

4. Domestic Regulatory Developments

The Council of Financial Regulators (CFR) is the forum for coordination between Australia's key financial regulatory agencies: the Australian Prudential Regulation Authority (APRA); the Australian Securities and Investments Commission (ASIC); the Australian Treasury; and the Reserve Bank of Australia. The CFR is chaired by the Bank, which also provides the secretariat. CFR agency heads typically meet quarterly, but inter-agency coordination and collaboration is ongoing, through CFR working groups and bilateral engagement at a number of levels and on a range of subjects.

Over the past six months, the CFR has been assessing the effects of inflation, rising interest rates and falling housing prices on households, businesses and the financial system. It has maintained its ongoing focus on climate-related financial risks and the need for financial institutions to increase their resilience to cyber-attacks. In conjunction with some non-CFR agencies, it has provided advice to the Australian Government on topics including de-banking, the use of derivatives by superannuation funds, and leverage and risk in the superannuation system. The CFR has also supported initiatives to modernise the regulatory framework in response to innovation in the financial sector.

The CFR is monitoring the effects of inflation, rising interest rates and falling housing prices

As discussed in the preceding chapters, the global economy and financial system are facing considerable uncertainty, including as a result of high inflation, rising interest rates, sharp

increases in energy prices and disruptions to supply chains. These forces are also at play in Australia, along with a marked softening in housing market conditions and falling housing prices. These factors are placing pressure on some household budgets and businesses' cash flows, and this is likely to continue in the period ahead. Understanding the effects of these developments and the associated risks in order to support appropriate and consistent policies is a high priority for the CFR and has been an important topic of discussion at recent meetings. The CFR is continuing to closely monitor trends in borrowing and lending behaviour, against the backdrop of high household debt, declining housing prices and rising interest rates.

Advice on de-banking has been provided to the government

In recent years, numerous non-bank providers of financial services have faced difficulties obtaining or retaining core banking services, a process often referred to as 'de-banking'. In March 2022, the Morrison Government requested that the CFR – with assistance from the Australian Transaction Reports and Analysis Centre (AUSTRAC), the Australian Competition and Consumer Commission (ACCC) and the Department of Home Affairs – provide advice on the 'de-banking' of financial technology firms, digital currency exchanges and remittance providers. Addressing de-banking has been a challenge in many countries, reflecting the balance faced by regulators between promoting innovation and competition on one hand and

controlling financial crime and associated reputational risks on the other. A working group comprising representatives of the seven agencies has examined these issues in the Australian context and consulted with the affected industries. The CFR and other agency heads discussed de-banking in June 2022. They considered how banks' risk aversion in dealing with some sectors might be addressed, along with ways to improve the transparency and processes associated with banks' decisions on the provision of banking services.

The CFR's advice was provided to the Albanese Government in late August 2022 and published in early October. The advice presents options to address de-banking across all businesses and individuals. It recommends that:

1. voluntary data collection on de-banking be undertaken by the four major banks, following which consideration be given to a formal phase of data collection, subject to appropriate resourcing for relevant agencies
2. all banks implement a number of specific measures to improve transparency and fairness, which would apply to all instances of de-banking
3. the four major banks be advised of the government's expectations that they publish guidance applicable to the digital currency exchange, financial technology and remittance sectors concerning their risk tolerance and their requirements to bank these sectors
4. consideration be given by government to funding targeted education, outreach and guidance to the financial technology, digital currency exchange and remittance sectors.

The government has indicated that it will release a response to the recommendations in due course.

The CFR is supporting the modernisation of financial regulation in light of technological innovation

The past year has seen volatility in crypto-asset markets, the failure of some crypto service providers internationally, a rise in crypto-related scams, and increased interest in issuing Australian dollar stablecoins (see 'Box A: Financial Stability Risks from Crypto-assets'). In this context, the CFR's June 2022 statement highlighted the importance of establishing a robust regulatory framework for these new technologies to protect investors and guard against potential financial stability risks. Following the release of the Morrison Government's 'Transforming Australia's Payments System' policy package in late 2021, the CFR agencies have been supporting Treasury in the development of a regulatory framework for crypto-assets in Australia. This has occurred through a working group comprising CFR members, the ACCC, AUSTRAC, the Australian Taxation Office (ATO) and the Department of Home Affairs. The working group has been providing input on key workstreams, such as licensing of crypto-asset secondary service providers and the regulation of payment stablecoins. Given that a number of the risks presented by payment stablecoins are similar to those posed by stored-value facilities (SVF), the CFR has endorsed the working group's proposal to incorporate payment stablecoins into the proposed SVF regulatory framework. A separate CFR working group is currently examining options for the implementation of this proposal. The CFR agencies have also been supporting work on modernising payments system regulation more generally in light of the 'Transforming Australia's Payments System' package.

