



CHAPTER SIX: APRA IN THE SYSTEM

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CHAPTER 6: APRA IN THE SYSTEM

Building on the examination of APRA's internal resources and structures in earlier Chapters, this Chapter assesses APRA's effectiveness in its external engagement with industry, other regulators and the Parliament. The Panel's main conclusion is that APRA needs to reconsider its approach to transparency, strategic communications and its assertiveness to varying degrees across its stakeholders. Its regulated entities are a critical part of its audience. But it should also consider the wider community and the Parliament. Public communication of what APRA expects of entities, and any failure to meet those expectations, will enable the public and Parliament to hold APRA and its regulated entities more effectively to account.

Noting some additions to powers are desirable, APRA should also reconsider its conservative and limiting assessment of its powers.

A more forceful supervision and enforcement approach is needed

APRA's approach towards regulated entities is changing. The Hayne Royal Commission, the introduction of the BEAR and APRA's current Corporate Plan have prompted a review by APRA. In its Enforcement Strategy Review, APRA acknowledges that to remain effective it should recognise the need to take stronger action earlier when it is appropriate — 'a constructively tough approach'. It also recognises that APRA should actively consider the deterrence benefits of enforcement action on more occasions, more effectively use its existing powers and coordinate more effectively with ASIC.

The Panel supports the direction of the Enforcement Strategy Review but notes that APRA should ensure that the new Enforcement Approach is embedded in its supervisory approach and culture. In line with the Enforcement Approach, the Panel believes that APRA needs to respond more quickly and effectively and increase its appetite to prosecute concerns in areas such as operational risk and GCA risks. While senior leadership appetite will be a key factor in the successful implementation of the Enforcement Approach, changes to APRA's internal culture will also be necessary and are considered in this Chapter.

The Panel has identified a number of cultural barriers to successful implementation of the Enforcement Approach:

- A strong bias against transparency in relation to entity-matters, linked to a desire to maintain open dialogue and cooperation with regulated entities;
- Lengthy timeframes in resolving cases with entities;
- Behaviours that limit the confidence of staff and their clarity around APRA's intent; and
- A conservative interpretation of its powers and supervisory toolkit.

The Enforcement Approach was only launched in April 2019. These observations, and the analysis that follows, are intended to be consistent with APRA's plan to roll out its new Enforcement Approach.

Moving from minimal transparency

APRA seeks to foster a cooperative, problem-solving relationship with regulated entities to achieve conformity with regulatory requirements. Much of APRA's effort involves working with regulated entities behind the scenes to address issues.¹²³ For the most part this is a successful strategy.

There are several reasons APRA gives to support this approach:

- It maintains an open dialogue between APRA and entities;
- It encourages entities to self-identify problems and work with APRA to rectify them; and
- A concern that publicly identifying financial issues in an entity may be destabilising for it.

While these are valid considerations, APRA has placed too much emphasis on discretion and cooperation. The Panel believes that APRA's strong preference to do things 'behind the scenes' with regulated entities is limiting its effectiveness. As noted in Figure 2.1, APRA is much closer to preferring minimal transparency than being fully transparent. Shifting the dial towards more transparency is part of its new Enforcement Approach.

There are some diverging views within APRA about the possible consequences of being more transparent. Senior management in the organisation most strongly and almost uniformly advocate for the behind the scenes approach and are concerned about the possible detrimental effects of being more transparent about its engagement with entities. This uniformity of view is not apparent in the Capability Review Staff Survey: 53 per cent of respondents agree that APRA is more effective in its supervision role when operating behind the scenes; and 55 per cent agreed that greater public transparency on APRA's dealings with an individual entity would adversely impact openness and cooperation from that regulated entity.

Capability Review Staff Survey — Transparency and regulated entities

Proposition: APRA is more effective in its supervision role when operating 'behind the scenes'.



Proposition: Greater public transparency on APRA's dealings with an individual regulated entity would adversely impact my team's ability to access information and elicit cooperation from that regulated entity.

Note: This is a negatively framed proposition.



¹²³ APRA, 2019, *Enforcement Strategy Review*.

Other staff support APRA taking a tougher approach on institutions:

APRA could achieve greater efficiency and effectiveness through taking a more forceful approach (particularly where entities are being uncooperative on issues), by the earlier and more tactical use of the full suite of its powers and by making its actions transparent more often.

[APRA should] be proactive and take brave decisions on financial institutions.

— APRA staff

The Panel believes that APRA's preference to engage with regulated entities behind the scenes limits its scope to deter poor outcomes. Prudential supervision is only effective if regulated entities believe that APRA will take increasingly forceful actions when prudential issues are not being properly addressed.¹²⁴ One of these actions is the public disclosure of APRA's concerns or penalties imposed on entities. APRA's reliance on behind the scenes cooperation with recalcitrant entities neutralises the deterrence element of a responsive regulation model,¹²⁵ because it offsets the credible promise of escalated action. The Panel acknowledges that in the case of severe financial distress, discretion will be preferable.

As noted, for the most part APRA's cooperative, behind the scenes engagement with entities is effective. But the Panel encourages APRA to bear in mind that the very nature of its role as a financial sector regulator has an inherently adversarial element designed to help it achieve prudential outcomes that benefit not only regulated entities, but Australia's financial system more broadly. Discretion and cooperation have their limits as revealed in the Hayne Royal Commission and the CBA Prudential Inquiry.

The Panel is not persuaded by the view expressed to it by board and senior finance industry executives that more transparency on the part of APRA would limit their cooperation and openness with it. While cooperation is preferred to compulsion, regulated entities must provide APRA with information. Protracted behind the scenes disputes or resolution of problems is out of step with public expectations following the Hayne Royal Commission. APRA should ensure that its strengthened enforcement appetite prevents these occurrences happening in the future.

