Chapter 1

Introduction

1.1 On 16 November 2017, the Senate referred the provisions of the Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017 (the bill) to the Senate Economics Legislation Committee (the committee) for inquiry and report by 9 February 2018.[1]

1.2 The bill seeks to strengthen the powers of the Australian Prudential Regulation Authority (APRA) to facilitate the orderly resolution of an authorised deposit-taking institution (ADI) or insurer so as to protect the interests of depositors and policyholders, and to protect the stability of the financial system in case of crisis.[2]

1.3 The bill also provides for an increase in APRA's powers to set appropriate prudential requirements and take action in relation to resolution planning so that ADIs and insurers are better prepared for resolution.[3]

1.4 In his second reading speech, the Treasurer, the Hon. Scott Morrison MP, highlighted the prudent management of Australia's financial system, particularly over the last 26 years, noting that 'the resilience of the financial system is the first line of defence against financial crises'.[4] He explained that, in implementing these reforms, the government is 'taking action to put in place a far-sighted framework to protect Australians'.[5] By affording APRA the power to work with ADIs and insurers in order to plan for economic stress events, the cost to the taxpayer will be significantly reduced in the event of a financial crisis.

Conduct of the inquiry

1.5 The committee advertised the inquiry on its website and wrote to relevant stakeholders and interested parties inviting submissions by 18 December 2017.

1.6 Following the call for submissions to the inquiry, the committee received a large amount of correspondence from individuals around the country. The large public response was in part prompted by an email campaign organised by the Citizens Electoral Council (CEC) which is a national political party.

1.7 The CEC wrote to all of its members outlining why it believed the bill should not be passed by the Parliament and encouraging its members to write to the committee to let them know that they thought the bill should not be passed.

---

1 *Journals of the Senate, No. 71*, 16 November 2017, p. 2249.

2 Explanatory Memorandum, p. 5.

3 Explanatory Memorandum, p. 5.

4 The Hon. Scott Morrison MP, Treasurer, Second Reading Speech, *House of Representatives Hansard*, 19 October 2017, p. 11272.

5 The Hon. Scott Morrison MP, Treasurer, Second Reading Speech, *House of Representatives Hansard*, 19 October 2017, p. 11272.

1.8 The correspondence received from individuals made two main points in opposition to the bill: firstly, they believed that this bill gives APRA the power to 'bail-in' depositors' savings to stabilise a failing financial institution; secondly, in place of the bill, the Australian Parliament should legislate a Glass-Steagall[6] style separation of the banks. These points echo the arguments put forward in *Submission 11* made by the CEC. The committee has published a selection of submissions which represent the types of views expressed in the correspondence received from these individuals. All correspondence and submissions were considered by the committee during the course of the inquiry.

1.9 In total, the committee published 46 submissions, which are listed at Appendix 1.

1.10 The committee thanks all individuals and organisations who assisted with the inquiry, especially those who took the time to write to the committee.

Background

1.11 The Global Financial Crisis (GFC) in 2008 highlighted the importance of ensuring the stability of financial systems around the world. Since the GFC, Australian Governments have conducted numerous consultation processes and reviews in order to determine what action should be taken to ensure Australia's continued economic growth and to maintain the stability of the financial system.

1.12 In October 2011, the Financial Stability Board (FSB) issued its *Key Attributes of Effective Resolution Regimes for Financial Institutions* (Key Attributes). These Key Attributes set out the 'core elements that the FSB considers to be necessary for an effective resolution regime'.[7] According to the FSB, the following features should form part of a jurisdiction's resolution regime:

1. Scope
2. Resolution authority
3. Resolution powers
4. Set-off, netting, collateralisation, segregation of client assets
5. Safeguards
6. Funding of firms in resolution
7. Legal framework conditions for cross-border cooperation
8. Crisis Management Groups (CMGs)
9. Institution-specific cross-border cooperation agreements

---

6 Glass-Steagall legislation refers to four provisions of the United States' Banking Act that were in force between 1933 and 1966. The provisions legislated a separation of commercial and investment banking. It is widely thought, though not proved, that the legislation prevented a financial crisis during that period.

7 Financial Stability Board, *Key Attributes of Effective Resolution Regimes for Financial Institutions*, October 2011, p. 1. http://www.fsb.org/wp-content/uploads/r_111104cc.pdf (accessed 15 January 2018).

