

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 on a range of subjects.

Following the emergence of stress in parts of the global banking system in March, the CFR agencies have been working closely to monitor for any adverse effects on the Australian financial system. More broadly, over the past six months the CFR has continued to assess the effects of higher interest rates and inflation on Australian households, businesses and the financial system. Cybersecurity and operational resilience in the financial system also remain a key focus for the CFR, with work underway across a range of government agencies to strengthen preparedness for and resilience to cyber-attacks. The financial risks associated with climate change are another area of ongoing focus, as is the CFR's continued support of initiatives to modernise financial regulation in Australia in response to innovation in the sector.

The Australian banking system has been resilient to the recent stress in the global banking system, but there are still lessons to be drawn

As discussed in preceding chapters, Australia's banks are strongly capitalised and highly liquid. APRA's prudential framework means that the requirements for banks operating in Australia are equivalent to – and, in some instances, stronger than – global requirements. In light of recent global banking developments, APRA is supervising domestic financial institutions more intensively than usual and, together with the other CFR agencies, is closely monitoring for any adverse effects on the broader financial system. It is important that financial institutions continue to invest in their capacity to absorb shocks, by maintaining strong capital and liquidity buffers.

CFR agencies are engaged in international regulatory discussions about the recent banking stresses, what went wrong and what lessons can be drawn for the regulatory regime to further strengthen the global banking system. Even though Australia's prudential framework is stronger than many of its overseas counterparts, APRA (together with the other CFR agencies) is reviewing the lessons learned from this episode to ensure Australia's regulatory regime remains fit for purpose and our financial system remains resilient as the environment changes over time.

The CFR continues to monitor the effects of higher interest rates and inflation on Australian households and businesses

The combination of higher interest rates and inflation is putting pressure on the budgets of Australian households and businesses. Overall, households have remained resilient, with household finances supported by strong labour market conditions and high levels of accumulated savings. However, the CFR recognises there is significant variation in experience among borrowers. There is already a small share of households experiencing debt-servicing challenges, and higher interest rates and a slowing economy are expected to result in an increase in non-performing housing and business loans over the period ahead – albeit from a very low level. Recognising the risks around the economic outlook, the CFR will continue its close monitoring of credit growth, asset price developments, lending standards and lenders' approaches to supporting customers experiencing hardship or other changes in financial circumstances.

In December 2022, the CFR undertook its annual review of non-bank financial intermediation. Non-bank lending for housing grew strongly over the year, though it has slowed more recently; on the other hand, non-bank business credit growth has increased sharply (see 'Chapter 2: The Australian Financial System'). Importantly, lending standards have been broadly maintained and CFR agencies agreed it was important this remains the case. The non-bank sector has a relatively small proportion of system-wide lending in Australia and has limited direct links with the banking system. Even so, the CFR continues to monitor this sector closely. In December, the CFR also discussed the disruptions in the UK pension fund sector, which highlighted how embedded leverage in some derivatives can amplify liquidity risks from large movements in asset prices. The CFR recognised

the important differences between UK pension funds and Australian superannuation funds; it also noted that APRA had strengthened investment governance standards for superannuation funds, which took effect in early 2023.

The CFR continues its work in enhancing cyber resilience in the Australian financial system

Recent cyber-attacks on Optus, Medibank and Latitude Financial have highlighted the ongoing threats and the potential for spillovers to the Australian financial system, even when the incident originates from outside the financial system. With cybercrime as one of the key risks facing both the global and domestic financial systems, the CFR continues to pursue a program of work aimed at further improving the cyber resilience of the Australian financial system. The scope of work of the CFR's Cyber Security Working Group (CSWG) has been expanded to include sector-wide operational resilience principles. This broader scope will enhance the CFR's capability to respond to future material operational incidents that affect day-to-day operations and payments systems. The CSWG also has a number of joint initiatives underway with other agencies, and APRA and ASIC have initiatives underway to further assess cyber resilience and preparedness across regulated entities. Moreover, the CFR has endorsed a work program to enhance the resilience of the financial system to geopolitical events.