APRA is on the right path with its more open Enforcement Approach. But it still needs to challenge its mindset against transparency. Its failure to publish self-assessments of the GCA arrangements of 34 regulated entities was a missed opportunity and a reminder of the need for more cultural change. APRA chose not to release any granular information from this exercise but published a broad assessment of them.

A new approach needed for recalcitrant institutions

APRA has been effective in addressing *industry-wide* financial resilience matters through top-down policy and supervisory measures:

- In banking, this includes implementing the Basel core principles and Murray Financial System Inquiry recommendations around capital, liquidity and funding and the recent interventions in residential mortgages; and

124 APRA, 2019, *Enforcement Strategy Review*.

125 Ayres, I and Braithwaite J, 1992, *Responsive Regulation: Transcending the Deregulation Debate*, Oxford University Press.

- In insurance, this includes implementing the LAGIC reforms.

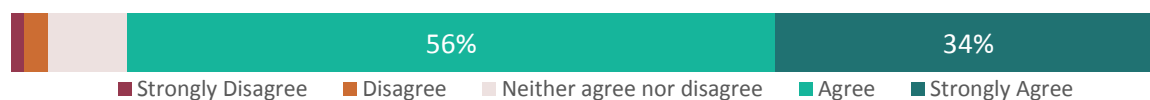
But APRA can be slow and inconsistent in pursuing firm-specific issues in cases where entities are recalcitrant and do not respond to its actions. Recent revelations about CBA and IOOF are cases in point. In both cases, APRA's reputation was damaged when the problems, the time taken and inability to resolve them behind the scenes were revealed. After the Hayne Royal Commission and shift in community expectations, such outcomes will now be more detrimental to APRA and further reduce public confidence in regulators and the financial system.

There appears to be limited consequences for entities that strongly contest APRA's positions on firm-specific matters. A number of factors inform this assessment:

- Based on APRA data collected as part of this Review concerning prudential review 'requirements'¹²⁶ and 'recommendations'¹²⁷ issued between July 2017 and June 2018, 34 (24 per cent of) requirements and 121 (24 per cent of) recommendations remained open, as at April 2019. While some matters will take an extended period to remediate, the number outstanding suggests that timely resolution may not be treated sufficiently seriously by APRA and hence its regulated entities;¹²⁸
- While 90 per cent of staff agree that APRA has a strong supervisory focus on identifying material risks and remedial actions, fewer (68 per cent) agree that APRA has a strong supervisory focus on ensuring identified material risks are addressed satisfactorily in a reasonable timeframe; and
- An in-depth review of APRA's supervision files conducted as part of this Review generally reflected well on APRA. However, there are a small number of instances of a reluctance to take strong action.

Capability Review Staff Survey — Supervision approach

Proposition: APRA has a strong supervisory focus on identifying material risks and remedial actions.



126 A 'requirement' is an action APRA issues to an entity following a prudential review. Entities must take specific action to address the issue. Requirements typically relate to an entity's failure to comply with legislation or prudential standards, or a fundamental deficiency in the entity's risk management and / or governance practices.

127 A 'recommendation' is an action APRA issues to an entity following a prudential review. Entities are expected to formally consider implementing the recommendation. Matters resulting in a 'recommendation' typically relate to areas of risk management and / or governance that are not fundamentally deficient but could be improved. Timeframes for completion may not be required.

128 Outstanding review findings are captured in internal management reports, and can inform inclusion of entities on internal 'watch lists'.

Proposition: APRA has a strong supervisory focus on ensuring identified material risks are addressed satisfactorily in a reasonable timeframe.



Many regulators agree that there is a tension between maintaining open and frank engagement and balancing the role of the regulator taking enforcement action. However, they note this could be resolved by distinguishing between areas where there has been an isolated mistake which has been addressed and cases where there are repeat issues, extended delays or a lack of transparent, fulsome disclosure.

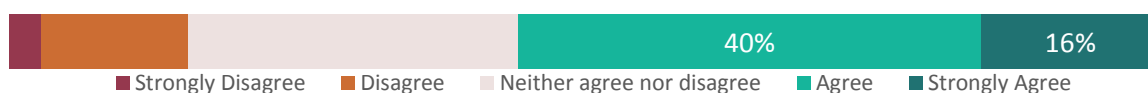
Improving management support and certainty of outcome

Varying confidence in management support and uncertainty about APRA's strategy in specific matters also play a role in APRA's low enforcement appetite. This will need to be addressed in order for a constructively tough approach to be successfully embedded. There are a number of contributing elements to this internal culture:

- The Capability Review Staff Survey reflects a strong theme of slow decision-making;
- While staff, and for that matter, the Panel, recognise the very nature of decision-making may require subjective judgment, there seems to be a degree of staff disenchantment about the consistency and approach to decision-making and a concern that these are difficult to navigate.¹²⁹ This leads to a sense of uncertainty amongst staff (see Chapter 2);
- The 'tone from the top' greatly influences organisational confidence. Some staff note that while rhetoric had shifted in favour of 'constructively tough', there is still a perception that this phrase is ambiguous and undefined. Staff indicate that 'sometimes support wanes as you go up the decision-making tree' and that some supervisors are 'significantly less tough on institutions than they should be'. The Capability Review Staff Survey reveals that 56 per cent of staff agree that APRA's senior leadership take effective action when regulated institutions 'push back'; and
- The acceptance of APRA's new constructively tough approach also seems to vary across the organisation. APRA's Enforcement Strategy Review and the Capability Review Staff Survey reveal divergences across divisions in the organisation.

Capability Review Staff Survey — Supervision leadership

Proposition: APRA's senior leadership take effective action when regulated institutions 'push back'.



[APRA needs to] clearly outline how the 'constructively tough' supervision regime will work in practice and embed this across all functions in a consistent manner.

— APRA staff

¹²⁹ Fifty-five per cent of staff agreed that the outcome of decisions at APRA depends on which person makes the decision.

The above internal factors may undermine the confidence and clarity of approach for staff, risking a successful implementation of the Enforcement Approach.