10. Resolvability assessments

11. Recovery and resolution planning

12. Access to information and information sharing.[8]

1.13 The FSB has 'urged member countries to undertake necessary legal reforms to equip the national authorities with the capacity to respond effectively and quickly to financial institution distress'.[9]

1.14 The legislation proposed in the bill draws on these criteria in forming its plan for financial crisis resolution and resolution planning.

1.15 The changes set out in the bill also draw on the work of a number of consultation papers and reviews conducted over the last seven years, since the release of the FSB's Key Attributes. The legislation particularly builds on the work of two publications: a government consultation paper 'Strengthening APRA's Crisis Management Powers' (2012); and, the final report of the Financial System Inquiry (2014).

1.16 The Australian Government released the consultation paper entitled 'Strengthening APRA's Crisis Management Powers' in September 2012. The paper sought submissions in relation to 'possible enhancements and streamlining of financial services legislation, particularly the prudential supervision of ADIs, insurers and superannuation funds regulated by APRA'.[10]

1.17 The consultation paper outlined the need for Australia to develop a financial crisis management strategy, noting that, since the GFC, there had been a substantial increase in international initiatives to promote and ensure financial stability.[11]

1.18 The consultation paper also commented on the Financial Claims Scheme (FCS). The FCS was established in 2008, following the GFC, and provides protection to deposits held in financial institutions and to policies with general insurers in the event that a financial institution fails. A number of the changes to the FCS set out in

---

8 Financial Stability Board, *Key Attributes of Effective Resolution Regimes for Financial Institutions*, October 2011, p. 1. http://www.fsb.org/wp-content/uploads/r_111104cc.pdf (accessed 15 January 2018).

9 The Treasury, *Strengthening APRA's Crisis Management Powers—Consultation Paper*, September 2012, p. 4. https://static.treasury.gov.au/uploads/sites/1/2017/06/Discussion-Paper-1.pdf (accessed 5 January 2018).

10 The Treasury, *Strengthening APRA's Crisis Management Powers—Consultation Paper*, September 2012, p. iii. https://static.treasury.gov.au/uploads/sites/1/2017/06/Discussion-Paper-1.pdf (accessed 5 January 2018).

11 The Treasury, *Strengthening APRA's Crisis Management Powers—Consultation Paper*, September 2012, p. 4. https://static.treasury.gov.au/uploads/sites/1/2017/06/Discussion-Paper-1.pdf (accessed 5 January 2018).

the bill were discussed in the consultation paper.[12] These changes are set out in the next section.

1.19 The Financial System Inquiry (FSI), led by Mr David Murray AO and finalised in November 2014, also examined the need for Australia to develop what it termed a 'crisis management toolkit'. The FSI explained that:

> Given the importance of ADIs, insurers, superannuation funds and FMI [financial market infrastructure] to the functioning and stability of the financial system and economy, regulators need comprehensive powers to facilitate the orderly resolution of these institutions.[13]

1.20 The FSI also highlighted the significant costs associated with the failure of an ADI, particularly where such a failure has the potential to cause damage to the financial system as a whole.[14]

1.21 Recommendation 5 of the FSI report suggested that the Australian Government:

> Complete the existing processes for strengthening crisis management powers [as set out in the 2012 consultation paper] that have been on hold pending the outcome of the Inquiry [FSI].[15]

1.22 The Government response to the FSI agreed with Recommendation 5 and proposed that 'regulatory settings should provide regulators with clear powers in the event a prudentially regulated financial entity or financial market infrastructure fails'.[16]

Overview of the Bill

1.23 The bill contains seven schedules which make amendments to eight separate Acts to give APRA additional powers for crisis resolution and resolution planning in relation to regulated entities. The Acts amended by the bill are the following:

- *Banking Act 1959*;

---

12 The Treasury, *Strengthening APRA's Crisis Management Powers —Consultation Paper*, September 2012, pp. 82–83. https://static.treasury.gov.au/uploads/sites/1/2017/06/Discussion-Paper-1.pdf (accessed 5 January 2018).

13 The Treasury, *Financial System Inquiry,—Final Report*, November 2014, p. 79. http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2017).

14 The Treasury, *Financial System Inquiry—Final Report*, November 2014, p. 80. http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2017).

15 The Treasury, *Financial System Inquiry—Final Report*, November 2014, p. 133. http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 27 November 2017).