In September 2022, the CFR discussed the Reserve Bank's collaboration with the Digital Finance Cooperative Research Centre on a pilot project for a central bank digital currency

(CBDC). Given that Australia already has modern and well-functioning payment and settlement systems, this research will focus on innovative use cases and business models that could be supported by the issuance of a CBDC. The project will also be an opportunity to further understand the technological, legal and regulatory considerations associated with a CBDC. The CFR has an open mind as to whether a public policy case will emerge to support the issuance of a digital form of the Australian dollar by the Bank. A paper was published in September explaining the objectives and approach of the project in more detail.

CFR agencies have continued to engage with ASX Group, including on the CHES replacement system

The Reserve Bank and ASIC have joint supervisory responsibility for the four clearing and settlement facilities in the ASX Group: two central counterparties – ASX Clear Pty Limited and ASX Clear (Futures) Pty Limited; and two securities settlement facilities – ASX Settlement Pty Limited and Austraclear Limited. Some elements of regulatory coordination occur through the CFR's Financial Market Infrastructure Steering Committee, as well as the CFR itself. The CFR has been monitoring ASX's program to replace its equities settlement system, CHES, with a system based on distributed ledger technology (CHES replacement). This is a critical project, affecting an important piece of national financial infrastructure. It is paramount that ASX continues to invest in and maintain the current CHES system so that it can continue to service the market reliably until the CHES replacement can safely go live. The CFR has discussed the repeated delays to the project, and ASIC and the Reserve Bank have welcomed an external review of the new CHES application software. The CFR has also discussed operational outages affecting ASX facilities over recent years and areas where ASX's regulatory engagement

could be strengthened. CFR agencies will continue to work closely with ASX on these issues over the period ahead.

Enhancing the cyber resilience of the financial system is an important ongoing focus of the CFR

The CFR's Cyber Security Working Group continues to pursue a program of work aimed at further improving the cyber resilience of the Australian financial system. The domestic cyber-attack protocol developed by CFR agencies has now been expanded to include New Zealand financial regulators, given the strong links between the Australian and New Zealand financial systems. The protocol outlines processes and procedures to better coordinate activities during cyber threats or incidents.

The CFR has also been developing the Cyber Operational Resilience Intelligence-led Exercises (CORIE) framework, to aid in the preparation and execution of industry cyber resilience exercises. These exercises use intelligence gathered on adversaries to simulate their modes of operation and assess the overall maturity of a financial institution's cyber defence and response capability.

A pilot program under the CORIE framework was successfully completed in 2021, with the participation of a number of financial institutions. The CFR's Cyber Security Working Group has since reviewed the framework in light of the feedback received. The CFR endorsed some minor changes at its June 2022 meeting, along with a plan for the wider rollout of the testing program. The updated framework (CORIE framework v2.0) has been published on the CFR website. While agencies have begun working towards the next round of formal exercises with the industry, institutions can also use the framework to support their own testing programs. The CFR continues to urge financial institutions to step up measures to strengthen their cyber resilience in light of growing threats.

CFR agencies continue to work closely with the Department of Home Affairs Cyber Infrastructure Security Centre through regular engagement on the rollout of the amended *Security of Critical Infrastructure Act 2018* and involvement in the Cyber Security Best Practice Regulation Task Force. This includes engaging with the Australian Cyber Security Centre. CFR agencies are working to ensure the new regime is as aligned as possible with existing cyber-security obligations placed on the financial sector.