The Enforcement Strategy Review acknowledges that management has had little appetite for enforcement action where APRA may not be successful in court.¹³⁰ In line with the Enforcement Strategy Review, the Panel agrees that APRA should increase its tolerance to challenge from regulated entities. This will not only require the use of formal processes (explored below) but importantly a shift in the beliefs on perceived reputational risks for APRA.

Departing from a conservative approach to its powers

The Panel and a range of industry specialists consulted during this Review observe that APRA takes an overly conservative approach to the interpretation of its powers.

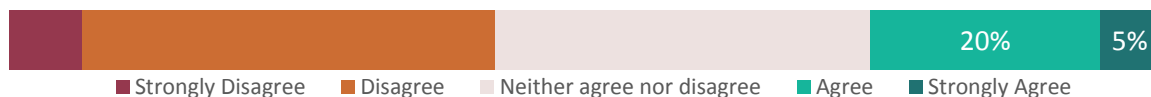
When surveyed, 78 per cent of staff feel that they have a good understanding of APRA's formal powers. However, only 25 per cent think that APRA effectively uses the full suite of tools and powers with regulated entities.

Capability Review Staff Survey — Use of APRA powers

Proposition: I have a good understanding of APRA's formal powers under relevant legislation and prudential standards.



Proposition: APRA effectively uses the full suite of its tools and powers with regulated entities.



Litigation should be a more significant focus.

— APRA staff

130 APRA Enforcement Strategy Review, p. 18.

CASE STUDY

INACTION IN SUPERANNUATION

Up until the Hayne Royal Commission, APRA had:

- Only applied to disqualify one person since 2008 (this resulted in an enforceable undertaking);
- Only entered into enforceable undertakings with respect to one matter — the collapse of Trio Capital; and
- Not commenced any court proceedings relating to superannuation in the last 10 years.

This track record is particularly striking, given capital levers are not applicable to superannuation entities.

Since the commencement of the Hayne Royal Commission, APRA has launched a number of actions against IOOF entities, directors and executives for failing to act in the best interests of superannuation members.

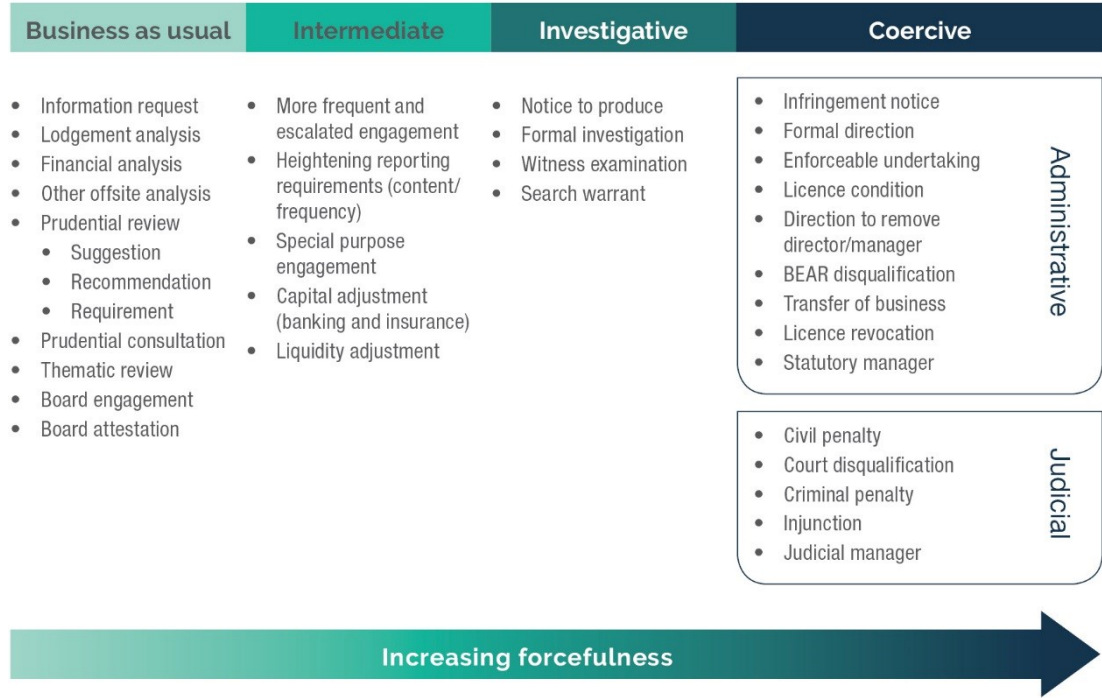
In June 2019, APRA imposed directions and conditions on AMP Super citing issues identified through ongoing prudential supervision and issues emerging from the Hayne Royal Commission.

Helen Rowell, APRA's superannuation member, stated that 'APRA plans to usher in a new era of superannuation transparency; providing better information on trustee and product performance, and increased visibility of APRA's actions to address underperformance.'¹³¹

APRA's existing set of powers provide a range of options (Figure 6.1). APRA's conservative approach may overstate the risks of an escalating and public use of its powers. To be clear, the Panel is not advocating a litigation-first approach for APRA. This would be detrimental. Rather, APRA should explore the full spectrum of its powers more effectively.

131 Rowell, H, 2019, *Opening the door to greater transparency in superannuation*, 13 March 2019.

Figure 6.1: APRA’s supervisory toolkit



Greater use of APRA’s toolkit has a number of benefits in addition to punishment and deterrence. Formal enforcement action can lead to jurisprudence and clarity around legal obligations imposed on entities.

RECOMMENDATION 6.1

The Panel supports the direction of the APRA Enforcement Strategy Review. To effectively embed the Enforcement Approach, APRA should change its existing internal norms that create a low appetite for transparent supervisory challenge and enforcement by:

- a. departing from its behind closed doors approach with regulated entities;
- b. adopting a stronger approach towards recalcitrant institutions;
- c. building organisational confidence and improving management support; and
- d. increasing its risk appetite and use of the escalation toolkit.