16 The Australian Government, *Improving Australia's Financial System—Government response to the Financial System Inquiry*, 2015, p. 10. https://treasury.gov.au/publication/government-response-to-the-financial-system-inquiry/ (accessed 4 December 2017).

- *Insurance Act 1973*;
- *Life Insurance Act 1995* (Life Insurance Act);
- *Australian Prudential Regulation Authority Act 1998*;
- *Payment Systems and Netting Act 1998*;
- *Financial Sector (Business Transfer and Group Restructure) Act 1999* (Transfer Act);
- *Corporations Act 2001*; and
- *Income Tax Assessment 1997*.

1.24 The explanatory memorandum outlines that the schedules to the bill make amendments in relation to crisis resolution in order to:

- enhance APRA's statutory and judicial management regimes to ensure their effective operation in a crisis;
- enhance the scope and efficacy of APRA's existing directions powers;
- improve APRA's ability to implement a transfer under the Transfer Act;
- ensure the effective conversion and write-off of capital instruments to which the conversion and write-off provisions in APRA's prudential standards apply;
- enhance stay provisions and ensure that the exercise of APRA's powers does not trigger certain rights in the contracts of relevant entities within the same group;
- enhance APRA's ability to respond when an Australian branch of a foreign regulated entity (foreign branch) may be in distress;
- enhance the efficiency and operation of the FCS and ensure that it supports the crisis resolution framework; and
- enhance and simplify APRA's powers in relation to the wind-up or external administration of regulated entities under the Industry Acts[17], and other related matters.[18]

1.25 Each of these proposed reforms is explained in detail below.

Statutory and judicial management

1.26 Under the current law, APRA has the power to appoint a statutory manager to an ADI when it is in distress. The bill expands the range of entity types to which APRA can appoint a statutory manager to include authorised non-operating holding companies (NOHCs) of ADIs/insurers as well as domestically incorporated subsidiaries of authorised NOHCs or ADIs/insurers. In practice, APRA would be able

17 The term 'Industry Acts' refers collectively to the Banking Act 1959, Insurance Act 1973 and the Life Insurance Act 1995.

18 Explanatory Memorandum, pp. 10–11.

to take control of a group entity to ensure the stability of the relevant ADI/insurer's operations when an entity is in distress.[19]

1.27 The bill also proposes to incorporate insurers into APRA's statutory management regime in certain circumstances. For example, if the insurer is part of a wider financial group or if its failure would pose an imminent risk to the financial system or economy, APRA would have the authority to appoint a statutory manager directly, rather than having to apply to the Court for a judicial manager. This measure would only be taken if APRA believed that quick action was necessary.

1.28 The bill also enhances the existing immunities afforded to statutory and judicial managers, to ensure that a manager can act with confidence when stabilising a distressed ADI or insurer without fear of incrimination.[20]

Directions powers

1.29 APRA currently has the authority to give instructions to an APRA regulated entity in certain circumstances; this authority is referred to as a directions power. The bill proposes to enhance the scope and efficacy of APRA's directions powers. The proposed broadening of APRA's powers will apply in respect of the matters on which direction can be given as well as the types of entities to which directions can be given.[21] Under the new law, APRA would have the authority to direct subsidiaries of ADIs, insurers or NOHCs, as well as the main ADI or insurer.

1.30 The new law would also provide clearer immunity from prosecution for an institution, its directors, or its officers as they comply with a direction from APRA. Non-compliance with a direction from APRA is an offence that gives rise to a criminal sanction.[22]

Transfer powers

1.31 The bill proposes to amend the Transfer Act to allow the three following changes:

- give APRA the power to compulsorily transfer the shares in a failing regulated entity to another body corporate;
- allow APRA to compulsorily transfer the business of a regulated entity of an ADI or insurers; and
- allow APRA to complete a transfer of business despite a lack of complementary state or territory legislation to facilitate the transfer.[23]

---

19 Australian Prudential Regulation Authority, *Submission 9*, p. 4.

20 Australian Prudential Regulation Authority, *Submission 9*, p. 4.

21 Explanatory Memorandum, p. 65.

22 Australian Prudential Regulation Authority, *Submission 9*, p. 5.

23 Explanatory Memorandum, p. 92.

1.32 These changes will give APRA the ability to act quickly when necessary. The bill will also amend the title of the Transfer Act to become the *Financial Sector (Transfer and Restructure) Act 1999*.

