes the situation worse in an economic sense, because those are the members who typically claim the most in benefits and are cross-subsidised by younger members.[110]

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108 Mrs Helen Rowell, Deputy Chair, APRA, *Transcript*, 23 October 2020, p. 47.

109 Mrs Helen Rowell, Deputy Chair, APRA, *Transcript*, 23 October 2020, p. 47.

110 APRA, 'APRA Member Geoff Summerhayes – Speech to the Members Health Directors Professional Development Program', <https://www.apra.gov.au/news-and-publications/apra-member-geoff-summerhayes-speech-to-members-health-directors-professional>, accessed 19 August 2020.

2.94 APRA advised that there is a 'rising disparity between growth in claims costs and premiums'. APRA predicted that 'if the gap between the two remains at around two percentage points a year, APRA's analysis indicates that only three private health insurers will still have a sustainable business model by 2022'.[111]

2.95 The committee asked about the urgency of the risk of smaller health insurers folding in the next couple of years. APRA explained that it is 'concerned about the sustainability of the health insurance industry' but that 'at this point in time, the industry is appropriately capitalised and we don't see any risk of failure in the near term'. However, APRA explained that it is 'worried about the twin challenges of declining affordability and adverse selection'.[112]

2.96 APRA noted that the health insurance sector is newer to APRA and that 'some of these standards and these governance approaches that we have put on the insurers have been a challenge for them to digest'.[113] However, APRA emphasised that PHIs must 'do their bit and don't just sit back and expect somebody else—that is, the government—to solve the problem for them'.[114]

2.97 APRA told the committee that it has asked insurers to 'focus on their own sustainability, their cost structure, their membership mix, and how they're delivering their services to their clients'. APRA explained that:

> And, as we do for all APRA-regulated entities, we have ramped up their planning around recovery and resolution—that is, do they have a plan B if they get into a problem? Have they identified a partner that they could merge with so that members wouldn't be adversely impacted?[115]

Climate risk

2.98 In February 2020, APRA announced it was seeking to undertake a climate change financial risk vulnerability assessment in collaboration with

111 APRA, 'APRA Member Geoff Summerhayes – Speech to the Members Health Directors Professional Development Program', <https://www.apra.gov.au/news-and-publications/apra-member-geoff-summerhayes-speech-to-members-health-directors-professional>, accessed 19 August 2020.

112 Mr Geoff Summerhayes, Executive Board Member, APRA, *Transcript*, 5 August 2020, p. 25.

113 Mr Geoff Summerhayes, Executive Board Member, APRA, *Transcript*, 5 August 2020, p. 25.

114 Mr Geoff Summerhayes, Executive Board Member, APRA, *Transcript*, 5 August 2020, p. 25.

115 Mr Geoff Summerhayes, Executive Board Member, APRA, *Transcript*, 5 August 2020, p. 25.

international and local stakeholders. The assessment would be coordinated with ASIC and the RBA via the Council of Financial Regulators.[116]

2.99 The committee asked APRA to provide an update on the progress of the assessment. APRA advised that it had paused activity, due to the pandemic, 'to ensure that we supported firms and focused on firms supporting the community'. However, APRA told the committee that it has recommenced work on the assessment and a 'range of other policy and industry engagement measures' and that it will 'commence consultation and discussion with major banks' in 2021.[117]

2.100 APRA advised that the assessment is 'mainly focused on the large institutions in the first instance'. It explained that the RBA, in particular, is interested in the 'whole-economy impacts of physical and transition risk' and the major banks provide a 'window' to that. APRA advised that, progressively, the assessment will expand out from there.[118]

2.101 The committee noted APRA's engagement in the Australian Sustainable Finance Initiative and asked about its level of involvement. APRA told the committee that the Australian Sustainable Finance Initiative is a group that was created by 'all of the major banks and major insurers and super funds' and has a 'very broad representation across the financial services sector'. APRA explained that:

> [The Australian Sustainable Finance Initiative] are looking to map out an agenda and a mandate for themselves as it relates to more sustainable practices for their firms going forward. That is across a broad range of sustainability metrics.[119]

2.102 APRA explained that APRA and ASIC are 'on the steering committee, as observers at their invitation'. It explained that APRA and ASIC 'are not voting members' and are 'not content providers of that group'. APRA advised that the Australian Sustainable Finance Initiative is expected to publish a report in late 2020.[120]

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116 APRA, 'Understanding and managing the financial risks of climate change', 24 February 2020 <https://www.apra.gov.au/understanding-and-managing-financial-risks-of-climate-change>, accessed 18 November 2020.