Some additions to APRA’s statutory powers are desirable

Recommendations of the Hayne Royal Commission, which were adopted by the Government, will enhance APRA’s regulatory toolkit. This includes enabling joint information sharing and investigations with ASIC and the extension of BEAR across other prudentially regulated industries. The Parliament has also recently passed legislation that significantly enhances APRA’s regulatory toolkit in superannuation.¹³²

132 Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Act 2019.

APRA has a generally sound and fit-for-purpose set of statutory powers to deliver its mandate. The Panel notes three areas that warrant further consideration by the Government:

- The adequacy of the current penalty regime;
- The inability of APRA to appoint a skilled person to review a regulated entity; and
- Gaps in the PHI licensing regime.

This is in addition to new non-objections powers over the appointment of directors and trustees (see recommendation 4.3).

An opportunity to review penalties

It is timely to review the current penalties in APRA's industry acts and the *Financial Sector (Collection of Data) Act 2001* (FSCOD Act) to ensure their appropriateness.

In 2018, the Parliament strengthened penalties for ASIC-regulated corporate and financial sector misconduct.¹³³ In contrast, many of the penalties prescribed in APRA's Industry Acts and FSCOD Act have not been reviewed or updated in some time. Some provisions only have strict liability offences with no corresponding ordinary offence provisions. Existing criminal penalty provisions may also benefit from new parallel civil penalty provisions to give APRA greater flexibility when enforcing the law. It is important to ensure that penalties are effective deterrents and in step with community expectations.

A review of the existing penalty regime is also appropriate in light of the Panel's other recommendations which seek to enhance APRA's enforcement toolkit, for instance providing APRA with a non-objections power to veto the appointment or reappointment of directors and senior executives of regulated entities (see recommendation 4.3).

However, the Panel notes that the case for changing the penalties in APRA-administered acts is not as clear-cut as the case for ASIC legislation. APRA is not the regulator of misconduct and has the powerful ability to adjust capital requirements where it is concerned about the impact of misbehaviour for all industries other than superannuation. Any review will also need to consider the impact of penalties in the SIS Act on superannuation members.

Skilled person review

APRA should be given the ability to appoint a skilled person to report to it in relation to the affairs of a regulated entity, or to require a regulated entity to appoint such a person to do so. This power should be general in nature, limited only by reference to APRA's statutory mandate. Such a review could be used for diagnostic, monitoring, preventative or remedial purposes. APRA currently has a number of powers to appoint third parties. But these are focussed on auditors and actuaries, and are not comprehensive.

The Panel notes that this power would enhance APRA's escalation toolkit as it would provide an additional option to supplement business as usual supervision activities in circumstances where escalation to enforcement activities is not yet warranted. Skilled person reviews would support observations that APRA should judiciously leverage external expertise to a greater extent and be in step with tools available to international regulators, such as the United Kingdom's Prudential Regulation Authority.

133 Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019.

Additional powers for PHI

APRA's PHI licensing powers could be strengthened. Currently, APRA can only impose a licence condition upon the initial registration of a PHI. APRA's powers should be extended to enable it to impose licence conditions where it has prudential concerns. Furthermore, APRA should be given broader powers to revoke insurer licences. For APRA's supervision of the PHI industry, see discussion below.

RECOMMENDATION 6.2

While APRA's regulatory tools are generally fit-for-purpose, the Government should consider:

- a. reviewing the adequacy of penalties across APRA's legislative framework;
- b. providing APRA with the power to appoint a skilled person to undertake a review of a regulated entity; and
- c. enhancing its private health insurance licensing powers.

Working effectively with other regulators

To execute its mandate, APRA should collaborate with a wide range of domestic and international regulators. While APRA collaborates well with the CFR, APRA's relationships with other regulators are not uniformly fit-for-purpose. APRA's 2018-22 Corporate Plan includes a strategic initiative to enhance engagement and collaboration with peer agencies.

In the immediate future, APRA will need to work more closely with ASIC. This is partly because they have been given joint, but different, roles for a range of matters. Also, the more intense focus on GCA risks has the potential to blur the boundaries between the 'two peaks'. APRA and ASIC should work closely together to define these boundaries. APRA will also need to continue to work closely with other regulators to lift it and the system's preparedness for a financial crisis.

The Panel observes that APRA's collaboration could be stronger in areas that are in need of a capability uplift (for instance GCA and superannuation) or where it requires intelligence from non-traditional sources. For instance, the IMF FSAP found that 'APRA's supervisory assessment of governance should also incorporate banks' management of non-financial risks, based on a closer engagement with the relevant domestic agencies, mainly ASIC and the Australian Transaction Reports and Analysis Centre (AUSTRAC).'¹³⁴

The increasing importance of APRA's relationship with ASIC

Cooperation and coordination with ASIC will be increasingly important over the next few years as ASIC takes on a growing role in relation to superannuation and the BEAR.¹³⁵ The Hayne Royal Commission found that APRA and ASIC failed to coordinate to take action regarding the payment of

¹³⁴ IMF, 2019, *Australia: Financial System Stability Assessment*, p. 28.

¹³⁵ As recommended by the Hayne Royal Commission and Productivity Commission Superannuation Inquiry.

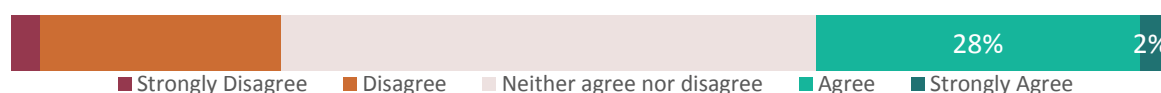
trailing commissions by trustees to related party financial advisers, and the charging of fees for no service.¹³⁶ It is vital that Wallis' two peaks of financial system regulation effectively engage.