Conversion and write-off of capital instruments

1.33 A capital instrument is a form of financial security (for example, a share, note or bond). Equity instruments, such as shares, allow investors to own a portion of the company commensurate with their investment. Debt instruments, such as bonds and notes, lend money to businesses with the expectation that interest will be paid. Some capital instruments, such as preferences shares and subordinates notes, contain conversion and write-off provisions so that they can be included as regulatory capital.

1.34 Capital instruments are categorised based on the level of risk that they carry. Through its implementation of the Basel III capital framework, APRA's prudential standards require that capital instruments categorised as Common Equity Tier 1 (CET1), Additional Tier 1 (AT1), and Tier 2 (T2) include certain conversion and write-off terms. Importantly, the terms of AT1 and T2 instruments must provide that they absorb losses in the event that an ADI or insurer is in distress.[24] This means that when an ADI or insurer is in distress, these specified capital instruments can be converted or written off in order to ensure the stability of the affected ADI or insurer.

1.35 The bill seeks to increase certainty in relation to the conversion and write-off of capital instruments by ensuring that any terms set out in AT1 and T2 capital instruments cannot be overturned due to any legal impediment.

1.36 The conversion and write-off of capital instruments to support an ADI or insurer in distress was an important concern for a majority of submitters to the inquiry. These concerns are addressed in detail in Chapter 2 of this report.

Stays

1.37 A stay is a legal provision that stops creditors from pursuing debtors for amounts owed. APRA has the power to effect a stay on ADIs and insurers in certain circumstances.

1.38 The bill amends APRA's existing stay provisions in respect of a failing ADI or insurer. The new legislation would extend APRA's stay provisions to cover group entities including a body corporate, an authorised NOHC of an ADI or insurer or a subsidiary of an authorised NOHC or ADI or insurer.

1.39 In practice, other entities dealing with the bodies described above will not be able to deny an obligation, accelerate a debt, close-out a transaction or enforce a security.[25]

24 Explanatory Memorandum, p. 107.

25 Explanatory Memorandum, p. 123.

Australian branches of foreign ADIs and insurers

1.40 The bill proposes to expand APRA's crisis management powers to include Australian branches of foreign regulated entities. Specifically, APRA will be given the power to:

- appoint a statutory manager to the Australian branch of a foreign ADI or insurer;
- apply to wind up the Australian branch of a foreign ADI or insurer; and
- implement a transfer of business of the Australian branch of a foreign ADI or insurer.[26]

Financial Claims Scheme

1.41 The FCS was established in 2008 following the GFC. The FCS provides protection to deposits held in financial institutions and to policies with general insurers in the event that a financial institution fails. The FCS will be activated by the Australian Government when an institution fails; and once activated will be administered by APRA.[27]

1.42 The bill proposes to make the following minor changes to the FCS:

- establish an additional payment mechanism to enable FCS entitlements to be satisfied when there has been a transfer of deposits to another ADI or policyholder claims to another general insurer;
- enable APRA to obtain information from third parties in relation to the FCS;
- facilitate the effective payout of FCS entitlements to third party claimants of a policyholder of a failed general insurer where the policyholder is in liquidation;
- enable APRA to make interim payments to claimants under the FCS applicable to general insurers;
- grant the Treasurer the discretion to declare the FCS at an earlier time, on appointment of a statutory manager; and
- reduce the reporting burden regarding withholding tax in relation to interest on amounts paid under the FCS.[28]

1.43 These proposed changes are administrative only and the FCS will continue to guarantee deposits up to $250 000. The FCS aims to ensure the stability of the financial system as a whole following the failure of a financial institution by protecting the interests of depositors and policyholders.

---

26 Australian Prudential Regulation Authority, *Submission 9*, p. 7.

27 Australian Prudential Regulation Authority, 'About the Financial Claims Scheme', https://www.fcs.gov.au/about-apra (accessed 11 January 2018).

