

EXPOSURE DRAFT

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FINANCIAL SECTOR LEGISLATION AMENDMENT (CRISIS RESOLUTION  
POWERS AND OTHER MEASURES) BILL 2017

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EXPLANATORY MEMORANDUM



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## **Glossary**

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The following abbreviations and acronyms are used throughout this explanatory memorandum.

<b><i>Abbreviation</i></b>	<b><i>Definition</i></b>
ADI	Authorised deposit-taking institution
Administrator	A person appointed by APRA to take control of an entity as statutory manager under section 13A of the Banking Act, new @13A-IA of the Insurance Act or new @13A-LIA of the Life Insurance Act, where APRA itself does not take over control of the entity under those sections.
APRA	Australian Prudential Regulation Authority
APRA Act	<i>Australian Prudential Regulation Authority Act 1998</i>
AT1	Additional Tier 1
ATO	Australian Tax Office
Authorised NOHC	A non-operating holding company that is authorised either under the <i>Banking Act 1959</i> or <i>Insurance Act 1973</i> , or registered under the <i>Life Insurance Act 1995</i>
Banking Act	<i>Banking Act 1959</i>
BCBS	Basel Committee on Banking Supervision
Bill	Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017
CET1	Common Equity Tier 1
CFR	Council of Financial Regulators
Corporations Act	<i>Corporations Act 2001</i>
Court	Federal Court of Australia
FCS	Financial Claims Scheme
FSB	Financial Stability Board
Foreign ADI	A foreign ADI as defined in subsection 5(1) of the <i>Banking Act 1959</i>
Foreign general insurer	A foreign general insurer as defined in

	subsection 3(1) of the <i>Insurance Act 1973</i>
Foreign insurer	A foreign general insurer or foreign life insurer
Foreign life insurer	An eligible foreign life insurance company as defined in the Schedule Dictionary of the <i>Life Insurance Act 1995</i>
Foreign regulated entity	A foreign ADI, foreign general insurer, or foreign life insurer
FSCODA	<i>Financial Sector (Collection of Data) Act 2001</i>
Holding company	In relation to a body corporate, refers to another body corporate of which the first body corporate is a subsidiary
IADI	International Association of Deposit Insurers
IAIS	International Association of Insurance Supervisors
Industry Acts	Refers collectively to the <i>Banking Act 1959</i> , <i>Insurance Act 1973</i> , and <i>Life Insurance Act 1995</i> but does not include the <i>Superannuation Industry (Supervision) Act 1993</i> or the <i>Private Health Insurance (Prudential Supervision) Act 2015</i> .
Insurance Act	<i>Insurance Act 1973</i>
Insurer	Refers collectively to general and life insurers
Key Attributes	Financial Stability Board, 'Key Attributes of Effective Resolution Regimes for Financial Institutions' (15 October 2014)
Life Insurance Act	<i>Life Insurance Act 1995</i>
NOHC	Non-operating holding company
PGPA Act	<i>Public Governance, Performance and Accountability Act 2013</i>
Policyholder	Means a 'policyholder' as per the <i>Insurance Act 1973</i> and a 'policy owner' as per the <i>Life Insurance Act 1995</i>
PSN Act	<i>Payment Systems and Netting Act 1998</i>
Regulated entity	An ADI, general insurer, or life insurer
Relevant group of bodies corporate	A group of bodies corporate comprising a regulated entity or authorised NOHC and all of its subsidiaries

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Statutory manager	Refers to APRA, or an administrator appointed by APRA, when it takes control of an entity under section 13A of the Banking Act, new @13A-IA of the Insurance Act or new @13A-LIA of the Life Insurance Act.
Target body corporate	A body corporate that is an authorised NOHC, subsidiary of a regulated entity or a subsidiary of an authorised NOHC.
Transfer Act	<i>Financial Sector (Business Transfer and Group Restructure Act) 1999</i> (the Bill amends the title of this Act to the <i>Financial Sector (Transfer and Restructure Act) 1999</i> )
T2	Tier 2
2012 Consultation Paper	'Strengthening APRA's Crisis Management Powers' Consultation Paper (September 2012)





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## **General outline**

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### **Crisis management powers**

The global financial crisis demonstrated that, when complex financial groups enter distress, failure to resolve these entities in an orderly fashion can lead to severe adverse economic consequences. To achieve effective resolution, it is essential for regulators to have access to flexible, timely and robust resolution powers. When dealing with complex groups, it is often not sufficient to apply powers to the regulated entity alone. Critical services (such as information technology, financial positions or essential staff) may be located in other group entities and contagion effects can occur within groups. Regulators need to be able to move swiftly to safeguard the critical operations of these entities where the need arises.

Just as important as the adequacy of the powers is the legislative context in which those powers are exercised. Regulators and key stakeholders such as directors, senior managers and administrators need to be confident that actions taken in good faith in pursuit of a resolution cannot be unwound, and that the stakeholders implementing said actions will be protected from adverse consequences.

Likewise, depositors, policyholders, taxpayers, shareholders and creditors require a legislative framework for resolution that meets the objectives of regulators and preserves value in distressed institutions, whilst maintaining to the extent possible the structure of commercial bargains struck prior to resolution. However, to achieve this, regulators and government will sometimes require space in which to properly understand the nature and extent of the problems facing a distressed institution, and time in which to fashion a solution. As such, regulators need to be able to conduct their work confidentially (where appropriate) and without being frustrated by pre-emptive actions by counterparties of the distressed institution. Where resolution has an adverse impact on counterparties such as creditors (relative, for instance, to ordinary insolvency), those counterparties ought to be confident that they will be compensated appropriately.

As well as flexible, timely and robust resolution powers, it is important regulators have clear powers to set appropriate prudential requirements for resolution planning, and to address potential barriers to the orderly resolution of regulated institutions and groups, prior to any crisis occurring.



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# **Chapter 1**

## **Overview of crisis management**

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### **Outline of explanatory memorandum**

1.1 The Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017 (the Bill) provides the Australian Prudential Regulation Authority (APRA) with an enhanced suite of crisis resolution powers applicable to prudentially regulated authorised deposit-taking institutions (ADIs), general insurers and life insurance companies (insurers), and certain group entities.

1.2 Chapters 2 to 9 deal with amendments to powers relevant to the resolution of a regulated entity in distress. These are specifically APRA's powers in relation to:

- statutory and judicial management (Chapter 2);
- directions powers (Chapter 3);
- transfer powers (Chapter 4);
- conversion and write-off of capital instruments (Chapter 5);
- stay provisions (Chapter 6);
- foreign branches (Chapter 7);
- Financial Claims Scheme (Chapter 8); and
- wind-up and other matters (Chapter 9).

1.3 Chapter 10 deals with amendments that relate to crisis resolution planning, to provide APRA with clear powers to ensure that regulated entities are better prepared for a resolution prior to such an event arising.

### **Context of the Bill**

1.4 The experience from the global financial crisis showed that regulators need wide-ranging powers to resolve a failing entity expeditiously in such a way as to protect the interests of depositors and policyholders, and to maintain financial system stability. Resolution

planning has also become an area of increased regulatory attention as an important part of preparing for effective resolution.

1.5 From 2008 to 2010, the then Government introduced a series of legislative reforms to enhance prudential regulation and consumer protections, including the Financial Claims Scheme (FCS).

1.6 In 2012, the then Government issued a consultation paper, 'Strengthening APRA's Crisis Management Powers' (2012 Consultation Paper), which canvassed a large number of proposals as part of an ongoing review of APRA's crisis management powers. These proposals sought to address the identified gaps and areas that could be strengthened with reference to domestic and international developments at the time.

1.7 This 2012 consultation process was put on hold pending the outcome of the 2014 Financial System Inquiry (FSI).

1.8 The Final Report of the FSI, delivered in December 2014, recommended that the Government complete the process for strengthening APRA's crisis management powers (Recommendation 5). In its response to the FSI, the Government agreed that regulatory settings should provide regulators with clear powers in the event that a prudentially regulated financial entity or any part of the financial market infrastructure (FMI) fails<sup>1</sup>.

1.9 The Government has prioritised the implementation of the crisis-oriented proposals in the 2012 Consultation Paper for APRA in relation to prudentially regulated ADIs and insurers. The Government has also prioritised the implementation of key proposals from consultations on the contractual loss absorption provisions in regulatory capital instruments in 2014 and on the FCS in 2011.

1.10 The proposals in the 2012 Consultation Paper were prepared to reflect international developments in financial regulation following the global financial crisis, particularly the work in the G20 and by the Financial Stability Board (FSB) to promote resilient financial systems and frameworks to resolve financial distress.

1.11 Since 2012, the G20 and FSB has continued to progress this work, including updating the FSB's Key Attributes on Effective Resolution Regimes (Key Attributes) in 2014 to address sector-specific considerations for insurance and FMI. The Basel Committee on Banking Supervision (BCBS) and the International Association of Insurance Supervisors (IAIS) have also taken steps to further address crisis preparedness in their core principles for the supervision of banks and

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<sup>1</sup> In this context, FMI refers to critical FMI in the form of market operators and clearing and settlement facilities

insurers. The proposals in the Bill help to provide a framework for resolution that is consistent with these international developments, in a manner that is appropriate for the Australian financial system.

1.12 Other proposals in the 2012 Consultation Paper that were less resolution-centric and those relating to FMI will be progressed separately. Similarly, while the Government has also agreed to consider other important crisis-related reforms, such as the implementation of a requirement for additional loss absorbing capacity (Recommendation 3 of the FSI's Final Report), that work is being progressed separately to these reforms.

## Summary of new law

1.13 The Bill amends the *Banking Act 1959* (Banking Act), *Insurance Act 1973* (Insurance Act), *Life Insurance Act 1995* (Life Insurance Act), *Australian Prudential Regulation Authority Act 1998* (APRA Act), *Payment Systems and Netting Act 1998* (PSN Act), *Financial Sector (Business Transfer and Group Restructure) Act 1999* (Transfer Act), *Corporations Act 2001* (Corporations Act) and *Income Tax Assessment Act 1997*.

1.14 For the purposes of this Bill, the Banking Act, Insurance Act and Life Insurance Act are collectively referred to as the Industry Acts.

1.15 The Schedules to this Bill make amendments in relation to crisis resolution 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 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, and other related matters.

1.16 Schedules 1 to 3 to this Bill also make amendments to the Industry Acts to ensure that APRA has clear powers to make appropriate prudential standards on resolution planning and ensure that regulated entities and their groups put in place measures to improve their preparedness for resolution.

## **Detailed explanation of new law**

1.17 The Bill gives APRA an enhanced set of powers for crisis resolution and resolution planning in relation to regulated entities.

### **Crisis resolution**

#### *Statutory and judicial management*

1.18 The existing statutory and judicial management regimes in the Industry Acts represent important powers for dealing with a financial institution in acute distress. APRA may need to use these tools to take control of an entity in cases where it does not have confidence that the board and management is capable of resolving a crisis satisfactorily, or where the board and management are mismanaging the entity, including where it is insolvent or near insolvent. Given the importance of these powers, particularly as a measure of last resort, certain key enhancements are proposed to ensure their effective operation in all relevant situations.

1.19 These enhancements include ensuring the statutory management tool can be applied in a group context where necessary. The structures of financial groups can be complex, involving numerous business lines and support services linked through different ownership and contractual arrangements. In the absence of effective group resolution powers, it may be particularly difficult to resolve a distressed regulated entity or group quickly and effectively.

1.20 A further enhancement is to extend the statutory management regime to insurers in certain defined circumstances. In most situations, applying to the Federal Court for the appointment of a judicial manager is likely to remain the appropriate resolution tool for a failing insurer. However, there may be specific situations where APRA needs the ability to appoint a statutory manager to an insurer. In particular, this could be

the case where the insurer is large or part of a complex financial group, or its distress poses a risk to the financial system or economy.

1.21 This Bill enhances APRA's capacity to take control of a distressed ADI or insurer and/or relevant parts of its group, subject to certain pre-conditions and safeguards, including amendments to:

- enhance APRA's statutory management powers in respect of ADIs, including new statutory management powers in relation to foreign ADIs;
- provide APRA with new statutory management powers in respect of insurers;
- provide APRA with new statutory management powers in respect of authorised non-operating holding companies (NOHCs) of regulated entities, and subsidiaries of authorised NOHCs or regulated entities;
- enhance the moratorium provisions with respect to the statutory and judicial management provisions of the Industry Acts; and
- enhance the statutory immunity provisions applying to statutory and judicial managers.

#### ***Directions powers***

1.22 Directions powers enable APRA to compel a regulated entity to take specific action to address particular prudential issues that have been identified. Directions powers may also be necessary to limit further deterioration in the financial condition of a regulated entity in a period of emerging stress, and to facilitate the resolution of a distressed regulated entity.

1.23 Refining and, where appropriate, enhancing the triggers that allow the issue of directions will help ensure that APRA can respond in a more timely and decisive way to emerging prudential concerns that affect an entity. Equally, broadening the scope of the directions powers, both in respect of the matters on which directions may be given and the entities to which directions may be given, will assist APRA to respond effectively and promptly to resolve a distressed regulated entity.

1.24 It is important that directors or other officers of an entity are able to implement a direction from APRA without potential conflicts of duties that may give rise to delay, or impede the effectiveness of the direction, particularly in a crisis. Introducing a specific immunity provision for directors and management when complying with an APRA direction will help address this issue.