APRA has indicated that it will work with ASIC to update their 2010 Memorandum of Understanding (MoU), agree clear principles for information sharing, consultation and coordination on enforcement action,¹³⁷ as well as removing impediments such as barriers to conducting joint investigations with ASIC.¹³⁸ This is consistent with the Hayne Royal Commission recommendation.¹³⁹

Senior representatives from both organisations told the Panel that the relationship is close and strengthening. This view is not echoed by APRA staff. The Capability Review Staff Survey identified that 30 per cent of staff agreed that APRA and ASIC work well together. In addition, 27 per cent of staff indicate that there are significant impediments to working closely with ASIC.

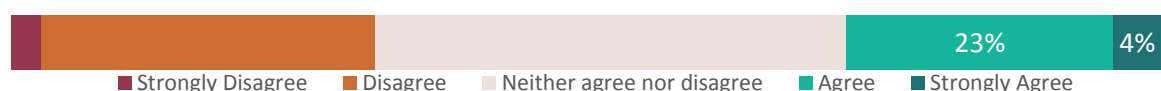
Capability Review Staff Survey — Relationship with ASIC

Proposition: APRA and ASIC work well together.



Proposition: There are significant impediments with working closely with ASIC.

Note: This is a negatively framed proposition.



One of the best things that could be done to enhance APRA's organisational capability would be to clarify the responsibilities between APRA and ASIC and that this would provide supervisors with more confidence in their actions and regulatory remit.

— APRA staff

The Panel's engagement with international peer regulators reveals that, in general, prudential regulators internationally are relatively less concerned than APRA about a potentially negative trade-off associated with sharing information with the conduct regulator.

APRA's leaders should improve their communication with staff members about the developing relationship with ASIC and seek ways to strengthen bilateral relationships throughout the organisation. The Panel notes APRA's internal protocols for sharing information are currently stricter than the legislative requirements, as the legislation allows APRA to share information with ASIC so that ASIC can perform its functions and powers. The Government's decision to impose a positive obligation on APRA and ASIC to co-operate and share information in response to a Hayne Royal Commission Recommendation will assist in improving this relationship.

¹³⁶ Hayne Royal Commission Final Report Vol. 1.

¹³⁷ APRA Enforcement Strategy Review, recommendation 1, p. 21.

¹³⁸ APRA Enforcement Strategy Review, recommendation 7, p. 54. This is consistent with an IMF FSAP recommendation — APRA should deepen the regular cooperation with ASIC, and explore the possibility of undertaking joint activities, where feasible and appropriate. (IMF, 2019, *Australia: Financial System Stability Assessment*, p. 29)

¹³⁹ Hayne Royal Commission Recommendation 6.10.

Other domestic relationships

The CFR is the highest level forum for managing financial system risk and is comprised of APRA, the RBA, ASIC and Treasury. The CFR provides a forum for identifying material risks, discussing appropriate actions and providing advice. Importantly, all delegated powers rest with the individual member agencies. The 2018 IMF FSAP and the Murray Inquiry found that the CFR was robust and comparable to international best practice. The Panel does not dispute that conclusion.

AUSTRAC is Australia's anti-money laundering and counter terrorism financing regulator. The 2019 IMF FSAP report recommended that APRA and AUSTRAC should significantly step up the frequency and the level of their cooperation by creating operational level working groups that meet on a frequent basis to discuss Anti-Money Laundering / Counter-Terrorism Financing issues in specific entities to better integrate associated risks into APRA's assessment of banks' risks as well as to support AUSTRAC's work.¹⁴⁰ APRA and AUSTRAC should implement the IMF's FSAP recommendation.

The Panel heard from stakeholders that the relationship between APRA and the RBA is cooperative and informal, particularly highlighting greater levels of collaboration when compared to international peers. The IMF's FSAP has also commented on this cooperative relationship with respect to financial stability and systemic risk issues.¹⁴¹ Similarly, the Panel heard positive feedback on APRA's relationship with Treasury, especially on policy matters.

The Panel would be supportive of APRA establishing a forum to ensure a coordinated, whole of government approach to financial sector misconduct issues. Such a forum could involve APRA, ASIC, ACCC, AUSTRAC and the ATO.

140 IMF, 2019, *Australia: Financial System Stability Assessment*, p.29

141 IMF, 2019, *FSAP: Detailed assessment of observance — Basel core principles for effective banking supervision*, p. 23.

APRA'S SUPERVISION OF PHI AND RELATIONSHIP WITH THE DEPARTMENT OF HEALTH

The PHI industry has several features that create different challenges for APRA in carrying out its prudential supervisory role compared to its other regulated industries.

PHI is a part of Australia's health financing system. As such, the PHI industry is subject to a high degree of government regulation. Key external factors relevant to APRA's prudential mandate include:

- Government regulation of pricing and product features, including annual ministerial approval of premium increases, community rating and risk equalisation;
- Government incentives to encourage greater participation in PHI, particularly by younger people and those on higher incomes, including Lifetime Health Cover, the PHI rebate and the Medicare Levy Surcharge; and
- Government regulation or control over the price of some inputs, including the cost of medical prostheses.

These factors produce risks that are largely unique to the PHI industry. The affordability of PHI is declining as premium increases outpace wages growth in order to keep pace with rising healthcare costs and utilisation. This risks impacting participation rates at the same time as the average age of policyholders is increasing, placing further pressure on premiums and affordability.

Since taking over responsibility for prudential regulation of PHI in 2015, APRA has worked to substantially improve entity resilience in terms of capital, risk management and governance to address these viability risks. APRA has also focussed on recovery planning. The Panel agrees this is appropriate, noting the work on recovery planning faces similar capability issues as discussed in Chapter 3.

The extent of government regulation of, and policy influence over, the PHI industry requires APRA to have an effective relationship with the DoH. APRA provides advice to the Department on the prudential sustainability of proposed premium changes. The direct link between premium changes and insurer viability means that APRA has an important role to play in this process. APRA should also have a sophisticated understanding of how PHI fits into the broader health system.