28 Explanatory Memorandum, p. 162.

Wind-up and other matters

1.44 The bill proposes to expand APRA's current powers as they relate to wind-up and other external administration, as well as enhancing APRA's powers to impose conditions on, or revoke, a regulated entity's authorisation.[29]

1.45 The bill seeks to increase uniformity in its approach to the wind-up of an institution by:

- ensuring that APRA's existing powers in the winding up of a regulated institution (e.g. to obtain information from the liquidator) extend to where a provisional liquidator is appointed;
- providing APRA with notice of proposed applications for external administration of regulated institutions; and
- enabling APRA to apply for the winding up of an ADI without the ADI having first been placed in statutory management.[30]

Resolution planning

1.46 The bill includes reforms to APRA's approach to resolution planning in advance of any possible future financial crisis, including changes to:

- refine and harmonise the definition of 'prudential matters' (which includes inserting a definition of this term in the Life Insurance Act for the first time);
- clarify which entities must comply with prudential standards set by APRA; and
- enable APRA to require a regulated entity to have an authorised NOHC, where appropriate.[31]

1.47 An authorised NOHC does not carry on a business, other than a business 'consisting of the ownership or control of other bodies corporate'.[32] In practice, this means that if a regulated entity is in distress, APRA can manage its resolution by directing the NOHC. The NOHC would be directed to act to stabilise the entity as a whole by prioritising the liabilities of all of the regulated entity's bodies (subsidiaries, bodies corporate, etc.).

Financial impact and regulatory impact statement

1.48 The explanatory memorandum to the bill states that the bill does not have any budget impact. The regulation impact statement notes that the bill will give rise to a compliance cost of $1.3 million annually for business affected by the bill.[33]

---

29 Explanatory Memorandum, p. 179.

30 Australian Prudential Regulation Authority, *Submission 9*, p. 8.

31 Explanatory Memorandum, p. 203.

32 Section 5, *Banking Act 1959*, https://www.legislation.gov.au/Details/C2017C00067 (accessed 17 January 2018).

33 Explanatory Memorandum, p. 215.

Legislative scrutiny

1.49 The explanatory memorandum to the bill states that the proposed legislation does not engage any of the applicable rights or freedoms under the *Human Rights (Parliamentary Scrutiny) Act 2011*, and, as such, is compatible with human rights.

1.50 The Parliamentary Joint Committee on Human Rights (PJC on Human Rights) considered the bill in its *Report 12 of 2017* and made a number of observations relating to the right not to incriminate oneself and privacy.[34]

1.51 The PJC on Human Rights noted that the bill would give APRA a new power to require a person who has, at any time, been an officer of the body corporate to give the statutory manager information relating to the business of the body corporate that the statutory manager requires. Further, failure to comply with this requirement may result in imprisonment for up to 12 months; and self-incrimination is not a justification for non-compliance with this requirement.[35]

1.52 The PJC on Human Rights considered that this requirement might place an undue limitation on the right not to incriminate oneself.

1.53 This limitation on the right not to incriminate oneself was also considered by the Senate Standing Committee for the Scrutiny of Bills in its Scrutiny Digests 13 and 15 of 2017.

1.54 The Scrutiny of Bills Committee suggested that derivative use immunity could be included in the proposed legislation to ensure that 'information or evidence indirectly obtained from an officer compelled to provide [such information] could not be used in evidence against them'.[36]

1.55 The Scrutiny of Bills Committee also commented that the bill proposes a reversal of the evidentiary burden of proof onto the defendant and that this would interfere with the common law right to be presumed innocent until proven guilty.

1.56 Specifically, the Scrutiny of Bills Committee noted that the bill's explanatory memorandum states that 'the evidentiary burden rests on the person bound by the secrecy provision because they are best positioned to provide the evidence as it is within their knowledge'.[37] The Scrutiny of Bills Committee considered that this requirement is unreasonable as 'it is not possible to say if a disclosure made in accordance with circumstances set out in the regulations would be peculiarly within the defendant's knowledge, given those regulations have not yet been made'.[38]

---

34 Parliamentary Joint Committee on Human Rights, *Report 12 of 2017*, November 2017, p. 25.

35 Parliamentary Joint Committee on Human Rights, *Report 12 of 2017*, November 2017, p. 25.

36 Senate Standing Committee for the Scrutiny of Bills, *Scrutiny Digest 15 of 2017*, December 2017, pp. 72–73.

37 Senate Standing Committee for the Scrutiny of Bills, *Scrutiny Digest 15 of 2017*, December 2017, p. 62.

38 Senate Standing Committee for the Scrutiny of Bills, *Scrutiny Digest 15 of 2017*, December 2017, p. 66.

Structure of this report

1.57 The report has two chapters including this introductory chapter. Chapter 2 discusses certain measures in the bill in more detail, and the related issues raised by participants in the inquiry.