1.25 This Bill enhances the scope and efficacy of APRA's existing directions powers, including amendments to:

- extend APRA's ability to issue directions to subsidiaries of authorised NOHCs and subsidiaries of regulated entities;
- clarify the scope of APRA's 'catch-all' directions power;
- clarify that APRA may issue directions requiring entities to take specified actions to facilitate resolution, whether in normal times or during a crisis;
- clarify that APRA may give directions despite external support being in place;
- extend APRA's ability to issue a recapitalisation direction to a regulated entity's authorised NOHC and certain other holding companies;
- harmonise recapitalisation directions powers with general directions powers;
- ensure that causing an entity to comply with an APRA direction will not be grounds for directors or management to be held liable under any other law (subject to a good faith and reasonableness test);
- harmonise the protection from liability provisions in the Industry Acts; and
- provide for APRA to determine that the giving of a direction should be confidential in certain circumstances.

### ***Transfer powers***

1.26 The compulsory transfer of business powers in the Transfer Act are an important tool in APRA's crisis resolution toolkit. The Transfer Act enables some or all of the business of a regulated entity (including assets, liabilities, legal rights and obligations, data and systems) to be transferred to another regulated entity in the same category.

1.27 By international standards, the existing Transfer Act provides a comprehensive framework for compulsory transfers of business in resolution. However, there are certain areas in which the provisions could be enhanced to provide APRA with greater flexibility and certainty when



arranging a compulsory transfer. For example, in some situations, rather than transferring all of the assets and liabilities comprising the business of a regulated entity, it may be more expedient to transfer ownership in the shares of the failed entity.

1.28 The Bill improves APRA's ability to implement a transfer under the Transfer Act, including amendments to:

- enable APRA to compulsorily transfer the shares in a failing regulated entity to another body corporate;
- widen the scope of the compulsory transfer powers to apply to related entities of insurers; and
- remove the requirement for complementary State or Territory legislation to be in place in relation to transfers of business.

#### *Conversion and write-off of capital instruments*

1.29 APRA's prudential standards require regulated entities to maintain minimum levels of regulatory capital. The prudential standards currently establish three categories of regulatory capital – Common Equity Tier 1 (CET1), Additional Tier 1 (AT1) and Tier 2 (T2) capital. AT1 and T2 capital instruments comprise securities (for example, preference shares and subordinated notes) that satisfy the eligibility criteria for AT1 and T2 capital set out in APRA's prudential standards.

1.30 APRA's prudential framework provides for two mechanisms by which AT1 and T2 capital instruments may absorb losses: conversion of those instruments into ordinary shares (or equivalent for mutually-owned ADIs), or the write-off of the instruments.

1.31 The amendments summarised below ensure that these conversion and write-off provisions operate as intended, notwithstanding any legal impediments. These proposals were developed following consultation on the Government's 2014 consultation paper 'Providing Certainty for Contractual Loss Absorption Provisions in Regulatory Capital'.

1.32 The Bill amends the Industry Acts to provide increased certainty in relation to the conversion and write-off of capital instruments, including amendments to provide that:

- conversion or write-off can happen despite any impediment there may be in:
  - any domestic or foreign law (other than, for conversion, any laws specified in the amendments or regulations made for that purpose, including laws applying to holdings in

companies under Chapter 6 of the Corporations Act or under the *Financial Sector (Shareholdings) Act 1998*;

- the constitution of the entity that has issued the instrument and, for conversion, the constitution of the entity into whose shares the instrument converts (if different);
- any contract or arrangement to which the issuing entity is a party and, for conversion, to which the entity into whose shares the instrument converts (if different) is a party;
- any listing rules of a financial market in whose official list the issuing entity and, for conversion, the entity into whose shares the instrument converts (if different), is included; and
- a stay provision applies to contractual close-out rights that may arise as a result of the conversion or write-off of a capital instrument or the occurrence of an event (such as the making of a determination by APRA) that results in a requirement for the conversion or write-off of a capital instrument.

### ***Stay provisions***

1.33 An important aspect of the resolution regime is the operation of the stay provisions located in the Industry Acts and the Transfer Act. These provisions prevent counterparties of a failing entity from taking action on the grounds of APRA exercising its powers (including directions, recapitalisation directions, statutory and judicial management and transfer powers) in respect of the entity. This is important in ensuring that pre-emptive actions by counterparties do not impede the ability for APRA to implement an orderly resolution.

1.34 Given the amendments noted above to extend the scope of certain powers to group entities, the Bill enhances the stay provisions to ensure that the exercise of crisis powers by APRA does not give rise to termination or other legal rights in contracts of entities within the same group.

1.35 A further important element of the resolution regime is the interaction of the stay provisions with the PSN Act. The PSN Act overrides a range of laws in order to ensure the validity of certain provisions relating to netting and the payments systems covered by the PSN Act. Consequential amendments are made to the PSN Act to take into account enhancements to the stay provisions, the moratorium provisions for statutory and judicial management, and the extension of certain powers to group entities. This is intended to ensure that current

protections under the PSN Act are retained and the rights of counterparties to close-out netting contracts are clear.

1.36 The Bill enhances the stay provisions, and makes consequential amendments to the PSN Act, including amendments to:

- ensure that an exercise of a power in relation to an entity does not give rise to termination rights or other rights (that is, denying an obligation, accelerating a debt, closing-out on a transaction, or enforcing a security) in contracts of entities within the same group;
- ensure that the current protections afforded to counterparties to certain close-out netting contracts under the PSN Act are retained (with appropriate amendments to take into account stays applying to cross-default rights); and
- set out the relationship between the enhanced moratorium provisions for statutory and judicial management and the PSN Act, as appropriate.

### ***Foreign branches***

1.37 Foreign ADIs in Australia provide a range of important services, such as corporate lending, trade finance, wholesale lending, the provision of risk hedging to ADIs and corporate clients, and securities trading.<sup>2</sup>

1.38 Foreign insurers also provide important services in the Australian financial system, including providing a significant amount of reinsurance capacity to the Australian general insurance market.

1.39 While some of APRA's existing crisis powers do apply to Australian branches of foreign regulated entities (for example, APRA can apply to the Court for a judicial manager to be appointed to a foreign insurer), certain important powers, including statutory management and transfer powers, either do not apply or their application to foreign branches is currently unclear.

1.40 Given the risks that a distressed foreign regulated entity could pose to depositors or policyholders, or to financial system stability in Australia, the Bill enhances APRA's crisis management powers with respect to foreign ADIs and foreign insurers operating in Australia.

1.41 The Bill enhances APRA's ability to respond when a foreign branch may be in distress, including amendments to:

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<sup>2</sup> Foreign ADIs are not permitted to accept retail deposits in Australia, which generally prevents them from accepting initial deposits smaller than \$250,000 from individuals.

- provide APRA with powers to appoint a statutory manager to the Australian branch of a foreign regulated entity;
- clarify APRA's powers to apply to wind up the Australian branch of a foreign regulated entity;
- harmonise the power to direct a foreign regulated entity not to transfer assets out of Australia across the Industry Acts;
- clarify APRA's powers to implement a voluntary or compulsory transfer of business of the Australian branch of a foreign regulated entity; and
- provide APRA with an explicit power to revoke the authorisation of a foreign regulated entity in Australia if the entity's authorisation is revoked by its home jurisdiction.

### ***Financial Claims Scheme***

1.42 The FCS provides an important backstop within Australia's resolution regime. It protects retail depositors and policyholders by providing prompt access to their funds which, in turn, contributes to financial stability, by limiting the propensity for a destabilising 'run' on deposits in the case of ADIs, and more generally by promoting confidence in the financial system.

1.43 The FCS for ADIs provides depositors with a guarantee of their deposits up to a pre-determined cap, which is currently set at \$250,000 per account-holder, per ADI. In the case of general insurers, the FCS provides compensation for most claims up to \$5,000 against a failed general insurer, with claims above \$5,000 also covered for eligible policyholders and certain third parties.

1.44 While the legislative framework for the FCS is broadly consistent with international standards, some of the provisions would benefit from further enhancements. Some of these enhancements were developed following consultation on the then Government's 2011 consultation paper 'Financial Claims Scheme', while others were set out in the 2012 Consultation Paper.

1.45 The Bill makes certain enhancements to the FCS framework, including amendments to:

- 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;
- ensure 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, upon appointment of a statutory manager; and
- reduce the reporting burden regarding withholding tax in relation to interest on amounts paid under the FCS.

#### ***Wind-up and other matters***

1.46 APRA's winding up powers in the Industry Acts are another important part of the crisis management toolkit, enabling it to act in situations where a regulated entity is insolvent or about to become insolvent. The ability to initiate the winding up of a regulated entity in a timely manner may assist to prevent further financial deterioration, potentially improving outcomes for depositors and policyholders, and minimising impacts on the financial system more broadly.

1.47 While these provisions operate satisfactorily, the application of them in the past has identified areas for enhancement, and there is a lack of uniformity in APRA's powers relating to provisional liquidators and administrators. The Bill therefore strengthens and simplifies APRA's powers in relation to the winding up and external administration of regulated entities under the Industry Acts.

1.48 In circumstances where a regulated entity is failing or likely to fail, APRA may also need to impose conditions on, or to revoke, the entity's authorisation under the Industry Acts. This may be an important step in minimising adverse impacts during resolution, and a complementary step to the winding up of a regulated entity. The Bill makes amendments to ensure that APRA has appropriate powers to impose conditions and revoke authorisations if certain grounds are met.

1.49 The Bill makes certain enhancements to APRA's winding up powers and powers to impose conditions on, or revoke, authorisations, including amendments to:

- harmonise the Industry Acts with regard to APRA's involvement in external administration of regulated entities;
- ensure that APRA's existing powers in the winding up of a regulated entity extend to where a provisional liquidator is appointed;
- enable APRA to apply for the winding up of an ADI without the ADI having first been placed in statutory management;
- provide APRA with notice of proposed applications for external administration of regulated entities;
- ensure that the institution of offence proceedings is no bar to judicial management or winding up of a regulated entity;
- enhance APRA's ability to impose, vary and revoke conditions of authorisation in certain circumstances; and
- enable APRA to revoke authorisations on certain additional grounds under the Industry Acts.

## **Resolution planning**

1.50 In addition to having a wide and flexible set of powers through which to intervene in a crisis, it is important APRA has clear powers to set appropriate prudential requirements for resolution planning, and to address potential barriers to the orderly resolution of a regulated entity, during normal times.

1.51 An important lesson from the global financial crisis was that effective resolution requires an advanced level of preparedness through contingency planning, before a failure or crisis event materialises. This has been reflected in the increased international focus on recovery and resolution planning, including in the Key Attributes and in BCBS and IAIS core principles.

1.52 The Bill clarifies the legislative framework for resolution planning by incorporating appropriate references within APRA's prudential standard-making powers (and matters for which regulations may be made) under the Industry Acts. It also includes amendments to clarify APRA's ability to require regulated entities and their groups to take actions to address potential barriers to orderly resolution (see 1.22 to 1.25).

1.53 The Bill makes amendments to strengthen the legislative framework for resolution planning, including amendments to:

- refine and harmonise the definition of ‘prudential matters’ in the Industry Acts (which includes inserting a definition of this term in the Life Insurance Act for the first time);
- specify which entities must comply with prudential standards; and
- enable APRA to require a holding company to ensure a regulated entity has an authorised NOHC, where appropriate.





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## **Chapter 2**

# **Statutory and judicial management**

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### **Outline of chapter**

2.1 Schedules 1-3, 5 and 6 to this Bill amend the Industry Acts, the PSN Act and the APRA Act to enhance APRA's powers related to the statutory and judicial management of regulated entities, authorised NOHCs, and subsidiaries thereof.

### **Context of amendments**

2.2 Statutory and judicial management are existing powers in APRA's crisis resolution toolkit. APRA can appoint itself or a third party to take control of an ADI under statutory management, and can apply to the Federal Court for the appointment of a judicial manager to take control of an insurer. Where a statutory or judicial manager is appointed to an entity, it replaces the board of directors and takes control of the entity.

2.3 Statutory and judicial management are important tools for dealing with a financial institution in acute distress. APRA may need to use these powers to take control of an entity in cases where it does not have confidence that the board and management is capable of resolving a crisis satisfactorily, or where the board and management are mismanaging the entity, including where it is insolvent or near insolvent.

2.4 The appointment of a statutory or judicial manager can help stabilise a failing entity, so that steps can be taken to implement an orderly resolution in a way that protects the interests of depositors and policyholders, and maintains financial system stability. Depending on the circumstances, this could include maintaining some or all of the entity as a going concern, facilitating the transfer of some or all of the business to another entity, or putting the entity into partial or complete wind-up (with declaration of the FCS where relevant).

2.5 Given the high level of intervention which it involves, statutory and judicial management would generally be used as a measure of last resort. To date, no statutory manager has been appointed to an ADI, reflecting the long period of financial stability that Australia has enjoyed. In the case of insurers, the Court has only appointed a judicial manager on APRA's application on two occasions. Both instances involved small general insurers that had been in run-off for many years (that is they were unable to write any new insurance business).

2.6 This Bill enhances the legislative framework underpinning the statutory and judicial management regimes to ensure their effective operation in a crisis situation, including providing for the appointment of a statutory manager to an insurer in certain special circumstances, and extending the scope of statutory management to address the resolution of groups, in each case subject to appropriate pre-conditions and safeguards.

