



OPENING STATEMENT

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Chairman
Australian Prudential Regulation Authority

Senate Economic Legislation Committee
Canberra
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I'd like to begin by acknowledging John Lonsdale, who earlier this month joined APRA as a second Deputy Chair. John is no stranger to these hearings and is well known to many of you from his previous senior roles in Treasury. We are very pleased to have an additional, experienced senior executive joining APRA at a time of intense activity and heightened scrutiny of the financial industry and its regulators.

John's appointment provides us with the opportunity to take a fresh look at APRA's governance and allocation of responsibilities amongst the APRA Members. John will oversee a number of our important strategic initiatives, as well as take on some responsibilities in relation to ADI supervision. In particular, John will take Member-level responsibility for APRA's work on governance, culture and remuneration (including implementation of the Banking Executive Accountability Regime), reviewing our enforcement strategy in response to BEAR and the issues that have emerged at the Royal Commission, further building APRA's crisis resolution capability, and strengthening APRA's collaboration with peer regulators.

Before we turn to questions, I'd like to highlight some of the important issues on APRA's agenda since we last appeared before this Committee. In doing so, I want to emphasise the overarching point that Australia's financial system remains fundamentally sound. While there are areas where the financial sector must lift its game – particularly in relation to operational and cultural improvements – we are thankfully working on these from a position of financial strength. Risk-based capital ratios within the banking system, for example, are at their highest level in the 20 years of APRA's existence. It is important, particularly in the current environment of volatility, that we protect and where possible reinforce the soundness and resilience of the financial system in anticipation of future adversity, whenever that may occur.

As I noted in a recent speech, however, the financial strength of the system does not make the evidence at the Royal Commission, or its Interim Report, any less confronting or uncomfortable. Clearly, there have been too many instances of behaviour that do not meet community expectations, and in some cases, the law. The Commission has identified failings that ultimately will need to be addressed by institutions, regulators and the Parliament.

We will, of course, be providing submissions to the Commission on the issues that it has identified. There are many of interest to APRA, but I would like to highlight two key themes.

The first is remuneration and incentives. The Commission has rightly highlighted the potential for these – if not well designed – to incentivise poor consumer outcomes. Being a prudential regulator, APRA has traditionally focused on the potential for poor incentives to impact the long-term financial soundness of a financial institution. That is primarily the lens through which our prudential standards are framed. The Commission has suggested a broader examination

of the issue is needed, and APRA and ASIC will need to work together to consider how this can best be done without exacerbating existing concerns that the responsibilities between the two agencies are becoming blurred.

The second theme I wanted to highlight is the issue of enforcement. While APRA has been able to generate improvements within the industry across a range of dimensions over many years, the Royal Commission noted that we have not utilised Court-based sanctions. As a supervision-led agency, our priorities have traditionally been prevention, rectification, and then sanction. With the benefit of John's fresh perspective we are re-examining how our enforcement philosophy, our governance structures for enforcement decisions, and our resourcing for enforcement activity can be improved. This will take account of not only the lessons from the Royal Commission, but also the need for new processes and structures to be developed for the BEAR. I do not wish to preempt the outcome of the review, but in our submissions to the Commission we have already flagged the potential for greater use of enforcement powers to achieve general deterrence across the industry.

On the subject of the BEAR, I should note it took effect for the four major banks on 1 July. Those banks have registered their accountable persons, and lodged their accountability statements and maps. Their senior executives and directors are now subject to the BEAR's obligations. Building on our experience with the initial four banks, last week we released an Information Paper to guide other ADIs – who become subject to BEAR from 1 July 2019 – in meeting the new requirements. Implementing the BEAR, and ensuring it is operating as intended, will be a major focus for our ADI supervisors over the next year or so.

While the Royal Commission has been an obvious priority, APRA has also continued to pursue its broader agenda to build resilience across all the industries we supervise. Since we last appeared, that has included:

- in June, we released a final package of measures to clarify and strengthen the important role of the Appointed Actuary within general, life and private health insurers;
- in July, we proposed changes to our requirements for ADIs in managing risks from associations with related parties;
- in August, we sought feedback on possible changes to the ADI capital framework to improve its transparency comparability and flexibility;
- in September, we released a package of prudential standards and guides aimed at improving governance and decision-making in the private health insurance industry;
- also in September, we released updated information on prudential considerations on the use of shared computing services, such as cloud, by APRA-regulated industries; and
- this week, we are releasing new requirements for life insurers to report claims data to APRA, an important milestone in our joint work with ASIC to improve transparency and consumer outcomes in that industry.

APRA's primary objective in undertaking all these actions is to continually build strength in the financial system for the benefit of depositors, policyholders and superannuation members.

Finally, throughout most of 2018, Australia – and particularly APRA – has been subject to an extensive, independent assessment of financial stability issues and regulatory oversight via the Financial Sector Assessment program (FSAP) program conducted by the International

Monetary Fund (IMF).¹ As part of this review, APRA has been subject to a comprehensive assessment of its supervisory approach and capabilities in banking and insurance supervision. The IMF also assessed the adequacy of systemic risk oversight by APRA and other members of the Council of Financial Regulators, our crisis preparedness, and financial safety nets. As I noted the last time we appeared before the Committee, we welcome this independent assessment as providing a valuable scorecard against which to measure our capabilities and performance. We expect the results of the review to be published by the IMF early in 2019.

¹ An FSAP is typically conducted every five or so years for G20 countries. Australia is undergoing its third FSAP in 2018, with previous FSAPs conducted in 2006 and 2012.