The Panel observes that APRA has a good working level relationship with the Department, with regular engagement on business as usual matters and an increasing appetite to engage on strategic issues. The relationship however is weak at more senior levels. For example, APRA does not have regular liaison meetings at senior levels with the Department, unlike its other key agency relationships. This is a risk for APRA in terms of its visibility of forthcoming political risks and its capability to work with the government to address urgent issues such as a failing entity. As part of its wider peer agency refresh, APRA should strengthen its engagement and relationship with the DoH at all levels of seniority.

International engagement

APRA is also part of the global regulatory community. APRA's international activities include bilateral and multilateral relationships with other regulators, facilitating information exchange, contributing to the policy development of global standard setting bodies and providing technical assistance to other regulators. APRA has information sharing arrangements with 32 overseas regulatory agencies through MoUs and letters of exchange. In 2018, APRA staff undertook 111 international visits — roughly two-thirds of these visits concerned core business (supervision, policy and resolution).¹⁴²

Refresh Memoranda of Understanding

While the frequency with which formal MoUs are signed is not always indicative of the strength and day to day effectiveness of regulator engagement, refreshing them is good housekeeping. Many of APRA's MoUs with other domestic and international agencies were signed when no current APRA Members were in office and do not reflect today's challenges (ACCC — 1999, ASIC — 2010, RBA — 1998, OSFI — 2007).

Industry representatives submitted to the Panel that it was important that the parameters of the relationship between the regulators, including any agreements for information sharing are transparent and well understood.¹⁴³

APRA should update their MoUs as part of its 2018-22 strategic initiative to enhance collaboration and engagement with peer agencies, ensuring that they reflect the current and emerging operating environment. As part of this refresh, APRA should consider its approach to information sharing and internally, inform staff of the appropriate information-sharing parameters.

RECOMMENDATION 6.3

APRA should reinvigorate its approach to collaboration and information sharing with regulators and its international peers including clear protocols for staff.

142 Sixty-six per cent core business (supervision, policy resolution), 23 per cent information exchange and 11 per cent technical assistance. APRA Insight Issue 4 2018.

143 Australian Institute of Company Directors, 2019, *Submission to the APRA Capability Review*.

Parliament and public — an opportunity to refresh external accountability

APRA's external accountability framework

APRA has a broad range of external accountability mechanisms to which it needs to respond (Figure 6.2).

The principal accountability mechanism for APRA is Parliamentary and ministerial oversight. APRA appears before Senate Estimates and the Standing Committee on Economics, which reviews APRA's annual report. In addition, APRA's prudential standards are subject to disallowance by the Parliament.

APRA's Parliamentary and ministerial oversight is a feature of Australia's democratic system. Independent agencies such as APRA are accountable to the Executive and the Parliament, which in turn are ultimately responsible to the public. It is important that these frameworks allow the Parliament and the public to assess how well APRA performs.

Ministerial responsibility centers on issuing a SoE to APRA. This aims to provide greater clarity about government policies and objectives. It includes the policies and priorities the government expects APRA to consider in conducting its operations. APRA is then given an opportunity to respond through its Sol. APRA is also subject to direction by the Minister,¹⁴⁴ although this power has never been utilised.

From time to time, APRA may be subject to ad hoc reviews, such as the recent PC Superannuation Inquiries as well as international reviews, and the five-yearly IMF FSAP, which focusses on compliance with international standards.

Outside these, there are a number of other reporting obligations including the whole-of-government regulator performance framework, annual reports of APRA's performance against the *Public Governance, Performance and Accountability Act 2013* (PGPA Act) and engagement with the Australian National Audit Office on its financial accounts.

It is important that accountability mechanisms in place allow the Parliament and the public to assess how well APRA performs. The Hayne Royal Commission examined APRA's external accountability framework and found that the existing oversight framework is heavily focussed on governance and financial stability. In addition, none of the existing processes involved a regular and systematic review of how well APRA discharges its statutory functions or exercises its statutory powers. As a result, the Hayne Royal Commission recommended the establishment of an independently chaired oversight body to report on the performance of APRA and ASIC.¹⁴⁵