2.7 Under the Insurance and Life Insurance Acts, APRA may apply to the Federal Court for the appointment of a judicial manager to assume control of an insurer where certain statutory preconditions are met, such as where an insurer has failed to comply with a prudential standard or a direction from APRA, or is in financial distress. In contrast, under the Banking Act, it is APRA that appoints a statutory manager to an ADI without application to the Court.

2.8 While applying to the Federal Court for the appointment of a judicial manager is likely to represent an appropriate resolution tool for a failing insurer in most circumstances, there may be specific situations where APRA needs the ability to appoint a statutory manager to an insurer. In particular, this could be the case where the insurer is large or part of a complex financial group, or its distress poses a risk to the financial system or economy, so that a more rapid resolution response may be needed.

2.9 In relation to groups, the global financial crisis demonstrated that it is particularly difficult to ensure the effective resolution of a failing entity that is part of a wider group of companies. The structures of financial groups can be complex, involving numerous business lines and support services linked through different ownership and contractual arrangements. It may not be clear exactly how the different members of a group are linked by inter-dependencies, for example through the provision of critical intra-group services, or where the risks and control in a group ultimately lie.

2.10 Understanding the position of the failing regulated entity, disentangling its affairs from those of the rest of the group, and ensuring it can be resolved quickly and effectively present considerable challenges. In the absence of effective group resolution powers, it may be particularly difficult to resolve a distressed regulated entity or group quickly and effectively.

2.11 Extending the statutory management regime to apply to insurers in certain circumstances, and to address the resolution of groups, is consistent with relevant international standards on resolution regimes. The Key Attributes note the need for resolution powers to apply to relevant group entities, and were updated in 2014 to include sector-specific guidance on the resolution of insurers. The BCBS and IAIS have also taken steps to incorporate the Key Attributes into their standards.

2.12 Other proposed amendments include new powers to appoint a statutory manager to the Australian business of a foreign ADI or insurer (see Chapter 7 for further details), and enhanced moratorium and immunity provisions in respect of statutory and judicial management. In recognition that the use of statutory management powers could affect third party rights, including those of creditors, the Bill also introduces certain new preconditions and safeguards where appropriate.

## **Summary of new law**

2.13 Schedules 1-3, 5 and 6 to this Bill amend the Industry Acts, APRA Act and the PSN Act to:

- enhance APRA's statutory management powers in respect of ADIs, including new statutory management powers in relation to foreign ADIs;
- provide APRA with new statutory management powers in respect of insurers;
- provide APRA with new statutory management powers in respect of authorised NOHCs of regulated entities, and subsidiaries of authorised NOHCs or regulated entities;
- enhance the moratorium provisions with respect to the statutory and judicial management provisions of the Industry Acts; and
- enhance the statutory immunity provisions applying to statutory and judicial managers.

2.14 The Bill also includes a number of other technical amendments to the Industry Acts in relation to statutory and judicial management, to:

- ensure that the Insurance and Life Insurance Acts prevail over the Corporations Act to the extent of any inconsistency (as is already the case under the Banking Act);
- confirm that the PGPA Act does not apply to an entity under the control of a statutory manager;
- clarify that APRA can replace a statutory manager and provide APRA with standing to apply for the replacement of a judicial manager with another person;
- confirm that more than one person can be appointed as a statutory or judicial manager;

- clarify the effect of the appointment of a judicial manager to an insurer on the directors and officers of that entity; and
- repeal unnecessary sections in the Insurance and Life Insurance Acts relating to judicial management.

### Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<i>Statutory management of group entities</i>	
APRA may, in certain circumstances, appoint a statutory manager to take control of an authorised NOHC of a regulated entity, or a subsidiary of an authorised NOHC or regulated entity. APRA will continue to have power to appointment a statutory manager to an ADI.	APRA may, in certain circumstances, appoint a statutory manager to an ADI. APRA does not have the power to appoint a statutory manager to an authorised NOHC of a regulated entity, or a subsidiary of an authorised NOHC or regulated entity, unless that subsidiary is also an ADI.
<i>Statutory management of insurers</i>	
APRA may, in certain circumstances, appoint a statutory manager to an insurer, and to certain related group entities of an insurer (as noted above).	APRA may, in certain circumstances, appoint a statutory manager to an ADI. APRA does not have the power to appoint a statutory manager to an insurer.
<i>External administration of holding company as a trigger for statutory or judicial management</i>	
A statutory manager may take control of a regulated entity where an external administrator has been appointed to a holding company of the entity.  APRA may apply for a judicial manager to be appointed to an insurer where an external administrator has been appointed to a holding company of the insurer.	The appointment of an external administrator to a holding company is not a ground for a statutory manager to take control of a subsidiary ADI.  It is also not a ground for APRA to apply for a judicial manager to be appointed to a subsidiary insurer.
<i>Application for appointment of an external administrator to a foreign ADI or foreign insurer as a trigger for statutory or judicial management</i>	
The fact that an appointment of, or an application to appoint, an external administrator to a foreign ADI (or similar procedure) has been undertaken in a foreign country will	The fact that an appointment of, or application to appoint, an external administrator to a foreign ADI (or similar procedure) has been undertaken in a foreign country is

<p>be a potential trigger for the appointment of a judicial manager to an insurer or a statutory manager to an ADI or insurer.</p>	<p>not a specific ground for appointment of an ADI statutory manager or a judicial manager.</p>
<p><i>Widening the moratorium provisions applicable where a statutory or judicial manager is appointed</i></p>	
<p>The moratorium provisions for statutory and judicial management have been enhanced to include moratoriums on enforcement processes and disposal of property and to place restrictions on exercise of third party property rights.</p> <p>A supplier of an essential service must not, in certain circumstances, refuse to provide those services while a statutory or judicial manager is in control of the entity's business.</p> <p>These provisions also apply where a statutory or judicial manager takes control of an authorised NOHC or a subsidiary of an authorised NOHC or regulated entity (that is, a target body corporate).</p>	<p>Court proceedings that are not criminal or civil penalty proceedings cannot begin or continue against an ADI or insurer while a statutory or judicial manager is in control of the ADI or insurer's business unless the Court grants leave or APRA consents to the proceedings.</p>
<p><i>Banking Act statutory manager not intended to be constrained by subsection 13A(3) of the Banking Act</i></p>	
<p>The Banking Act is amended to put beyond doubt that a statutory manager is able to manage an ADI's business without being constrained by the operation of subsection 13A(3) (which establishes the priority of certain creditors).</p>	<p>It is unclear whether a Banking Act statutory manager that has taken control of an ADI would be constrained in their actions by subsection 13A(3) which sets out the priorities for application of assets of an ADI in Australia.</p>
<p><i>Enhanced immunity for statutory and judicial managers</i></p>	
<p>Enhanced statutory immunities apply to statutory and judicial managers. Statutory and judicial managers are exempt from civil or criminal liability for actions done or not done in the exercise, or purported exercise, of powers, functions, or duties of the statutory manager under the Industry Acts, except where these actions or omissions are taken in bad faith.</p>	<p>ADI statutory managers are covered by immunity for losses that are not incurred because of fraud, dishonesty, negligence, or wilful failure to comply with the Banking Act.</p> <p>Judicial managers are not subject to any liability to any person in respect of anything done or not done, in good faith in the exercise of the powers, functions or duties of the judicial manager under the Insurance or Life Insurance Acts.</p>

<i>Terminating statutory management of an ADI that remains a going concern</i>	
<p>There is no longer a condition for terminating the statutory management of an entity that deposit liabilities have been paid or APRA is satisfied that they will be paid out. APRA will still need to be satisfied that it is no longer necessary to remain in control of the body corporate's business (for example, because the resolution of the entity has been successfully implemented).</p> <p>(Note that this amendment is concerned with the ultimate termination of the statutory management process, defined as an 'ultimate termination of control', rather than the termination of a particular administrator's appointment. In relation to the latter, see below.)</p>	<p>One of the conditions for the termination of statutory management of an ADI is that deposit liabilities have been paid or APRA is satisfied that they will be paid out, and APRA considers that it is no longer necessary for it or an administrator to remain in control of the body corporate's business.</p>
<i>Discretion for APRA to terminate appointment of a statutory manager</i>	
<p>In addition to the current law, APRA will be able to terminate the appointment of an administrator where APRA considers that such action is necessary to:</p> <ul style="list-style-type: none"> <li>• facilitate the resolution of the body corporate or its group or group members; or</li> <li>• protect the interests of policyholders or depositors; or</li> <li>• promote financial system stability in Australia.</li> </ul> <p>This amendment is concerned with the situation where the appointment of a particular administrator is terminated rather than an ultimate termination of control in relation to the entire statutory management process.</p>	<p>APRA may only terminate the appointment of a particular administrator of an ADI's business where the administrator contravenes a requirement of Division 2 of Part 2 of the Banking Act, or where the terms and conditions of the administrator's appointment provide for termination.</p>
<i>Replacing a statutory or judicial manager</i>	
<p>Where APRA terminates an administrator's appointment (as distinct from an ultimate termination of statutory management control of the entity), APRA may appoint a</p>	<p>APRA does not currently have explicit power to appoint a replacement statutory manager, and does not have standing to apply to the Court for the cancellation of a</p>

<p>replacement (which might mean appointing itself). APRA may apply to the Court for the cancellation of a judicial manager's appointment.</p>	<p>judicial manager's appointment.</p>
<p><i>Application of legislation during statutory management</i></p>	
<p>The provisions of the Industry Acts and FSCODA will continue to apply to an entity under statutory management. The amendments also ensure that the PGPA Act does not apply to an entity if that entity's business is controlled by a statutory manager.</p>	<p>The Banking Act provides that the obligations on ADIs and the continuing operation of the Banking Act and FSCODA in relation to ADIs are unaffected by the appointment of an administrator to, or the fact that a statutory manager is in control of, an ADI's business. It is unclear if the PGPA Act applies in relation to an ADI under statutory management.</p>
<p><i>Clarifying the effect of judicial management on officers and the board</i></p>	
<p>When a judicial manager is appointed to an insurer, the existing officers (within the meaning of the Corporations Act) of the insurer cease to have the powers of an officer with respect to that insurer, and the judicial manager gains the powers and functions of the board of directors of the insurer, including the board's powers of delegation. Any purported act by an officer who ceased to have the powers and functions of an officer is invalid and of no effect.</p>	<p>When a judicial manager is appointed to an insurer, the scope of the judicial manager's powers is unclear. It is also unclear whether directors and officers of an insurer continue to have powers and functions with respect to the management of the insurer under judicial management.</p>
<p><i>Clarifying the law regarding multiple statutory/judicial manager appointments</i></p>	
<p>Provisions have been included to clarify that multiple individuals may be appointed as statutory or judicial managers, and consequential amendments are made to allow references to an individual statutory or judicial manager in the Industry Acts to be interpreted as a reference to any one of the statutory or judicial managers appointed to an entity.</p>	<p>APRA's powers regarding the appointment of multiple statutory managers are unclear. The Court's powers regarding the appointment of multiple judicial managers are also unclear.</p>
<p><i>Amending the definition of 'subsidiary' under the Insurance Act to align with the Banking Act and Life Insurance Act</i></p>	
<p>Under the Insurance Act, a company</p>	<p>Under the Insurance Act, a company</p>

is defined as a subsidiary if its holding company is in a position to cast, or control the casting of, more than 50 per cent (the threshold percentage) of the maximum number of votes that might be cast at a general meeting of the company, or holds more than 50 per cent of the issued share capital of the company.	is defined as a subsidiary if its holding company is in a position to cast, or control the casting of, more than 25 per cent (threshold percentage) of the maximum number of votes that might be cast at a general meeting of the company, or holds more than 25 per cent of the issued share capital of the company. In contrast, under the Banking Act and Life Insurance Act, the threshold percentage is 50 per cent.
<i>Insurance and Life Insurance Acts to have effect despite the Corporations Act</i>	
The Insurance and Life Insurance Acts have effect despite the Corporations Act where there is a conflict between the provisions of those Acts.	It is unclear whether the Insurance Act or Life Insurance Act have priority over the Corporations Act where there is a conflict between the provisions of those Acts. By contrast, the Banking Act states that in the event of an inconsistency between the Banking Act and Corporations Act, the provisions in the Banking Act will prevail to the extent of the inconsistency.

## Detailed explanation of new law

### General provisions

2.15 The Bill expands the existing statutory management regime for ADIs to apply to related bodies corporate of the regulated entity in certain circumstances. This expanded statutory management regime under the Banking Act is then adapted into the Insurance and Life Insurance Act (see 2.41 to 2.43) so that a statutory manager can now be appointed to a regulated entity, its authorised NOHC, and a subsidiary of the authorised NOHC or a subsidiary of the regulated entity.

2.16 For ease of reading, the Explanatory Memorandum will first address the amendments applying the statutory management regime to related bodies corporate in the Banking Act, followed by an explanation of how the newly expanded Banking Act statutory management regime is transposed into the Insurance and Life Insurance Acts. Cross-references to the equivalent new provisions of the Insurance and Life Insurance Acts in the Schedules to the Bill are included below for ease of reference.



## Statutory management of group entities

### *Definitions – related body corporate*

2.17 The Bill inserts a new definition of ‘related body corporate’. It is defined as a body corporate that is related to the first-mentioned body corporate. For the purposes of the Banking Act, this is determined in the same way as the Corporations Act. *[Schedule 1, item 10, Schedule 2, item 9, Schedule 3, item 99, subsection 5(1) of the Banking Act, subsection 3(1) of the Insurance Act, and the Schedule Dictionary of the Life Insurance Act]*

2.18 This new definition is used throughout the Banking Act, including in the provisions that place safeguards on the exercise of a statutory manager’s powers and functions (see 2.34 to 2.40).

