

Inquiry into the Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017

**Submission to the
Senate Economics Legislation Committee**

December 2017

The Reserve Bank of Australia supports the package of reforms set out in the Bill and considers passage of the Bill to be critical for ensuring that APRA has the appropriate powers to manage the resolution of financial institutions in distress.

The global financial crisis prompted a comprehensive international regulatory response, focused on making financial institutions and the financial system more resilient. The global measures agreed by standard setting bodies such as the Basel Committee on Banking Supervision and the Financial Stability Board broadly fall into three main categories: (i) increasing buffers by requiring banks to hold more capital; (ii) strengthening prudential regulatory standards; and (iii) improving the tools for regulators to deal with crises. There has been a great deal of progress addressing the first two of these categories. This Bill aims to address the third category.

In recognition that a key element of the resilience of a financial system is the ability to deal with crises through supervisory and resolution powers, the Financial Stability Board developed an international standard for resolution regimes in 2011. The Key Attributes of Effective Resolution Regimes for Financial Institutions were endorsed by Australia at the G20 in 2011. The implementation of the Key Attributes aims to allow a financial institution to be resolved in an orderly manner without severe systemic disruption or exposing taxpayers to the risk of loss. The Bill's provisions address many of these Key Attributes where the legal basis in Australia presently is unclear or insufficiently developed. The provisions are also consistent with the recommendation of the Financial System Inquiry to enhance the crisis management toolkit for regulators in order to minimise negative spill-overs to the financial system, the broader economy and taxpayers.

A financial crisis in Australia, whether it originates domestically or overseas, would require a flexible set of resolution policies to enable regulators to respond without delay in order to limit the damage where possible. The Council of Financial Regulators (consisting of APRA, ASIC, the Reserve Bank and the Treasury and chaired by the Reserve Bank Governor) has established a process for managing the orderly resolution of a distressed institution to ensure a coordinated response. Much of the robustness of this process depends on APRA having sufficient and

effective crisis management powers to resolve financial institutions. We believe these powers will be greatly enhanced by this Bill.

The Reserve Bank supports the package of reforms set out in the the Bill in its entirety. The reforms clarify APRA's current regulatory powers and remove uncertainty regarding when they can be used and their scope of operation. They also provide new powers to support resolution planning outside times of crisis and resolution management in the event of a crisis. In particular, we note the important contributions that the Bill will make in the following areas:

- *Direction powers:* Direction powers are an integral part of APRA's ability to manage the resolution of a financial institution, by requiring directors to undertake specific actions to address prudential issues that have been identified. It is equally important that directors or officers of the bank can follow an APRA direction without risking non-compliance with other laws. The Bill will extend APRA's powers to cover a wider range of institutions, including subsidiaries of non-operating holding companies and regulated entities, while ensuring that there are no barriers to directors complying with any APRA direction.
- *Stay provisions:* APRA's ability to prevent counterparties of a failing entity from taking action (such as exercising termination rights for derivative contracts) on the grounds of APRA exercising its crisis powers are critical for achieving an orderly resolution.
- *Conversion and write-off of capital instruments:* To increase the capacity to absorb losses during financial distress, banks are required to hold capital instruments that are capable of being converted into equity or written down. The Bill provides greater certainty for regulators that these instruments will serve their intended purpose.
- *Foreign branches:* Foreign ADIs and insurers provide important services to the Australian market, however APRA currently has limited powers to manage the resolution of a foreign branch in distress. The Bill will provide APRA with stronger powers to manage resolution and thereby better respond to and contain the resulting impact on the domestic financial system, as well as meeting its obligations to support overseas regulators during a cross-border resolution.
- *Resolution planning:* A key lesson from the financial crisis was that, in order to ensure an orderly resolution of a financial institution, comprehensive resolution planning must be undertaken in advance. The Bill will clarify the legislative framework that provides for resolution planning, including allowing APRA to direct entities to address any potential barriers that could hinder an orderly resolution.

This Bill is an important step in providing APRA with the necessary powers to manage resolution of financial institutions in an orderly way. We note that similarly robust resolution powers will be required for financial market infrastructure and look forward to progress being made in this area over the coming year.

Reserve Bank of Australia
15 December 2017