117 Mr Geoff Summerhayes, Executive Board Member, APRA, *Transcript*, 23 October 2020, p. 57.

118 Mr Geoff Summerhayes, Executive Board Member, APRA, *Transcript*, 23 October 2020, p. 57.

119 Mr Geoff Summerhayes, Executive Board Member, APRA, *Transcript*, 23 October 2020, p. 57.

120 Mr Geoff Summerhayes, Executive Board Member, APRA, *Transcript*, 23 October 2020, p. 57.

Managing investment risks

2.103 APRA confirmed that it intends to update its Prudential Practice Guide SPG 530 on Investment Governance.[121] SPG 530 requires an RSE licensee to have in place a sound investment governance framework for the selection, management and monitoring of investments, including appropriate monitoring and management of investment risk, that is in the best interests of beneficiaries.[122] APRA explained that the revised standards will:

> …update the requirements and considerations of trustees to reflect the world we're in now and the importance of [environmental, social and governance (ESG)] considerations as part of understanding the risk and return from different investments and how that gets reflected in investment strategies.[123]

2.104 APRA explained that, when the guide was initially released in 2013, investment in emissions-reducing energy sources or technology compared to high carbon emissions industries was 'seen as a choice that an investor might make based on a personal preference...[it] was something that was seen as an ethical or purely environmental position'. APRA noted that, 'in the standard as it was written then it was almost like you were giving up on return to pursue that strategy'. However, 'the evidence now is in fact, return and ESG considerations, as we've seen play out on a range of issues, are highly correlated'.[124]

Stress testing

2.105 The committee asked whether APRA's climate risk stress testing considers the trajectory of net zero emissions by 2050. APRA explained that central banks and regulators globally are 'asking firms to model their balance sheets' against three scenarios adopted by the Network for Greening the Financial System. The first scenario is an 'orderly transition to net zero in 2050'; the second scenario is a late transition which is 'quite disruptive'; and the third is a 'hothouse world: there's no transition and the trajectory continues'.[125]

2.106 The committee asked APRA to comment on whether Australia is more vulnerable to climate change financial risk than other developed countries

121 Mrs Helen Rowell, Deputy Chair, APRA, Transcript, 23 October 2020, p. 58.

122 APRA, *Prudential Practice Guide, SPG 530 – Investment Governance*, November 2013, p. 5.

123 Mrs Helen Rowell, Deputy Chair, APRA, *Transcript*, 23 October 2020, pp. 58-59.

124 Mr Geoff Summerhayes, Executive Board Member, APRA, *Transcript*, 23 October 2020, p. 59.

125 Mr Geoff Summerhayes, Executive Board Member, APRA, *Transcript*, 23 October 2020, p. 58.

because of its industrial structure. APRA explained that Australia has its own 'particular set of circumstances' and that it is 'uniquely placed to capitalise on the huge opportunities that will flow from the transition to a low-carbon economy'.[126]

2.107 APRA told the committee that while Australia has some challenges, 'it is incredibly well placed' with precious metals that are in high demand for battery use, lots of space for solar power and 'a very large agricultural sector which has a really important role to play in sequestering carbon and producing food'.[127]

Conclusion

2.108 The COVID-19 pandemic has caused unprecedented disruption to our lives. While the pandemic is primarily a public health issue, it has significantly impacted economies and financial systems around the world. It has led to the closure of our borders; the biggest economic downturn in close to a century; a large budget deficit; and historically low interest rates.

2.109 The Australian financial sector and its regulators responded quickly to the pandemic. Financial institutions provided support to Australian families and businesses as they worked to manage their mortgages and debts during a time when income is disrupted and the future is uncertain. Superannuation funds paid out billions of dollars, as affected individuals accessed their superannuation under the early release scheme.

2.110 The committee notes APRA's timely response to the pandemic. APRA quickly adapted to the challenges of the pandemic, adjusting its regulatory priorities to focus on ensuring that financial systems remained financially and operationally sound. In particular, the committee credits APRA's prudential guidance regarding pandemic risk and its requirements around stress-testing for pandemics as key factors contributing to the stability and resilience of the Australian financial sector during this challenging period.

2.111 The committee notes APRA's proactive and ongoing engagement with peak bodies, superannuation funds, and financial institutions throughout the various stages and changing circumstances of the pandemic. In particular, the committee notes the strong relationship and high level of

126 Mr Geoff Summerhayes, Executive Board Member, APRA, *Transcript*, 23 October 2020, p. 59.

127 Mr Geoff Summerhayes, Executive Board Member, APRA, *Transcript*, 23 October 2020, p. 59.

cooperation and coordination that ASIC and APRA have displayed during this challenging period.

2.112 The committee notes APRA's progress implementing the Capability Review and the Royal Commission's recommendations, acknowledging the disruption caused by the pandemic and the deferral of implementation of commitments associated with the Royal Commission.

2.113 The committee will continue to scrutinise APRA's performance; its ongoing implementation of the Royal Commission recommendations and the Capability Reviews recommendations; and the ongoing strengthening of APRA's capability. In particular, the committee will follow APRA's ongoing response to the COVID-19 pandemic as we continue to manage the impacts of the pandemic and begin to focus on the path to recovery.

Mr Tim Wilson MP
Chair
3 December 2020

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Appendix A — Hearings and witnesses

Public hearings

Wednesday, 5 August 2020 – Canberra

Australian Prudential Regulation Authority

Mr Wayne Byres, Chairman

Mr John Lonsdale, Deputy Chair

Mrs Helen Rowell, Deputy Chair

Mr Geoff Summerhayes, Executive Board Member

Friday, 23 October 2020 – Canberra

Australian Prudential Regulation Authority

Mr Wayne Byres, Chairman

Mr John Lonsdale, Deputy Chair

Mrs Helen Rowell, Deputy Chair

Mr Geoff Summerhayes, Executive Board Member