### *Definitions – Banking Act statutory manager*

2.19 The Bill repeals the definition of ‘ADI statutory manager’ and inserts a new definition of ‘Banking Act statutory manager’. A Banking Act statutory manager is either APRA (where it is in control) or an administrator appointed by APRA to control an entity under section 13A of the Banking Act. *[Schedule 1, items 1 and 3, section 5(1) of the Banking Act]*

2.20 The reason for the change in definition is that, as a result of the amendments in the Bill, it will be possible to appoint a statutory manager to not only an ADI but also an authorised NOHC or a subsidiary of an ADI or authorised NOHC under the Banking Act. The term ‘ADI statutory manager’ is therefore no longer appropriate.

### *Definitions – target body corporate and relevant ADI*

2.21 The Bill amends section 13A of the Banking Act, which currently provides for statutory management of only ADIs, to extend the statutory management regime to authorised NOHCs and subsidiaries of authorised NOHCs and ADIs. The amendments include a new subsection 13A(1B) that allows APRA to appoint a statutory manager to a ‘target body corporate’ in certain circumstances. *[Schedule 1, item 49, Schedule 2, item 59, Schedule 3, item 18, subsection 13A(1B) of the Banking Act, subsection @13A(1B)-IA of the Insurance Act, and subsection @13A(1B)-LIA of the Life Insurance Act]*

2.22 The term ‘relevant ADI’ is defined with respect to its relationship to the target body corporate. For example, if a Banking Act statutory manager takes control of an authorised NOHC, the ADI subsidiary of that authorised NOHC, in connection with which the appointment was made, would be the ‘relevant ADI’.

2.23 The Bill also introduces paragraph 13A(1B)(c) to the Banking Act, which excludes the kinds of entities specified in any regulations

made under that section from the scope of the statutory management regime. For example, regulations might carve out entities that are regulated under other legislation and subject to a bespoke external administration regime. *[Schedule 1, item 49, Schedule 2, item 59, Schedule 3, item 18, paragraph 13A(1B)(c) of the Banking Act, paragraph @13A(1B)(c)-IA of the Insurance Act, and paragraph @13A(1B)(c)-LIA of the Life Insurance Act]*

***Pre-conditions to appointing a statutory manager to target entities***

2.24 The Bill introduces subsection 13A(1C), which provides that APRA may take control of a target body corporate or appoint an administrator to take control of a target body corporate if the conditions in subsection 13A(1B) are satisfied. *[Schedule 1, item 49, Schedule 2, item 59, Schedule 3, item 18, subsection 13A(1C) of the Banking Act, subsection @13A(1C)-IA of the Insurance Act, and subsection @13A(1C)-LIA of the Life Insurance Act]*

2.25 The Bill amends section 13A of the Banking Act to include new subsections 13A(1D), (1E), and (1F) which state the circumstances where a Banking Act statutory manager may take control of a target body corporate.

2.26 The new subsection 13A(1D) allows a Banking Act statutory manager to take control of a target body corporate if:

- APRA has appointed a statutory manager to the relevant ADI, or has a statutory basis and intention to do so; and
- the target body corporate provides services or conducts functions or business considered essential to maintain the operations of the relevant ADI. *[Schedule 1, item 49, Schedule 2, item 59, Schedule 3, item 18, subsection 13A(1D) of the Banking Act, subsection @13A(1D)-IA of the Insurance Act, and subsection @13A(1D)-LIA of the Life Insurance Act]*

2.27 Group entities may perform services or functions that are essential to the operation of the relevant ADI, including for example IT and human resource functions, treasury and corporate services, custodial services, funding and other specialist financial services. Further, groups can be structured so that entities in the group may hold assets or liabilities on behalf of each other, including the relevant ADI. Subject to the relevant pre-conditions being met, the new subsection 13A(1D) empowers APRA to take control of such a target body corporate, enhancing APRA's ability to stabilise the operations of the relevant ADI in a crisis situation.

2.28 The new subsection 13A(1E) permits a Banking Act statutory manager to take control of a target body corporate where:

- APRA has appointed a statutory manager to the relevant ADI, or has a statutory basis and intention to do so; and

- APRA considers that it is necessary for a Banking Act statutory manager to take control of the target body corporate to facilitate the resolution of the relevant ADI, an authorised NOHC of the relevant ADI, a ‘relevant group of bodies corporate’ of which the relevant ADI is a member, or a member or members of such a group. *[Schedule 1, item 49, Schedule 2, item 59, Schedule 3, item 18, subsection 13A(1E) of the Banking Act, subsection @13A(1E)-IA of the Insurance Act, and subsection @13A(1E)-LIA of the Life Insurance Act]*

2.29 A ‘relevant group of bodies corporate’ is defined in section 5 of the Banking Act as either the group comprising an ADI and its subsidiaries together or the group comprising an authorised NOHC and its subsidiaries together.

2.30 The new subsection 13A(1E) is intended to provide APRA with the flexibility to ensure that if necessary, and where a Banking Act statutory manager has or intends to take control of an ADI, a statutory manager can be appointed to a target body corporate to facilitate the orderly resolution of the relevant ADI and/or its group or one or more related entities. The term ‘resolution’ is further explained at Chapter 10 below. *[Schedule 1, item 49, Schedule 2, item 59, Schedule 3, item 18, subsection 13A(1E) of the Banking Act, subsection @13A(1E)-IA of the Insurance Act, and subsection @13A(1E)-LIA of the Life Insurance Act]*

2.31 The new subsection 13A(1F) permits a Banking Act statutory manager to take control of a target body corporate where:

- an external administrator has been appointed to the target body corporate, or APRA considers that, in the absence of external support, the target body corporate may become unable to meet its obligations or may suspend payment; and
- APRA considers that it is necessary for a Banking Act statutory manager to take control of the target body corporate to enable the relevant ADI to maintain its operations, or to facilitate the resolution of the relevant ADI, an authorised NOHC of the relevant ADI, a relevant group of bodies corporate of which the relevant ADI is a member, or a particular member or members of such a group. *[Schedule 1, item 49, Schedule 2, item 59, Schedule 3, item 18, subsection 13A(1F) of the Banking Act, subsection @13A(1F)-IA of the Insurance Act, and subsection @13A(1F)-LIA of the Life Insurance Act]*

2.32 The new subsection 13A(1F) is intended to address the circumstances where the appointment of an external administrator to an entity in the group, or more generally the financial distress of such an entity, may cause or exacerbate distress in the relevant ADI. This could

arise through a number of channels, including as a result of adverse contagion impacts to the relevant ADI, or through interruption to essential services provided to the relevant ADI by the target body corporate.

2.33 This new subsection also allows APRA to co-ordinate resolution of the relevant ADI, including the continued provision of appropriate services within the group, in circumstances where this might be frustrated if an external administrator of another kind is appointed with conflicting duties.

***Safeguards on the powers and functions of a statutory manager of a target body corporate***

2.34 The Bill inserts section 14AAA in the Banking Act, which provides for two safeguards in relation to the use of a Banking Act statutory manager's powers and functions for certain target bodies corporate. These are intended to provide additional protections for the interests of relevant stakeholders (for example, shareholders and creditors) of the target body corporate or other entity in the group. ***[Schedule 1, item 73, Schedule 2, item 59, Schedule 3, item 18, section 14AAA of the Banking Act, section @14AAA-IA of the Insurance Act, and section @14AAA-LIA of the Life Insurance Act]***

2.35 The first safeguard is contained in the new subsection 14AAA(2), and it generally requires the Banking Act statutory manager to consider fair value where performing or exercising its powers and functions to require the provision of services to or by the target body corporate.

2.36 Specifically, the subsection prevents the provision of services between related bodies corporate or transfer of assets (including cash and other funds) between the entity under management and another entity in the group in certain circumstances. The prohibition will not apply if:

- the supply or transfer is made for fair value;
- the supply or transfer occurs under a binding arrangement that existed before the statutory management;
- in the case of an asset transfer (including a transfer of funds), if it was in the ordinary course of business; or
- in the case of a transfer of funds, if it has been approved by shareholders as contemplated by subsection 14AAA(3) (see 2.38) ***[Schedule 1, item 73, Schedule 2, item 59, Schedule 3, item 18, subsection 14AAA(2) of the Banking Act, subsection @14AAA(2)-IA of the Insurance Act, and subsection @14AAA(2)-LIA of the Life Insurance Act]***

2.37 These provisions are intended to enable the statutory manager to rely on existing binding arrangements (such as intra-group arrangements) that were provided before its appointment whether or not at fair value, or to otherwise only make new arrangements which are for fair value.

2.38 The second safeguard is in the new subsection 14AAA(3), which prevents the use of a Banking Act statutory manager's powers and functions over an authorised NOHC of an ADI where:

- the performance or the exercise requires using funds of the authorised NOHC or a subsidiary of the authorised NOHC to increase the level of capital of the relevant ADI to a specified level; and
- the shareholders of the authorised NOHC have not agreed, by ordinary resolution, to that use of the funds. [*Schedule 1, item 73, Schedule 2, item 59, Schedule 3, item 18, subsection 14AAA(3) of the Banking Act, subsection @14AAA(3)-IA of the Insurance Act, and subsection @14AAA(3)-LIA of the Life Insurance Act*]

2.39 In this section, the term 'ordinary resolution' refers to the ordinary meaning of the term in company law – generally, this means an ordinary resolution that is passed by a majority of votes cast by shareholders of the company entitled to vote on the resolution at the meeting in person or by proxy (if proxies are allowed).

2.40 This section does not prevent a statutory manager of an authorised NOHC from using funds of the authorised NOHC to increase the level of capital of the relevant ADI, where those funds were raised following the exercise of the statutory manager's power to facilitate a recapitalisation under section 14AA.

## **Statutory management of insurers**

2.41 The Bill amends the Insurance and Life Insurance Acts to create a statutory management regime for insurers.

2.42 The statutory management regimes for the Insurance and Life Insurance Acts are intended to substantially align with the Banking Act (as amended by this Bill) where appropriate. As noted earlier at 2.15, this includes applying the expanded statutory management regime detailed at 2.17 to 2.40 (with relevant modifications) to insurers and their related bodies corporate. This means that a statutory manager can now be appointed to an insurer, its authorised NOHC, and a subsidiary of the authorised NOHC or insurer. [*Schedule 2, item 59, Schedule 3, item 18, section @13A-IA of the Insurance Act and section @13A-LIA of the Life Insurance Act*]

2.43 There are some important differences with respect to statutory management under the Industry Acts, in particular in relation to the circumstances in which a statutory manager can take control of an insurer, as explained below.

***Objects of the Insurance and Life Insurance Acts***

2.44 The Bill amends section 2A of the Insurance Act and section 3 of the Life Insurance Act to include references to the powers, functions, and purpose of statutory management under the respective Acts. The amendments describe the purpose of the statutory management regime for insurers and related bodies corporate as the protection of the interests of policyholders and financial system stability in Australia. *[Schedule 2, item 1, Schedule 3, item 1, section 2A of the Insurance Act and section 3 of the Life Insurance Act]*

***Power to take control of an insurer***

2.45 The Bill empowers APRA to appoint a statutory manager to an insurer, an authorised NOHC of an insurer, and subsidiaries of the authorised NOHC or insurer.

2.46 The Bill amends the Insurance and Life Insurance Acts to provide for the pre-conditions that must be satisfied in order for APRA to appoint a statutory manager to a general insurer or life insurer (see the new section @13A-IA of the Insurance Act and section @13A-LIA of the Life Insurance Act). *[Schedule 2, item 59, Schedule 3, item 18, section @13A-IA of the Insurance Act and section @13A-LIA of the Life Insurance Act]*

2.47 These require that APRA be satisfied that at least one of the existing grounds for appointing a judicial manager to an insurer be met (see sections 62L and 62M of the Insurance Act, and sections 158 and 159 of the Life Insurance Act) and further statutory management pre-conditions are met (see @13A-IA(1A) of the Insurance Act and @13A-LIA(1A) of the Life Insurance Act). *[Schedule 2, item 59, Schedule 3, item 18, paragraph @13A(1)(a)-IA of the Insurance Act and paragraph @13A-LIA(1)(a) of the Life Insurance Act]*

2.48 Under the existing law, the Court has power to appoint a judicial manager under section 62L of the Insurance Act or section 159 of the Life Insurance Act if APRA has undertaken a formal investigation of the insurer and, having regard to the results of the investigation, it is in the interests of policyholders that the order be made. The Court also has power to appoint a judicial manager under section 62M of the Insurance Act or section 159 of the Life Insurance Act if, in general terms, the insurer is in financial difficulty or something has occurred that may threaten its position, or it has defaulted in compliance with a regulatory requirement. Under sections 62M and 159 the Court must also consider that the time needed to make or complete an investigation of the insurer would be likely to prejudice the interests of policyholders.

2.49 Note that the Bill separately makes amendments to sections 62M and 159 in relation to the grounds for appointment of a judicial manager in situations where an investigation has not been undertaken; see 2.67 and 2.70.