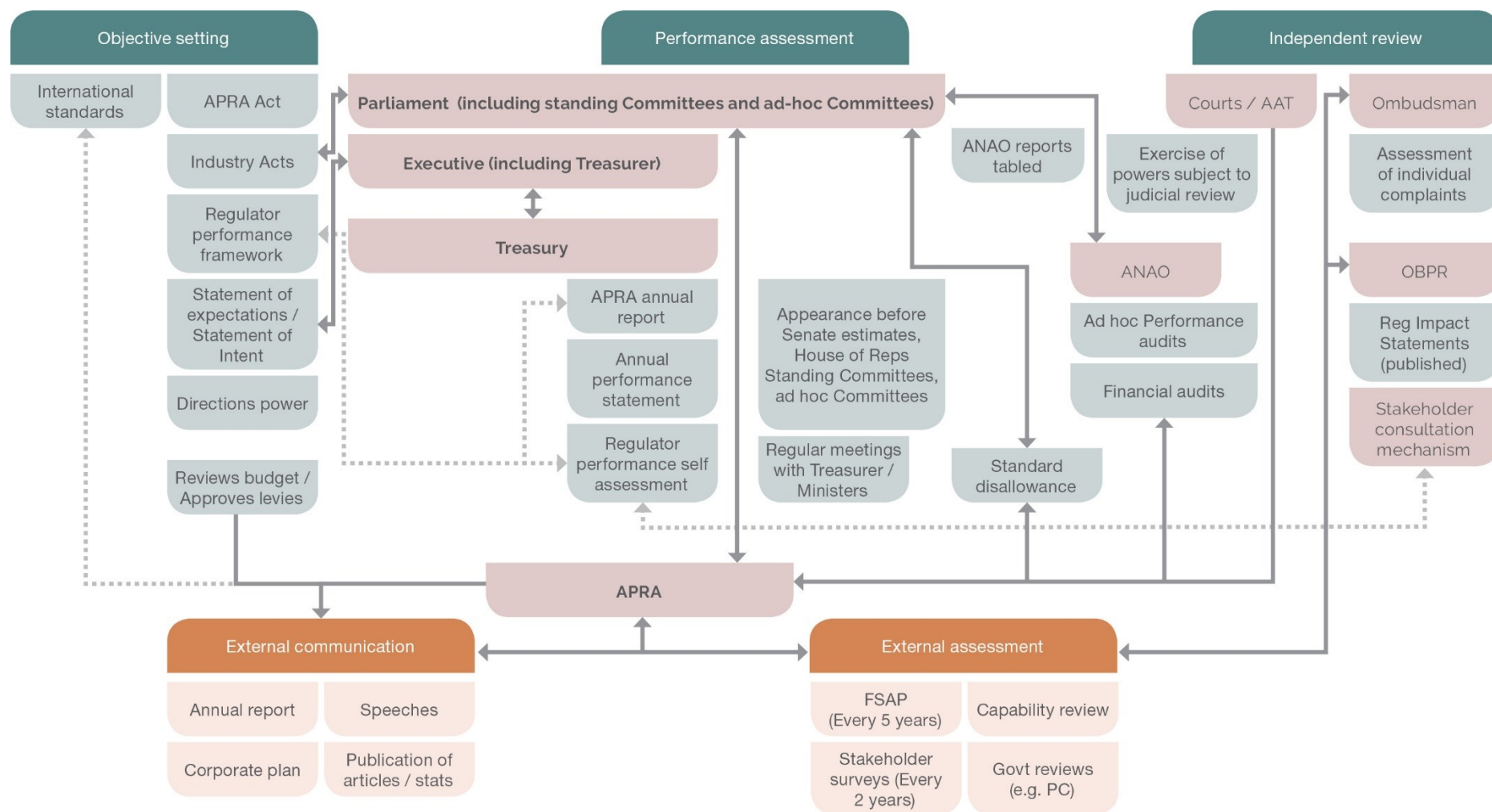
In addition, APRA has agreed to implement the recommendation of the Hayne Royal Commission to internally formulate and apply to its own management accountability principles of the kind established by the BEAR.¹⁴⁶

144 Section 12, APRA Act.

145 Hayne Royal Commission, recommendation 6.4.

146 APRA, 2019, *Table with APRA's Responses to Royal Commission Recommendations*.

Figure 6.2: Complexity of existing external accountability arrangements



Accountability post-Hayne — regulator oversight authority

The Hayne Royal Commission recommendation to establish a new oversight authority for both APRA and ASIC provides a good opportunity to reconsider the current external accountability regime.

Current oversight arrangements are made up of a range of reporting obligations, some that apply broadly across public service agencies and regulators and others which are more specific to APRA. The resulting framework is not purpose-designed and contains substantial duplication. It entails a considerable and ongoing resource drain on APRA, but does not efficiently hold APRA to account for the delivery of its mandate.

In meetings with the Panel, APRA's view was that aspects of the current external accountability framework are inefficient as they are duplicative and not adequately focussed on agreed performance criteria.

The Panel agrees with the observations made by Commissioner Hayne that none of the existing frameworks involve a regular and systematic review of how APRA discharges its statutory functions or exercises its statutory powers. It is not held to account against its mandate. The ASIC Capability Review made similar observations about ASIC's external accountability framework. It noted that Parliamentary oversight had become issues driven and reactive, at the expense of a more strategic long-term function.¹⁴⁷

The Panel will not pre-empt how the financial regulator oversight authority may design its arrangements, and is mindful that such arrangements will apply to both APRA and ASIC. Below, one approach is outlined that would assist APRA and be a more effective way for it to be held to its mandate.

APRA's external accountability framework could be adapted to more closely resemble the framework applied to the RBA. This would involve two Parliamentary testimonies per year. APRA could prepare a public document which would include an assessment, informed by any benchmarks or metrics developed by the oversight authority of how it is meeting its mandate. This could include issues of concern in the financial system or in particular sub-sectors and a forward-looking account of policy or strategic issues that it is considering. This would provide Parliament with a regular and systematic review of how APRA discharges its powers, tested against independently developed standards. Over time, APRA could be held to account against its public testimony. Unnecessary and overlapping existing parts of the framework could be removed under this arrangement.

More assertiveness with Statement of Intent

The ASIC Capability Review considered at length the role of governments' SoEs and ASIC's Sols. It observed that 'SoEs and Sols were not being fully leveraged to ensure broad public understanding of what is expected of ASIC, and what the limitations of its mandate are'.¹⁴⁸ Similar issues have been identified in this Review and raised in consultation.

It is important that regulators are informed about the governments' expectations of it and it is for governments to set those expectations. When applied to independent institutions they are high level statements, taking into account the institution's mandate and other idiosyncrasies.

147 Australian Government, 2015, *Fit for the future: A capability review of the Australian Investments Commission*, p. 48.

148 Australian Government, 2015, *Fit for the future: A capability review of the Australian Investments Commission*, p. 7.

APRA notes that, at times, past SoEs have forced it to reprioritise resources and delay the implementation of important strategic plans. This led to underinvestment in areas that have since led to problems emerging in its capability. The Panel accepts this. In the future APRA should use its Sols more effectively. It should clearly inform government of the extent to which its expectations fall within APRA's Corporate Plan. It should also identify the organisational impact of embedding the government's expectations and assess whether this is consistent with the effective execution of APRA's mandate.

APRA should also reconsider its broader communication strategy to better inform the public and the Parliament of its priorities and concerns. This will make it a more effective regulator and advocate for itself. This is explored further below.

RECOMMENDATION 6.4

APRA should use its existing external accountability framework more effectively, including a more assertive use of the Statement of Intent and it should publish a regular external accountability assessment.