CFR agencies are promoting the management of risks to the financial system from climate change

With CFR agencies and financial institutions increasing their focus on the financial risks associated with climate change, the CFR in recent years has regularly discussed agencies' activities and planned future work on climate. The 2022 annual stocktake of climate activities was discussed at the CFR's September meeting and published on its website. CFR agencies aim to improve the ability of Australian corporates and financial institutions to manage the financial risks associated with climate change and to provide high-quality comparable disclosures on these risks. For example:

- APRA's Climate Vulnerability Assessment (CVA) of the five largest banks will play a key role in assisting APRA-regulated entities to understand and manage the financial risks associated with climate change. The CVA is in its final stages, with APRA intending to publish aggregate insights and lessons later in 2022. APRA has also issued prudential guidance on climate-related financial risks.
- ASIC continues to encourage Australian large and listed companies to improve standards of climate-related governance and disclosure. The CFR's Climate Working Group will prioritise its work to facilitate high-quality comparable climate-related disclosures, in line with the government's

commitment to introduce disclosure requirements aligned with international standards.

- CFR agencies have been engaging with the Australian Sustainable Finance Institute as it develops an industry-led sustainable finance taxonomy for Australia.

A significant international development in the past year has been the establishment of the International Sustainability Standards Board (ISSB). The ISSB is preparing a global baseline of disclosure standards that provide investors and other capital market participants with information about companies' sustainability-related risks and opportunities. The CFR provided a submission on the proposed disclosure standards for sustainability and climate-related financial information in July 2022, in which it expressed its support for the ISSB's work. The submission highlighted that the provision of consistent, comparable and reliable climate and sustainability-related information is a critical component of ensuring investors can make fully informed decisions and that capital markets remain fair and efficient. The CFR also drew attention to several areas of the draft standards for further consideration, including transitional arrangements and proportionality for smaller entities.

Reviews of the use of derivatives and leverage in the superannuation system have been provided to the government

The CFR has completed two pieces of work related to superannuation funds in recent months. First, it undertook an assessment of the use of derivatives by superannuation funds following a request for advice by the Morrison Government. The CFR concluded that derivatives usage by superannuation funds is predominantly for risk management purposes and is supported by appropriate financial and operational risk management regulatory standards and frameworks. Funds' capabilities in

respect of derivatives investment are monitored by APRA for ongoing compliance with prudential requirements. The CFR concluded that there is currently limited scope for financial instability to result from the use of derivatives by superannuation funds, noting that the industry had managed the liquidity issues arising from pandemic-related withdrawals reasonably well. It highlighted the importance of both strong liquidity risk management regulatory standards and trustees maintaining a strong focus on funds' liquidity positions.

The second superannuation-related workstream – undertaken jointly with the ATO – responded to a previous government request to review leverage and risk in the superannuation system, focused on limited recourse borrowing arrangements (LRBA). Whereas superannuation funds are generally restricted from borrowing, LRBA's allow a fund to borrow to purchase an asset to be held in a separate trust. If the loan defaults, the lender's rights are limited to the asset held in that trust. These arrangements are almost exclusively used by self-managed superannuation funds, predominantly for the purchase of property. The CFR discussed the implications of the review's findings and provided a report to the government in September 2022.

The CFR engages with other regulators, domestically and in New Zealand

Each year in June, the CFR meets with other domestic regulators that are involved with the

financial system, including the ACCC, AUSTRAC and the ATO. The Australian Financial Complaints Authority (AFCA) also participated in the 2022 meeting.

This year's meeting provided an opportunity to discuss the agencies' work on de-banking and regulation of the crypto-ecosystem (see above), along with competition in banking and the pass-through of interest rate increases. Participants also discussed with AFCA trends in financial complaints. Key developments included: increased investment in internal dispute resolution, particularly among some of the large financial institutions; and a sharp rise in complaints related to scams, including crypto-asset scams and other investment scams. The CFR has indicated that it supports actions being taken by banks and other financial institutions to block scams, build awareness and, where appropriate, remediate losses by customers.

The CFR agencies continue to meet periodically with their New Zealand counterparts through the Trans-Tasman Council on Banking Supervision (TTBC). The TTBC currently meets separately at the agency heads, deputies and working levels. The TTBC heads met most recently in June 2022, with discussions including economic and housing market developments, initiatives related to managing climate financial risks and cooperation on responses to cyber-attacks.