2.50 Specifically, in addition to being satisfied that a ground exists for the appointment of a judicial manager, APRA must also be satisfied that one of five further conditions (or triggers) is met in order for an Insurance Act statutory manager or a Life Insurance Act statutory manager to be appointed to a general insurer or life insurer respectively. These further pre-conditions reflect the fact that judicial management is likely to remain an appropriate means of resolving a failing insurer in most circumstances, whereas statutory management is only expected to be used where further specific pre-conditions are met. [*Schedule 2, item 59, Schedule 3, item 18, subsection @13A(1)(b)-IA of the Insurance Act and subsection @13A-LIA(1)(b) of the Life Insurance Act*]

2.51 The five triggers are set out in the new subsection @13A(1A)-IA of the Insurance Act with respect to general insurers, and subsection @13A(1A)-LIA of the Life Insurance Act with respect to life insurers. They require that APRA must be satisfied that:

- an AFS statutory manager has taken control of a related body corporate to the insurer (for example, a Banking Act statutory manager has been appointed to a related ADI to the insurer); or
- the insurer's financial position is deteriorating rapidly or is likely to deteriorate rapidly, and failure to respond quickly to the deterioration would be likely to prejudice policyholders of the insurer; or
- it is unlikely that the insurer will be able to carry on insurance business in a way that is consistent with the stability of Australia's financial system; or
- an external administrator has been appointed to a holding company of the insurer (or a similar appointment has been made in a foreign country in respect of such a holding company) and the appointment poses a significant threat to the operation or soundness of the insurer, the interests of policyholders of the insurer, or the stability of the Australian financial system; or
- if the insurer is a foreign insurer:
  - an application for the appointment of an external administrator (or for a similar procedure) in a foreign country); or

- an appointment of an external administrator to the foreign insurer (or a similar appointment has been made) in a foreign country

***[Schedule 2, item 59, Schedule 3, item 18, subsection @13A(1A)-IA of the Insurance Act and subsection @13A-LIA(1A) of the Life Insurance Act]***

2.52 The term ‘AFS statutory manager’ is defined in the Insurance and Life Insurance Acts as a Banking Act statutory manager under the Banking Act, an Insurance Act statutory manager under the Insurance Act, or a Life Insurance Act statutory manager under the Life Insurance Act.

2.53 The first trigger above addresses circumstances where a statutory manager has been (or will be) appointed to another entity in the same group as the insurer; for example, an ADI. The fact that a statutory manager has been appointed to another entity in the group will often be indicative of wider group problems requiring co-ordinated resolution. In these situations, rather than having both a statutory manager and a judicial manager in place within the same group, it may be desirable to have the same person in charge of the different entities in the group, appointed under the same or similar terms of engagement, and subject to directions from APRA. However, depending on the particular circumstances, it is also possible that APRA may choose to appoint different statutory managers, or to apply for the court to appoint a judicial manager, to different entities in the group. ***[Schedule 2, item 59, Schedule 3, item 18, paragraph @13A(1A)(a)-IA of the Insurance Act and section @13A(1A)(a)-LIA of the Life Insurance Act]***

2.54 The second trigger addresses circumstances where the deterioration or likely deterioration of an insurer’s financial position is rapid enough to warrant a quicker and more certain means of stabilising the insurer, and implementing a resolution, than applying to the court for appointment of a judicial manager. Speed of action and certainty could be particularly important in situations where an insurer’s financial condition is deteriorating rapidly, such as where it is part of a financial group and is adversely affected by intra-group contagion. ***[Schedule 2, item 59, Schedule 3, item 18, paragraph @13A(1A)(b)-IA of the Insurance Act and paragraph @13A(1A)(b)-LIA of the Life Insurance Act]***

2.55 The third trigger addresses circumstances where an insurer may conduct activities that are sufficiently critical to the stability of the Australian financial system (and potentially the real economy) that the financial distress of the insurer requires rapid action to be taken in the interests of financial stability. ***[Schedule 2, item 59, Schedule 3, item 18, paragraph @13A(1A)(c)-IA of the Insurance Act and paragraph @13A(1A)(c)-LIA of the Life Insurance Act]***

2.56 The fourth trigger addresses circumstances where an appointment of an external administrator to a holding company of a



regulated entity has the potential to trigger contagion impacts within the group, which could lead to or exacerbate distress in the regulated entity. The Bill also inserts this trigger in the Banking Act at paragraph 13A(1)(d). See 2.59 to 2.65 for more detail. [*Schedule 2, item 59, Schedule 3, item 18, paragraph @13A(1A)(d)-IA of the Insurance Act and paragraph @13A-LIA(1A)(d) of the Life Insurance Act*]

2.57 The fifth trigger applies only to foreign insurers and applies where:

- an application for the appointment of an external administrator in a foreign jurisdiction or jurisdictions, or for a similar procedure, has been made in a foreign jurisdiction; or
- an external administrator has been appointed, or a similar appointment has been made, in a foreign jurisdiction.

This trigger captures situations where, for example, a court process has been commenced in foreign jurisdictions for an appointment of an external administrator, or a foreign regulator has directly appointed an external administrator or similar person, or a secured creditor has appointed an external administrator under a deed or contract. See 2.65 to 2.67 for more detail. [*Schedule 2, item 59, Schedule 3, item 18, paragraph @13A(1A)(e)-IA of the Insurance Act and paragraph @13A(1A)(e)-LIA of the Life Insurance Act*]

2.58 As described above, the statutory management regimes for the Insurance and Life Insurance Act will include the power to appoint a statutory manager to target bodies corporate of the relevant insurer (see 2.24 to 2.36), subject to the same preconditions and safeguards on these powers described at 2.34 to 2.40.

## **Other reforms to the statutory and judicial management frameworks**

### ***Appointment of external administrator to holding company as grounds for taking control of a regulated entity***

2.59 In a situation where an external administrator (for example, a liquidator or receiver) is appointed to a holding company of a regulated entity, this has the potential to trigger contagion impacts within the group which could that could lead to or exacerbate distress in the regulated entity. In particular, the appointment of an external administrator to a holding company may interfere with the financial condition or orderly resolution of regulated entities that are subsidiaries of the holding company, as the external administrator of the holding company may take actions that affect other entities in the group.

2.60 In these circumstances, it may be necessary for APRA to move quickly to assume control of the entity via statutory management, or to apply to the Court for the appointment of a judicial manager to an insurer, where the holding company's external administration presents serious risks to the regulated entity.

2.61 The Bill adds a new paragraph 13A(1)(d) of the Banking Act that provides an additional trigger for the appointment of a statutory manager to a regulated entity. This provides that a Banking Act statutory manager can be appointed to take control of a regulated entity's business where the regulated entity is a subsidiary of a holding company and an external administrator has been appointed to the holding company (or a similar appointment has been made in a foreign country in respect of such a holding company). As noted above, an equivalent trigger is included in the new statutory management regime for insurers in the Insurance Act (@ 13A-IA (1A)(d)) and Life Insurance Act (@ 13A-LIA(1A)(d)).

2.62 This trigger is subject to the further condition that APRA be satisfied that the appointment of an external administrator (or similar person) to the holding company poses a significant threat to either:

- the operation or soundness of the ADI; or
- the interests of depositors of the ADI; or
- the stability of the financial system in Australia. [*Schedule 1, item 48, Schedule 2, item 59, Schedule 3, item 18, paragraphs 13A(1)(d)(i)-(iii) of the Banking Act, section @13A(1)(d)(i)-(iii)-IA of the Insurance Act, and section @13A(1)(d)(i)-(iii)-LIA of the Life Insurance Act*]

2.63 These provisions refer to a 'holding company' with respect to the regulated entity. The Bill defines the term 'holding company' for various purposes in the Industry Acts. The definition is based on the definition of 'holding company' in subsection 4(1) of the Transfer Act, and includes bodies corporate that are incorporated either in Australia or a foreign country. This amendment is intended to address a risk that can materialise whether or not the holding company is a regulated entity, so it is appropriate to extend this new ground for appointing a statutory manager to the ADI (or insurer, in the corresponding Insurance and Life Insurance Act provisions) in circumstances where the holding company is not a regulated entity.

2.64 Note that this additional trigger extends to procedures that are similar to external administration that have been made in a foreign country. For example, this could include circumstances where a foreign creditor begins an action to wind-up the holding company in another jurisdiction, or where a foreign resolution authority uses its powers to implement a resolution of the holding company in its jurisdiction.

2.65 The Bill adds an equivalent of the new subsection 13A(1)(d) of the Banking Act as a new trigger for an appointment of a judicial manager under the Insurance Act (new paragraph 62M(a)(iva)) and Life Insurance Acts (new paragraph 159(a)(iiia) of the Life Insurance Act). [*Schedule 2, item 27, Schedule 3, item 22, paragraph 62M(a)(iva) of the Insurance Act and paragraph 159(a)(iiia) of the Life Insurance Act*]

2.66 The Bill adds a new subsection 13A(1)(e) in the Banking Act that provides additional triggers for the appointment of a statutory manager to a foreign ADI. The additional triggers are that if the ADI is a foreign ADI:

- an application for the appointment of an external administrator of the foreign ADI, or for a similar procedure in respect of the foreign ADI, has been made in a foreign country; or
- an external administrator has been appointed to the foreign ADI, or a similar appointment has been made in respect of the foreign ADI, in a foreign country.

2.67 The equivalent of these triggers has been added as the new @13A(1A)(e) of the Insurance Act for general insurers and @13A-LIA(1A)(e) of the Life Insurance Act for foreign life insurers. [*Schedule 1, item 48, Schedule 2, item 59, Schedule 3, item 18, subsection 13A(1)(e) of the Banking Act, subsection @13A(1)(e)-IA of the Insurance Act, and subsection @13A(1)(e)-LIA of the Life Insurance Act*]

2.68 The Bill adds an equivalent of the new subsection 13A(1)(e) in the Banking Act as new triggers for the appointment of a judicial manager to foreign insurers under the Insurance Act (new paragraphs 62M(a)(ivb) and (ivc)) and the Life Insurance Act (new paragraphs 159(a)(iiib) and (iiic)). [*Schedule 2, item 27, Schedule 3, item 22, section 62M(a)(ivb) and (ivc) of the Insurance Act and section 159(a)(iiib) and (iiic) of the Life Insurance Act*]

***Widening the moratorium provisions applicable where a statutory or judicial manager is appointed***

2.69 When a statutory manager is appointed to an ADI or insurer, or a judicial manager is appointed to an insurer, the statutory or judicial manager must not be subjected to a multiplicity of time-consuming and costly litigious and enforcement actions that have the potential to distract from or hamper the stabilisation or orderly resolution of the entity or group. The statutory or judicial manager will also need time to assess the nature of the financial damage affecting the institution, and need to have access to, and be able to utilise, the institution's resources for the purposes of the administration.

2.70 The Bill amends the Industry Acts to expand the moratorium provisions applicable upon the appointment of a statutory or judicial manager to a regulated entity, authorised NOHC or subsidiary of a regulated entity or authorised NOHC. The enhancements assist with one of the primary aims of statutory or judicial management, which is to stabilise the relevant entity and prepare for implementation of the resolution, by ensuring this can be done without the constraints of creditor or other third party actions that could otherwise impede the orderly nature of a resolution.

2.71 The Bill replaces section 15B of the Banking Act with the new sections 15B to 15BF. These enhanced moratorium provisions from the Banking Act are replicated in the Insurance Act (@15B-IA to @15BF-LIA) and Life Insurance Acts (@15B-LIA to @15BF-LIA) as part of the new statutory management regime in these Acts. The new moratorium provisions are broadly based on provisions in Division 6 of Part 5.3A, and section 600F of the Corporations Act (with appropriate amendment).

2.72 The enhanced moratorium provisions in the statutory manager regime are reflected in the judicial manager regime by amending section 62P of, and adding new sections 62PA to 62PE to, the Insurance Act and amending section 161 of, and adding new sections 161A to 161E to, the Life Insurance Acts.

2.73 The existing section 15B of the Banking Act states that a person cannot begin or continue a proceeding in a court against an ADI while a statutory manager is in control of the ADI's business. Sections 62P of the Insurance Act and 161 of the Life Insurance Act include the same provisions in relation to judicial management.

2.74 The enhanced moratorium provisions in the Industry Acts provide that a person cannot begin or continue a proceeding in a court or a tribunal (that is, a body that has characteristics similar to those of a court of law) against a body corporate while a statutory or judicial manager is in control of the body corporate's business. *[Schedule 1, item 86, Schedule 2, items 30 and 59, Schedule 3, items 18 and 24, section 15B of the Banking Act, sections @15B-IA and 62P of the Insurance Act, and sections @15B-LIA and 161 of the Life Insurance Act]*

2.75 The amendments to sections 15B of the Banking Act, 62P of the Insurance Act and 161 of the Life Insurance Act do not change the status quo in the respect that these stays against proceedings beginning or commencing do not apply to a proceeding in respect of an offence or a contravention of a provision of a law for which a pecuniary penalty may be imposed.