RECOMMENDATION 6.5

The Government should consider streamlining and improving the effectiveness of existing accountability arrangements when establishing the financial regulator oversight authority.









Improving strategic communications

Public communications provide opportunities for regulators to achieve outcomes and demonstrate accountability. There are three broad categories of information that APRA publicly discloses: information about APRA, information about an industry or a group and information about an individual entity. This section focusses on the first two categories; APRA's communication approach regarding individual entities is discussed earlier in this Chapter.

APRA uses a number of channels of public communication (Figure 6.3). Members and senior leaders give public speeches. APRA also publishes information on its website — such as policy papers and FAQs. APRA also releases Prudential Practice Guides and statistical publications. In 2017, APRA expanded and rebranded its centralised communications team.

Every two years APRA conducts an independent survey of its key stakeholders on APRA's performance. Results from its 2019 stakeholder survey are largely positive.¹⁴⁹ On the whole, stakeholders consider that APRA's communications are useful, clear and effective. Results on APRA's statistical publications were more mixed (see Chapter 5 for a discussion of superannuation data).

Figure 6.3: Number of visits to APRA communications channels per month
May 2017—April 2019 (6 month moving average)

| | Oct 2017 | Apr 2018 | Oct 2018 | Apr 2019 |
|---|-------------|-------------|-------------|-------------|
|  Twitter followers | 3,617 | 3,883 | 4,177 | 4,429 |
|  Media enquiries | 30 | 20 | 30 | 27 |
|  APRA phone inquiries | 508 | 454 | 490 | 497 |
|  People visits to APRA website | 104,300 | 106,158 | 113,332 | 114,922 |
|  Page views of APRA website | 330,500 | 302,763 | 364,450 | 330,551 |
|  Number of news articles (print, radio, TV, online) | 1,265 | 1,625 | 4,959 | 4,855 |
|  Media Releases | 5 | 5 | 5 | 7 |
|  Speeches delivered | 7 | 5 | 7 | 4 |

The Wallis Inquiry noted that the operations of the regulator should be publicly disclosed to the maximum extent practicable.¹⁵⁰ In addition, the Palmer Report recommended that APRA promote further transparency for markets to assess the risks posed by financial institutions' activities.¹⁵¹ Increased public transparency through strategic industry level communications can provide the

149 Results from the 2019 APRA Stakeholder Survey have not yet been published.

150 Wallis Inquiry, p. 335-336.

151 Review of the Role Played by the Australian Prudential Regulation Authority and the Insurance and Superannuation Commission in the Collapse of the HIH Group of Companies (Palmer Report).

deterrence element that is necessary for effective regulation. In the Panel's view, APRA has not sufficiently embedded these observations into its communication strategy.

APRA should communicate the terms upon which it should be judged

As an independent regulator, APRA should use communications to set the framework against which it wishes to be judged and manage community and government expectations of it. This communication should go well beyond what is provided for in publications such as its annual report — a rudimentary requirement under the PGPA Act. The publishing of APRA's Enforcement Strategy Review, assessments of its interventions in the residential mortgage market and entity GCA self-assessments this year are steps in the right direction.

As Chapter 3 outlines, the Panel believes that APRA needs to more clearly articulate its interpretation and approach to its mandate and its role and views about macro-prudential policy.

A more communicative, transparent and assertive APRA will allow it to set the terms upon which it should be judged — by industry, media, Parliamentarians and the community. This communication style would reinforce APRA's new 'constructively tough' enforcement approach and the Panel's recommended proactive, transparent direction for APRA.

Painting a vision for regulated industries

APRA has developed industry strategies for its regulated population. While APRA uses speeches and quarterly *Insights* articles to convey its key messages, emerging issues and industry visions could be conveyed more clearly, forcefully and frequently.

Many international prudential regulators are more transparent and granular about industry issues and areas of supervisory focus than APRA. For example:

- The Office of the Comptroller of the Currency's Semi-annual Risk Perspective outlines its perspective on the operating environment, bank performance, key and emerging risks, and credit underwriting standards. It also provides aggregate details of banks' ratings, outstanding levels of 'matters requiring attention' and outstanding levels of formal and informal enforcement actions; and
- De Nederlandsche Bank publishes a strategy document highlighting strategic themes for the next five years.

Responses to the Capability Review Staff Survey indicated that many staff do not believe that greater public transparency on APRA's assessment of industry-level issues would adversely impact their team's ability to access information and elicit cooperation from regulated entities (the appropriateness of which is discussed earlier in this Chapter).

Capability Review Staff Survey: Transparency of industry issues

Proposition: Greater public transparency on APRA's assessment of industry-level issues would adversely impact my team's ability to access information and elicit cooperation from regulated entities.

Note: This is a negatively framed proposition.



APRA should publish periodic reports on its vision and assessment of the state of its regulated industries. This more strategic approach to communication will help reset APRA's leadership role with its regulated industries.

APRA has recently indicated that external communication that promotes better prudential outcomes and demonstrate ability will be a priority in the near term.¹⁵² More recently, there has been an increase in the number of information papers communicating outcomes from thematic reviews and papers on its expectations of industry. There has also been an increase in the number of media releases relating to supervision.¹⁵³ The Panel welcomes these developments.

RECOMMENDATION 6.6

APRA should take a more strategic, active and forceful approach in its public communications. As an independent regulator, it should use public communications to shape community and government expectations of it. In relation to specific areas, APRA should:

- a. publish an interpretation of its mandate;
- b. clearly articulate its role and approach to macro-prudential policy (see recommendation 3.3);
- c. advise the Government of the current state of its resolution capability and crisis preparedness (see recommendation 3.4). Taking account of the impact on the market, part of this advice could be published; and
- d. be more transparent in relation to superannuation, including by publishing objective benchmarks for superannuation performance on member outcomes and a strategy to promote long-term industry performance.

¹⁵² APRA, 2018, *2018-22 Corporate Plan*.

¹⁵³ Over the last 18 months. APRA data.