CFR agencies have strengthened cooperation on cybersecurity over recent years, including via the agreement on cyber-attack protocols with New Zealand agencies. The agreement enhances communication and co-ordination between jurisdictions in the event of a significant cyber-attack on the Australian financial system.

The CFR has also continued its development of the Cyber Operational Resilience Intelligence-

led Exercises (CORIE) framework, to aid the preparation and execution of industry cyber resilience exercises. CORIE uses 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. The CFR continues to remind financial institutions of the importance of stepping up measures to strengthen their cyber resilience in light of growing threats. Financial institutions can use the latest CORIE framework (published on the CFR website) to support their own testing programs.

ASIC and the Bank will continue to closely monitor ASX's compliance with its regulatory obligations and hold it publicly accountable

The Bank and ASIC have joint supervisory responsibility for the four clearing and settlement facilities in the ASX Group, which involves extensive coordination between ASIC and the Bank. Regulatory coordination also occurs through the CFR's Financial Market Infrastructure Steering Committee, as well as the CFR itself.

At the December meeting, the CFR discussed ASX's announcement to reassess all aspects of the CHES Replacement program. As the outcome of this project affects an important piece of national financial infrastructure, it is vital that ASX continues to invest and maintain the current CHES. CHES must continue to service Australia's cash equities markets reliably until its replacement can be safely delivered by ASX and users of CHES. ASIC and the Bank have taken regulatory actions since ASX's announcement and will continue to closely monitor the ASX's compliance with its regulatory obligations. The CFR also welcomed the government's announcement to implement legislative reforms to enhance CFR agencies' ability to effectively regulate financial market infrastructures, to enforce requirements for a monopoly provider

of clearing and settlement services to achieve competitive outcomes and to promote safe and effective competition for the clearing and settlement of cash equities.

CFR agencies continue to support and promote the management of risks to the financial system from climate change

The CFR and the Australian Government are committed to helping corporate and financial institutions improve their ability to manage the financial risks associated with climate change. In December 2022, the CFR welcomed the government's announcement of a sustainable finance agenda, which is designed to improve the transparency of financial reporting, deepen Australia's green finance markets and take advantage of opportunities in sustainable finance. The CFR will continue to monitor risks, coordinate regulatory responses and ensure Australia's financial system is well positioned to support climate transition-related initiatives outlined by the government over the period ahead. This work builds on related workstreams already underway.^[1]

The CFR continues to support the modernisation of financial regulation in response to technological advancements

The CFR and the Australian Government recognise the need to have flexible and forward-looking regulatory frameworks that are equipped to deal with the introduction of a wide range of innovative products, including crypto-assets, stablecoins and central bank digital currency (CBDC). The government has announced a series of reforms intended to modernise elements of the regulatory framework, in order to support both innovation and consumer protection. The CFR has discussed the government's proposed reforms, which include: developing a strategic plan for

the payments system; developing a new tiered payments licensing framework; consulting on a licensing and custody framework for crypto-asset service providers; and modernisation of the *Payment Systems (Regulation) Act 1998*. The Treasury, supported by other CFR agencies, is undertaking much of this work. In addition, public consultation on the taxation of digital assets and transactions commenced in August 2022 and will be reported on by the Board of Taxation by 30 September 2023; public consultation on token mapping commenced in March 2023.

Separately, the CFR discussed progress on the Bank's research project with the Digital Finance Cooperative Research Centre that is exploring potential use cases and economic benefits of a

CBDC in Australia. The project, which began in mid-2022, involves industry participants demonstrating potential use cases for a CBDC using a limited-scale pilot CBDC that is a real digital claim on the Reserve Bank. There has been significant interest in the project and a number of industry participants were recently selected to participate in the live pilot, which will take place over the next few months. Given the nature of the pilot CBDC as a claim on the Bank, there has also been strong engagement with regulators on the regulatory implications of the use cases to be tested as part of the pilot. The CFR agencies have reiterated their support for the Bank's ongoing research on CBDC, and the CFR maintains an open mind as to whether there will be a case for issuing a CBDC in Australia at some point in the future. ✎

Endnotes

- [1] See CFR Climate Working Group (2022), 'Council of Financial Regulators Climate Change Activity Stocktake', September.