2.76 The enhanced moratorium provisions in the Industry Acts also ensure that no enforcement process in relation to the property of a body corporate can be begun or proceeded with if a statutory manager or judicial manager is in control of that body corporate's business. *[Schedule*

*1, item 86, Schedule 2, items 30 and 59, Schedule 3, items 18 and 24, section 15BA of the Banking Act, sections @15BA-IA and 62PA of the Insurance Act, and sections @15BA-LIA and 161A of the Life Insurance Act]*

2.77 In the case of the statutory management regime, APRA or the statutory manager could consent to such proceedings beginning or continuing, or the court or tribunal could grant leave for the proceedings or enforcement process to begin or continue on the ground that the person would be caused hardship if leave was not granted. *[Schedule 1, item 86, Schedule 2, item 59, Schedule 3, item 18, subsections 15B(2) and (5) and 15BA(2) and (4) of the Banking Act, subsections @15B(2) and (5)-IA and @15BA(2) and (4)-IA of the Insurance Act, and subsections @15B(2) and (5)-LIA and @15BA(2) and (4)-LIA of the Life Insurance Act]*

2.78 In the case of the judicial management regime, the judicial manager, after considering APRA's views, could consent to such proceedings or enforcement processes regarding property to begin or commence (see sections 62P(5) and 62PA(4) of the Insurance Act and sections 161(5) and 161A(4) of the Life Insurance Act), or the court or tribunal would be able to permit such proceedings or enforcement processes regarding property to commence or continue on the ground that the person would be caused hardship if leave was not granted. *[Schedule 2, item 30, Schedule 3, item 24, subsections 62P(5) and 62PA(4) of the Insurance Act and subsections 161(5) and 161A(4) of the Life Insurance Act]*

2.79 The amendments to the Industry Acts also ensure that a person must not dispose of property if the property is owned by a body corporate that has a statutory or judicial manager in control of its business. Disposal is allowed if APRA or the statutory manager consents under the statutory management regime, or if the court or tribunal consents under the judicial management regime. *[Schedule 1, item 86, Schedule 2, items 30 and 59, Schedule 3, items 18 and 24, section 15BB of the Banking Act, sections 62PB and @15BB-IA of the Insurance Act, and sections @15BB-LIA and 161B of the Life Insurance Act]*

**2.80** The amendments ensure that section 440B ('Restrictions on exercise of third party property rights') of the Corporations Act applies during a period in which a statutory or judicial manager is in control in the same way it applies during the administration of a company. The reference in paragraph 440B(2)(a) of the Corporations Act to the administrator's written consent is to be treated as a reference to the statutory or judicial manager's written consent (whichever is relevant) or APRA's written consent. Paragraph 440B(2)(b) of the Corporations Act also applies, which means that the Court can also provide leave to proceed. This basically means that the restrictions on exercise of third party property rights set out in section 440B of the Corporations Act do not apply in relation to the exercise of a third party's rights in property if the rights are exercised with the statutory or judicial manager or APRA's written consent, or with the leave of the Court. *[Schedule 1, item 86, Schedule 2, items 30 and 59, Schedule 3, items 18 and 24, section 15BC of the*

***Banking Act, sections 62PC and @15BC-IA of the Insurance Act, and sections @15BC-LIA and 161C of the Life Insurance Act]***

2.81 The amendments also ensure that suppliers of essential services to a body corporate that is under statutory or judicial management, cannot refuse services to the body corporate on the basis solely of an amount owing to them, and relating to services provided before the statutory or judicial management, or make it a condition of the supply of the essential service that the amount be paid first. An ‘essential service’ for these purposes has the same meaning as in section 600F of the Corporations Act, namely electricity, gas, water or a carriage services within the meaning of the *Telecommunications Act 1997*. [*Schedule 1, item 86, Schedule 2, items 30 and 59, Schedule 3, items 18 and 24, section 15BD of the Banking Act, sections 62PD and @15BD-IA of the Insurance Act, and sections @15BD-LIA and 161D of the Life Insurance Act]*

2.82 The amendments include Aa new section 15BF is inserted (with equivalent sections inserted into the Insurance (@15BF-IA and 62PE) and Life Insurance Acts (@15BF-LIA and 161E)) to clarify that provide that whilst a statutory or judicial manager is in control of a body corporate, the a body corporate is not required to hold an annual general meeting in accordance with the requirements under sections 250N or 601BR of the Corporations Act while a statutory or judicial manager is in control of the body corporate. [*Schedule 1, item 86, Schedule 2, items 30 and 59, Schedule 3, items 18 and 24, section 15BF of the Banking Act, sections @15BF-IA and 62PE of the Insurance Act, and sections @15BF-LIA and 161E of the Life Insurance Act]*

2.83 In the case of the Life Insurance Act, where it is possible to appoint a judicial manager to only part of the business of the life insurer, the new section 161E(3) provides that if only part of the business of the life company is under judicial management, then sections 250N or 601BR of the Corporations Act will apply, in which case the life insurer must continue to hold an annual general meeting. This is because, when a judicial manager is appointed to only part of the business of a life insurer, the appointment will in most cases be made to a particular statutory fund, or particular statutory funds, of the life insurer, leaving other business of the company to be managed by the board, who will be accountable to the company’s shareholders.

2.84 Refer to Chapter 6 for more detail on how the new moratorium provisions interact with the PSN Act.

***Clarifying that a Banking Act statutory manager is not constrained by subsection 13A(3) of the Banking Act***

2.85 The Bill amends the Banking Act to include a new subsection 13A(3AA), clarifying that a statutory manager is able to manage an ADI’s business in accordance with the provisions of the Banking Act, without being constrained by the operation of 13A(3).

2.86 Subsection 13A(3) provides that if an ADI becomes unable to meet its obligations or suspends payment, the assets in Australia of the ADI are to be available to meet the ADI's liabilities in a particular order of priority. The first two priority liabilities are APRA's costs and expenses of the financial claims scheme (if relevant), followed by the ADI's liabilities in Australia in relation to protected accounts, followed by certain other debts.

2.87 The wording of subsection 13A(3) could be interpreted to apply to a statutory manager appointed after the ADI has become unable to meet its obligations or has become insolvent. This interpretation would place the statutory manager under an obligation to refrain from paying liabilities other than in the order of priority set out in this section. The amendment puts it beyond doubt that this is not the intention by providing that a statutory manager is not constrained by subsection 13A(3). [*Schedule 1, item 54, subsection 13A(3AA) of the Banking Act*]

#### ***Immunity for statutory managers and judicial managers***

2.88 The Bill amends the existing provisions in the Industry Acts to enhance the statutory immunity of statutory and judicial managers under those Acts.

2.89 Robust immunity provisions are important components of the statutory and judicial management frameworks. In taking the actions considered necessary by APRA to protect depositor and policyholder interests and promote financial system stability, statutory and judicial managers could be required to take actions that have the potential to adversely affect others, including directors, shareholders and certain classes of creditors of the relevant entity. They may also be concerned about the risk of liability arising from the management of a large and complex organisation that is undergoing financial stress.

2.90 It is conceivable that adversely affected stakeholders may subsequently seek to recover any loss suffered via legal action against the statutory or judicial manager personally. Moreover, the circumstances of a statutory or judicial manager's appointment are such that they may be required to take actions of a higher-than-usual level of risk or in situations of considerable uncertainty.

2.91 Therefore, it is necessary that a statutory or judicial manager has confidence that they can take the actions required to manage and stabilise a distressed entity within the limits of their powers, without the risk of incurring personal liability. If there is significant uncertainty on this matter, there is a high risk that suitable persons will not be willing to assume an appointment as statutory or judicial managers.

2.92 The amendments to sections 14C of the Banking Act, 62ZM of the Insurance Act, and 179 of the Life Insurance Act, and the new sections @14C-IA of the Insurance Act and @14C-LIA of the Life Insurance Act

increase the level of protection afforded to statutory and judicial managers to a level similar to that afforded to APRA, its members, staff or agents under section 58 of the APRA Act. [*Schedule 1, item 81, Schedule 2, items 56 and 59, Schedule 3, items 18 and 49, section 14C of the Banking Act, sections 62ZM and @14C-IA and of the Insurance Act, and sections @14C-LIA and 179 of the Life Insurance Act*]

2.93 Each of those sections has been amended to include provisions equivalent to section 58 of the APRA Act, including a limitation on the statutory immunity for ‘bad faith’.

2.94 It is not intended that these provisions affect the ability of a statutory or judicial manager to incur personal contractual liability. For example, these provisions do not cover contractual arrangements entered into by the statutory or judicial manager when retaining advisors or acquiring goods and services on their own account. Nor do the provisions affect the liability of the entity under statutory management itself.

2.95 Subject to the above, these enhanced immunity provisions are intended to provide that statutory or judicial managers are protected from any breaches of directors’ duties under the Corporations Act, any other Commonwealth legislation or common law. For the avoidance of doubt, the Bill replaces the current subsection 14C(4) of the Banking Act with the new subsection 14C(3) to clarify that a statutory manager cannot be liable for insolvent trading under section 588G of the Corporations Act. The existing subsection 14C(4) provides similar protection; however, the new subsection 14C(3) is located within the new general immunity provision. This protection is replicated in the new subsection @14C(3)-IA in the Insurance Act and @14C(3)-LIA Life Insurance Acts, and paragraph 62ZM(3) and section 179 of the Insurance and Life Insurance Acts respectively.

2.96 These enhanced immunity provisions operate independently of the other immunity sections within each respective Industry Act and section 58 of the APRA Act. The immunity provisions are not intended to limit each other. [*Schedule 1, items 115, Schedule 2, item 118, Schedule 3, item 92, section 70AB of the Banking Act, section 127D of the Insurance Act, and section 246C of the Life Insurance Act*]

#### ***Transactions under statutory management not voidable***

2.97 The Bill amends the Banking Act to prevent the transactions of a Banking Act statutory manager from being voidable under section 588FE of the Corporations Act (section 14CA of the Banking Act). This applies to uncommercial transactions, insolvent transactions and unfair preferences, and is similar to protection given by section 588FE where an administrator has been appointed under Part 5.3A of the Corporations Act (voluntary administration). Equivalent provisions are inserted into the Insurance Act (@14CA-IA) and the Life Insurance Act (@14CA-LIA).



2.98 These amendments are intended to help ensure that service providers and other counterparties can be confident in any dealings with the statutory manager regardless of the financial position of the entity under statutory management.

***Terminating control of a regulated entity***

2.99 The Bill amends section 13C of the Banking Act, which empowers APRA to terminate its control of an ADI, or the statutory management of the ADI, where APRA has achieved its resolution objectives with respect to the ADI. Such a termination is defined in the section as an ‘ultimate termination of control’ and it brings the statutory management process to an end.

2.100 This amendment removes the previous requirement that, in order to end the statutory management of an ADI, its deposit liabilities in Australia need to have been repaid, or APRA needs to be satisfied that suitable provision has been made for their repayment. *[Schedule 1, item 55, section 13C of the Banking Act]*

2.101 Given that the resolution of an ADI may not always involve the winding up of the ADI or the repayment of deposit liabilities (for example, where a transfer or recapitalisation is undertaken), this amendment is necessary to give APRA the ability to end the statutory management of an ADI at the point where it considers that statutory management is no longer necessary.

2.102 Further, because the statutory management regime has been extended in scope to cover entities that may not have deposit liabilities (such as authorised NOHCs or subsidiaries that are not ADIs), the Banking Act has been amended to ensure that APRA can end the statutory management of such entities when it deems it necessary to do so.

2.103 For example, APRA may appoint a statutory manager to a service company within a relevant group of bodies corporate to ensure that it continues to provide essential services to a relevant ADI. As the service company itself has no deposit liabilities, this amendment will ensure APRA is able to end the statutory management when it deems it appropriate.

2.104 An example of circumstances where APRA may deem it necessary to end the statutory management of a target body corporate would be where appropriate arrangements have been made for the continued provision of the essential services provided by the target body corporate as part of the resolution of the relevant ADI.

2.105 As explained at 2.41 to 2.43, an equivalent of the newly amended section 13C of the Banking Act will be inserted in the Insurance and Life Insurance Acts with respect to statutory management of insurers. *[Schedule 2, item 59, Schedule 3, item 18, section @13C-IA of the Insurance Act, and section @13C-LIA of the Life Insurance Act]*

***Replacement of a statutory manager***

2.106 The Bill amends section 14E of the Banking Act to allow APRA to terminate the appointment of an administrator of a body corporate's business and to appoint another person as administrator or itself take control. This is important to ensure APRA maintains confidence in the ability of the statutory manager to carry out APRA's instructions and meet APRA's objectives for the orderly resolution of the relevant ADI. The statutory management itself will continue, as this process does not involve an 'ultimate termination of control' as described at 2.99..

2.107 APRA may only exercise this power if the administrator contravenes a requirement of Division 2 of Part II of the Banking Act (regarding statutory management and protection of depositors), or if APRA considers that this is necessary to;

- facilitate the resolution of the entity, a relevant group of bodies corporate of which the entity is a member, or another member of such a group; or
- if the body corporate is an ADI – protect the interests of depositors of the ADI; or
- promote financial system stability in Australia. [*Schedule 1, item 83, Schedule 2, item 59, Schedule 3, item 18, section 14E of the Banking Act, section @14E-IA of the Insurance Act, and section @14E-LIA of the Life Insurance Act*]

2.108 The exercise of this power does not cancel the statutory management of the body corporate; rather, it cancels the appointment of a particular person as the Banking Act statutory manager of the body corporate.

2.109 Where APRA is the statutory manager of a body corporate, and a condition listed at 2.107 is satisfied, APRA can replace itself as statutory manager by appointing a person as administrator.

2.110 The Bill also inserts an adapted form of this provision into the Insurance and Life Insurance Acts, referring to policyholders rather than depositors, with respect to statutory management of insurers. [*Schedule 2, item 59, Schedule 3, item 18, section @14E-IA of the Insurance Act, and section @14E-LIA of the Life Insurance Act*]

***Statutory manager not subject to PGPA Act***

2.111 The Bill ensures that the PGPA Act does not apply to a statutory manager under any of the Industry Acts, avoiding an unintended outcome that might otherwise arise where an entity is placed into statutory management. This amendment addresses the concern that APRA's influence or control in relation to the statutory management process may

result in the entity falling with the definition of Commonwealth company in the PGPA Act. The PGPA Act imposes a variety of corporate governance and financial reporting obligations on Commonwealth companies, having regard to their public sector ownership or control. It is not intended that these requirements apply in relation to a body under statutory management. [*Schedule 1, item 88, Schedule 2, item 59, Schedule 3, item 18, section 15D of the Banking Act, section @15D-IA of the Insurance Act, and section @15D-LIA of the Life Insurance Act*]

***Clarifying amendments to judicial management***

2.112 The Bill repeals sections 62Q of the Insurance Act and 162 of the Life Insurance Act, as these sections, which provide that an insurer is not to be judicially managed except under the Insurance Act or Life Insurance Act as the case may be, are unnecessary. This is because judicial management of a life insurer, as defined in the Life Insurance Act, can only occur under that Act, and judicial management of a general insurer can only occur under the Insurance Act. [*Schedule 2, item 31 and Schedule 3, item 25, section 62Q of the Insurance Act, and section 162 of the Life Insurance Act*]

***Effect of judicial management on existing directors and officers***

2.113 The Bill amends sections 62T of the Insurance Act and 165 of the Life Insurance Act to clarify the effect of judicial management on the powers of directors and officers of the insurer.

2.114 The new law replaces the existing terminology regarding the ‘vesting’ and ‘divesting’ of the ‘management’ of the insurer, as these terms do not precisely define the effect of judicial management on the existing directors and officers of the insurer.

2.115 For example, it is uncertain whether the appointment of a judicial manager under the current law results in the removal of directors and officers – as well as other persons exercising management functions – from their position or only removes their powers and functions. Further, the current law does not describe which powers (if any) the directors and officers of the insurer keep, including whether the directors may exercise any of their collective powers and functions as the Board of the insurer.

2.116 The new law provides that a person who had the powers and functions of an ‘officer’ ceases to have those powers and functions once a judicial manager has been appointed. The new law also includes provisions that invalidate any actions taken after the commencement of the judicial management by a person who had the powers and functions of an officer before the appointment of a judicial manager. These purported acts have no effect to the extent that they are performed after the appointment of a judicial manager to the insurer. [*Schedule 2, item 36, Schedule 3, item 30, section 62T of the Insurance Act, and section 165 of the Life Insurance Act*]

2.117 These amendments also include provisions that explain the effect of judicial management on a foreign general insurer's agent in Australia, as well as the members of a foreign life insurer's Compliance Committee; see 7.23.

2.118 The new subsections 62T(4) of the Insurance Act and 165(4) of the Life Insurance Act define the term 'officer' as having the same meaning as it has in the Corporations Act, where it is defined in section 9 and includes (among other people) directors of the corporation. In particular, it includes a person who makes, or participates in the making of, decisions that affect the whole or a substantial part of the business of the entity, or who have the capacity to affect significantly the entity's financial standing.

2.119 Consequential amendments have been made to the provisions for judicial management in the Insurance and Life Insurance Acts to update the judicial management regimes of both Acts as a consequence of this change.

***Effect on directors of cancelling judicial management***

2.120 The Bill amends sections 62ZF of the Insurance Act and 172 of the Life Insurance Act to clarify the effect of cancelling judicial management on the board of directors of the insurer. [*Schedule 2, item 50, Schedule 3, item 43, section 62ZF of the Insurance Act, and section 172 of the Life Insurance Act*]

2.121 The amendments ensure that, on the cancellation of judicial management of an insurer, the board of directors resumes the powers and functions of officers of the general insurer.

2.122 In the event that all the directors of the insurer have either resigned or for some other reason are no longer in office, the judicial manager may seek to appoint new directors before the cancellation takes effect. Alternatively, APRA can apply to the Court for an order that directs the judicial manager to appoint directors to the insurer.

***Powers and functions of multiple statutory or judicial managers***

2.123 The Bill amends subsection 13A(2A) of the Banking Act, and makes corresponding provision in subsections @13A(2A)-IA of the Insurance Act and @13A(2A)-LIA of the Life Insurance Act, to clarify that one or more persons may be appointed as statutory managers. The amendments also clarify the powers and functions of each statutory manager where more than one person has been appointed as a statutory manager of an entity. [*Schedule 1, item 51, Schedule 2, item 59, Schedule 3, item 18, section 13A(2A) of the Banking Act, subsection @13A(2A)-IA of the Insurance Act, and subsection @13A(2A)-LIA of the Life Insurance Act*]

2.124 In particular, the amendments define the default arrangements where multiple statutory managers have been appointed to an entity, being

that each of the statutory managers may exercise all of the powers and functions under the relevant Act either jointly or individually.

2.125 The amendments also provide that APRA may place limits or conditions on the ability of any or all statutory managers to perform powers and exercise functions jointly or individually. APRA may do so by giving a notice to the statutory managers that specifies these limits and conditions.

2.126 The amendments also clarify that a reference in each of the Industry Acts to a statutory manager is a reference to one or more of those statutory managers in the relevant Act, as the case requires.

2.127 The Bill also amends sections 62R of the Insurance Act and 163 of the Life Insurance Act to reflect the above amendments in relation to judicial managers. Some minor adaptations were required in order to apply these changes to the judicial management provisions; for example, it is the Court (and not APRA) that has the power to specify the limits or conditions on the ability of any or all judicial managers to perform powers and exercise functions jointly or individually. [*Schedule 2, item 32, Schedule 3, item 26, subsection 62R(2) of the Insurance Act, and section 163 of the Life Insurance Act*]

2.128 Subsections 62R(1B) of the Insurance Act and 163(1B) of the Life Insurance Act clarify that the Federal Court may make an initial appointment of two or more judicial managers, and may subsequently appoint one or more additional judicial managers. Where multiple or additional appointments are made, the default position is that the functions and powers of a judicial manager may be performed or exercised by all of the judicial managers acting jointly, or each of them acting individually. However at the time of making the appointment the Federal Court may specify limits or conditions on the ability of judicial managers to perform functions or exercise powers jointly or individually.

2.129 These provisions are broadly based on similar provisions in the Corporations Act providing for multiple appointments of liquidators, provisional liquidators and other external administrators under that Act. In addition, subsections 62R(1A) of the Insurance Act and 163(1A) of the Life Insurance Act provide that if, subsequent to the appointment of a judicial manager, a situation arises or is likely to arise where there may be no judicial manager the Court may appoint another judicial manager of the general insurer. This will ensure that casual vacancies can be filled but does not limit the more general power in subsection 62R(1B) of the Insurance Act and 163(1B) of the Life Insurance Act to appoint an additional judicial manager in other situations.

#### ***Cancelling the appointment of a judicial manager***

2.130 Subsections 62R(2) of the Insurance Act and 163(2) of the Life Insurance Act provide that the Federal Court may also cancel the

appointment of a judicial manager and appointment another judicial manager on application by APRA or of its own motion. These provisions are concerned with the removal and replacement of a particular judicial manager (or particular judicial managers) rather than the termination of the judicial management process as such (sections 62ZF of the Insurance Act and 172 of the Life Insurance Act are concerned with the cancellation of the judicial management itself). *[Schedule 2, item 33, Schedule 3, item 27, subsection 62R(2) of the Insurance Act, and subsection 163(2) of the Life Insurance Act]*

2.131 The power to apply to the Court for the cancellation of a judicial manager's appointment is intended to be flexible and might be used in a range of situations. For example, APRA may apply where the judicial manager is unable, for unforeseen reasons, to continue to act, or where the judicial manager does not have the skills or resources to continue the judicial management or has otherwise lost the confidence of the court or APRA.

***Appointing a statutory or judicial manager in absence of external support***

2.132 The Bill amends the Insurance and Life Insurance Acts to expressly allow the Court to disregard external support for the entity when it is making an order to place the entity under judicial management. *[Schedule 2, items 25 and 26, Schedule 3, item 21, section 62M of the Insurance Act, and section 159 of the Life Insurance Act]*

2.133 The Bill amends the Insurance and Life Insurance Acts to expressly allow the Court to disregard external support for the entity when it is making an order to place the entity under judicial management.

2.134 Equivalent provisions are also inserted into the Insurance and Life Insurance Acts to expressly allow APRA to disregard external support for the entity when exercising its discretion to appoint a statutory manager or apply for the judicial management of an entity. This is intended to ensure that the provision of external support to a stressed entity, for example some form of temporary public support, would not fetter the ability of APRA to determine that the preconditions are met for appointing a statutory manager or placing the entity under judicial management. *[Schedule 2, item 59, Schedule 3, item 18, section @13A(1F)-IA of the Insurance Act, and section @13A(1F)-LIA of the Life Insurance Act]*

2.135 In effect, these amendments harmonise the Insurance and Life Insurance Acts with existing paragraph 13A(1)(b) and new paragraph 13A(1F)(a) of the Banking Act.

2.136 The existing Banking Act provisions also include the power to establish regulations that define things that may not be considered external support for this purpose, and an equivalent of this regulations-making

power is included in the equivalent provisions in the Insurance and Life Insurance Acts.

***Statutory manager recommending directions from APRA***

2.137 Upon the appointment of an administrator to take control of an entity under statutory management, the administrator may decide that a possible course of action will have strategic implications, and should therefore be determined by APRA. While it is expected that processes for addressing these situations would be provided for in the contractual or other arrangements agreed between APRA and the administrator, there is currently no provision that provides a means by which the administrator can request APRA to formally direct it as to the appropriate course of action to take.

2.138 The current law in paragraph 14B(1)(a) of the Banking Act provides formal means by which an administrator may recommend that APRA issues a formal direction under Division 1BA or section 29 to the ADI under its control. The Bill amends paragraph 14B(1)(b) by providing that an administrator may also recommend that APRA issues a formal direction under subsection 14D(3) in respect of the ADI. The expansion of the statutory management regime to group entities means that paragraph 14B(1)(b) is further enhanced so that an administrator may also recommend that APRA issues a formal direction under subsection 14D(3) in respect of a related bodies corporate to the ADI.

2.139 Equivalent provisions have been added to the Insurance Act (@14D-IA) and Life Insurance Act (@14D-LIA).

***Appointing a statutory manager over a foreign regulated entity***

2.140 The Bill implements provisions allowing for the appointment of a statutory manager over the Australian business assets and liabilities of a foreign regulated entity.

2.141 The term ‘Australian business assets and liabilities’ refers to the scope of business of a foreign regulated entity that APRA’s crisis management powers are to extend to under the amendments in this Bill – see Chapter 7 for more information about the amendments to APRA’s crisis management powers regarding foreign regulated entities.

2.142 It is intended that such a statutory manager would be able to exercise any powers and functions necessary to manage the Australian business assets and liabilities of the entity in order to achieve the objectives of the statutory management in Australia. To that end, the Bill provides that the statutory manager have the powers and functions of the board of the foreign regulated entity in so far as they relate to the Australian business assets and liabilities of the entity. This would include the powers and functions of a foreign general insurer’s agent in Australia and Compliance Committee members of a foreign life insurer.

2.143 See Chapter 7 for more information about the amendments to APRA's crisis management powers over foreign regulated entities.

### **Amending the definition of 'subsidiary' under the Insurance Act to align with the Banking Act and Life Insurance Act**

2.144 Under the existing definition of 'subsidiary' in the Insurance Act, a company will be a 'subsidiary' of another company if the other company is in a position to cast, or control the casting of, more than 25 per cent (the threshold percentage) of the maximum number of votes that might be cast at a general meeting of the company, or holds more than 25 per cent of the issued share capital of the company. In contrast, under the Banking Act and Life Insurance Act, the threshold percentage is the usual 50 per cent. The definition in the Banking and Life Insurance Acts follows the definition of 'subsidiary' in the Corporations Act.

2.145 The reason for the different definition of 'subsidiary' in the Insurance Act appears to be historical. The 25 per cent threshold percentage was originally employed in a test defining when two companies were related to each other for the purpose of certain provisions of the Insurance Act. Most of those provisions, with the exception of the investigation provisions discussed in 2.149 below, were repealed in 2002, or prior to that..

2.146 However, despite the repeal of those provisions, the definition of 'subsidiary' has remained unchanged and continues to apply to newer provisions of the Insurance Act, although the definition is not intended to apply as a matter of policy. For example, under prudential standards made by APRA applicable to general insurers, 'subsidiary' is defined according to the 50 per cent percentage threshold, in harmony with the definition of 'subsidiary' in the Banking Act, Life Insurance Act and the prudential standards applicable to ADIs and life companies.

2.147 In light of this, the Bill amends the definition of 'subsidiary' in section 4 of the Insurance Act to be consistent with the definition used in the Banking Act and Life Insurance Acts.

2.148 Section 16 of the Life Insurance Act determines how bodies corporate are related to each other for the purposes of the Life Insurance Act, except for the purposes of Part 7 of the Life Insurance Act relating to monitoring and investigation powers. In existing Part 7 of the Life Insurance Act, which relates to investigations, APRA is given power to investigate not only a life company but also an 'associated body corporate' of a life company. Section 128 provides that two bodies are 'associated' with each other if they are 'related to each other' and certain other conditions are satisfied. Section 129 provides that the question of whether two bodies are 'related' to each other for these purposes is to be determined applying the Corporations Act tests but on the basis of a 'more than a quarter' control test instead of the usual 'more than half' control



test. This operates, as noted, for the purposes of the investigation provisions.

2.149 The equivalent of Part 7 of the Life Insurance Act is the existing Part V of the Insurance Act. Subsection 52(3) in Part V provides for the investigation of an ‘associated body corporate’ of an insurer. Subsection 50(2) of the Insurance Act, like section 128 of the Life Insurance Act, provides that two bodies are associated with each other where they are ‘related to each other’ and certain other conditions are satisfied. The Bill will insert a new subsection 50(3) in similar terms to section 129 of the Life Insurance Act (and in similar terms to a provision that was incorrectly repealed by the *General Insurance Reform Act 2001*). This will restore consistency between the scope of monitoring and investigation powers under the Insurance Act and Life Insurance Act.

### **Insurance and Life Insurance Acts to have effect despite the Corporations Act**

2.150 The Bill amends the Insurance and Life Insurance Acts to clearly indicate that those Acts have effect despite any provisions in the Corporations Act. The Banking Act already includes a provision for the Banking Act to have effect despite provisions of the Corporations Act. [*Schedule 2, item 118, Schedule 3, item 93, section 127E of the Insurance Act, and section 251AA of the Life Insurance Act*]

2.151 Further consequential amendments have been made to the Industry Acts, for the avoidance of doubt, regarding the way that these Acts interact with the Corporations Act. These amendments are included because certain provisions are expressed to apply despite the Corporations Act for the avoidance of doubt, even though there is a general override of the Banking Act in section 70B, Insurance Act in the new section 127E and Life Insurance Act in the new section 251AA. These amendments will ensure that the mentions of the Corporations Act in the specific provisions do not limit the general scope of section 70B of the Banking Act and the counterpart provisions in the Insurance and Life Insurance Acts. The amendments have been made to;

- subsections 13G(3)(a), 14A(5B)(a), and 14AA(4)(a) of the Banking Act;
- subsections 62Z(4)(a), 62ZJ(3)(b)(i), and 103D(3)(a) of the Insurance Act; and
- subsections 168A(4)(a), 176(3)(b)(i), and 230AD(3)(a) of the Life Insurance Act.

## **Consequential and minor amendments**

2.152 To facilitate the extension of the Banking Act statutory management regime to group entities, the term ‘ADI statutory manager’ has been replaced with the term ‘Banking Act statutory manager’ in the Banking Act. This is to ensure that no confusion arises as to the scope of entities that a statutory manager may take control of under the Banking Act.

2.153 Further minor amendments have been made to the Transfer Act and PSN Act to reflect the changes in terminology and structure in the Industry Acts. For example, the amendments will include references to ‘Banking Act statutory manager’, ‘Insurance Act statutory manager’ and ‘Life Insurance Act statutory manager’ in section 25 of the Transfer Act in the relevant pre-condition for the making of a transfer determination under that section.

2.154 Further amendments have been made to adapt the existing provisions of the Banking Act to replace the term ‘ADI’ with ‘body corporate’ as appropriate. This is to ensure that each provision in the Banking Act that relates to statutory management can be applied with respect to target bodies corporate where appropriate.

2.155 As the statutory management regimes in the Insurance and Life Insurance Acts are closely adapted from the provisions of the Banking Act, equivalent changes have been carried over to those Acts.

2.156 A number of minor changes have been made to the Banking and Life Insurance Acts to clarify and distinguish between the use of the term ‘related body corporate’ for the purposes of the statutory management regime and the use of ‘related body corporate’ for the whistleblower protection provisions of those Acts.

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## **Chapter 3**

### **Directions powers**

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#### **Outline of chapter**

3.1 Schedules 1 to 3 to this Bill amend the Industry Acts to enhance the scope and efficacy of APRA's directions powers.

#### **Context of amendments**

3.2 The Industry Acts enable APRA to issue enforceable directions to regulated entities and authorised NOHCs in specified circumstances.

3.3 In most situations, APRA is able to address any prudential concerns that arise in relation to regulated entities by working cooperatively with the board and management and, where applicable, their authorised NOHC. In these instances, the board and senior management maintain full responsibility for decisions made by the regulated entity and, where applicable, the group of which it may be part.

3.4 However, there may be times when APRA considers it necessary to use more direct tools, such as its directions powers, to rectify or manage prudential concerns.

3.5 Directions powers enable APRA to compel a regulated entity to take specific action to address particular prudential issues that have been identified. Directions powers may also be necessary to limit further deterioration in the financial condition of a regulated entity in a period of emerging stress, and to facilitate the resolution of a distressed regulated entity.

3.6 By international standards, APRA's directions powers are reasonably comprehensive. However, refining and, where appropriate, enhancing the triggers that allow the issue of directions will help ensure that APRA can respond in a more timely and decisive way to emerging prudential concerns that affect an entity.

3.7 Equally, broadening the scope of the directions powers, both in respect of the matters on which directions may be given and the entities to which directions may be given, will assist APRA to respond effectively and promptly to resolve a distressed regulated entity.

3.8 A related issue is that in complying with an APRA direction, directors or other officers may breach what would (but for the existence of the direction) normally be their obligations or duties under the

Corporations Act or other law. Such a potential conflict of duties could give rise to delay and impede the effectiveness of APRA's direction powers, particularly in a crisis. The Bill therefore addresses this issue by introducing a specific immunity provision for directors and management when complying with an APRA direction. This is consistent with the Key Attributes, which note the need for directors and other key officers of financial institutions to be protected from liability arising from compliance with directions.

## **Summary of new law**

- 3.9 Schedules 1 to 3 to this Bill amend the Industry Acts to:
- extend APRA's ability to issue directions to subsidiaries of authorised NOHCs and subsidiaries of regulated entities;
  - clarify the scope of APRA's 'catch-all' directions power;
  - clarify that APRA may issue directions requiring entities to take specified actions to facilitate resolution, whether in normal times or during a crisis;
  - clarify that APRA may give directions despite external support being in place;
  - extend APRA's ability to issue recapitalisation directions to a regulated entity's authorised NOHC and certain other holding companies;
  - harmonise recapitalisation directions powers with general directions powers;
  - ensure that causing an entity to comply with an APRA direction will not be grounds for directors or management to be held liable under any other law (subject to a good faith and reasonableness test);
  - harmonise the protection from liability provisions in the Industry Acts; and
  - provide for APRA to determine that the giving of a direction should be confidential.

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<i>Directions to subsidiaries</i>	
APRA may give directions to subsidiaries of authorised NOHCs and subsidiaries of regulated entities.	APRA does not have the power to give directions directly to subsidiaries of authorised NOHCs and subsidiaries of regulated entities.
<i>Catch-all directions power</i>	
APRA may give directions about other matters regarding the affairs of the regulated entity (including in relation to specific transactions and other matters).	It is unclear whether APRA has the power under the 'catch-all' ground to give directions regarding specific transactions involving the regulated entity.
<i>Pre-positioning directions power</i>	
APRA may give directions to require entities to take specified actions to facilitate resolution, whether during normal times or in an emerging stress.	It is unclear whether APRA has the power to give directions, or all the kinds of directions that might reasonably be necessary, to require regulated entities to take specified actions to facilitate resolution, both in normal times or in an emerging stress.
<i>Power to give directions despite external support being in place</i>	
APRA may give directions to insurers despite external support being in place.	It is unclear whether APRA may disregard external support for an insurer in deciding whether to give a direction.
<i>Scope of recapitalisation directions powers</i>	
Where APRA is giving a recapitalisation direction to a regulated entity, a corresponding direction may be given to the entity's authorised NOHC and any subsidiary of the authorised NOHC which is also a holding company of the regulated entity.	APRA does not have the power to give recapitalisation directions to authorised NOHCs or other holding companies of regulated entities.
<i>Harmonise recapitalisation directions powers with general directions powers</i>	
APRA may give a recapitalisation direction that can: <ul style="list-style-type: none"> <li>• deal with some or a particular class of matters;</li> <li>• specify time for</li> </ul>	In relation to a recapitalisation direction, APRA does not have express power in the Industry Acts to: <ul style="list-style-type: none"> <li>• deal with some or a particular class of matters;</li> </ul>

<p>compliance;</p> <ul style="list-style-type: none"> <li>• be varied by notice in writing if APRA considers that the variation is necessary and appropriate; and</li> <li>• be later revoked if APRA considers that the direction is no longer necessary or appropriate.</li> </ul>	<ul style="list-style-type: none"> <li>• specify time for compliance;</li> <li>• vary the direction; or</li> <li>• revoke the direction.</li> </ul>
<i>Protection from liability when complying with an APRA direction</i>	
<p>Directors or management who ensure compliance with an APRA direction will not be held liable for actions or omissions in good faith that are reasonable in order to achieve the purpose of complying with the direction.</p>	<p>It is unclear that the general immunity provision in section 70A of the Banking Act provides directors with the requisite level of immunity when ensuring compliance with an APRA direction.</p>
<i>Streamline the protection from liability provisions in the Industry Acts</i>	
<p>A person will be protected from liability if they act in good faith and without negligence in the exercise or performance of powers, functions or duties under the Insurance and Life Insurance Acts. (This is separate from the special protection afforded for compliance with a direction.)</p>	<p>No equivalent provision of section 70A of the Banking Act is in the Insurance or Life Insurance Acts; although various provisions under the Insurance and Life Insurance Acts provide some protection for auditors and actuaries.</p>
<i>Confidentiality of certain directions</i>	
<p>APRA may make a determination that the giving of a direction should be confidential in certain circumstances.</p>	<p>Currently only APRA staff are subject to legislative secrecy obligations in relation to directions.</p>

## Detailed explanation of new law

3.10 To assist with the operation of APRA’s directions powers under the Industry Acts, the Bill inserts a definition of ‘direction under this Act’ to mean a direction under any of the following provisions:

- sections 11CA, 11CC, 13E, 17, 23, 29 and 31F of the Banking Act;
- sections 17, 27, 49R, 74, 76, 78, 103B and 104 of the Insurance Act; or

- sections 27A, 125A, 230AB or 230B of the Life Insurance Act. [*Schedule 1, item 3, Schedule 2, item 2, Schedule 3, item 94, subsection 5(1) of the Banking Act, subsection 3(1) of the Insurance Act, and the Schedule Dictionary of the Life Insurance Act*]

## General directions powers

### *Triggers for issuing directions to a regulated entity or authorised NOHC*

3.11 Paragraphs 11CA(1)(c) of the Banking Act, 104(1)(b) of the Insurance Act, and 230B(1)(b) of the Life Insurance Act currently provide that APRA may give a direction to a body corporate if APRA has reason to believe that the body corporate is likely to contravene any one of certain listed laws and ‘such a contravention is likely to give rise to a prudential risk’.

3.12 The Bill amends these provisions to replace the condition that ‘such a contravention is likely to give rise to a prudential risk’ with ‘the direction is reasonably necessary for one or more prudential matters relating to the body corporate’. [*Schedule 1, item 29, Schedule 2, item 109, Schedule 3, item 80, paragraph 11CA(1)(c) of the Banking Act, paragraph 104(1)(b) of the Insurance Act, and paragraph 230B(1)(b) of the Life Insurance Act*]

3.13 This amendment reflects that the term ‘prudential matters’ is specifically defined in the Industry Acts and so provides greater clarity to the relevant grounds for APRA’s directions powers. In addition, given the proposed amendments to the definition of ‘prudential matters’ (see 10.13 to 10.16), this clarifies that APRA can direct a body corporate to take actions to address issues concerning their resolvability (or the resolvability of a group of which it is a member) for resolution purposes.

3.14 The Bill amends the grounds under subsections 11CA(1AA) of the Banking Act, 104(1A) of the Insurance Act, and 230B(1AA) of the Life Insurance Act to enhance APRA’s ability to give a direction to a body corporate (a regulated entity or authorised NOHC) as a result of the conduct or circumstances of its subsidiaries. The new grounds are:

- APRA has reason to believe that:
  - a subsidiary has contravened a provision of the relevant Industry Act, a regulation (in the case of the Banking Act, a prudential requirement regulation), a prudential standard or the FSCODA; or
  - a subsidiary is likely to contravene an Industry Act, a regulation (in the case of the Banking Act, a prudential

requirement regulation), a prudential standard or the FSCODA; or

- a subsidiary is conducting its affairs in a way that may cause it to be unable to continue to supply services to the body corporate (IT or treasury functions for example); and
- APRA considers that the direction is reasonably necessary for one or more prudential matters relating to the regulated entity or authorised NOHC (prudential matters test) under the new subsections 11CA(1AB) of the Banking Act, 104(1AB) of the Insurance Act and 230B(1AB) of the Life Insurance Act.

3.15 The Bill also inserts additional grounds to enable APRA to give a direction to a body corporate (a regulated entity or authorised NOHC), if:

- APRA has reason to believe that:
  - the direction is in respect of a subsidiary and is necessary in the interests of depositors or policyholders of the regulated entity; or
  - the direction is in respect of a subsidiary and the failure to issue such a direction would materially prejudice the interests of depositors or policyholders of the regulated entity.

3.16 The Bill provides that these grounds, as well as the existing ground that a subsidiary is conducting its affairs in a way that may cause or promote instability in the Australian financial system, are not subject to the additional prudential matters test. This is because a prudential element is implicit in each of these three grounds themselves. *[Schedule 1, item 30, Schedule 2, item 110, Schedule 3, item 81, subsections 11CA(1AA) and 11CA(1AB) of the Banking Act, subsections 104(1A) and 104(1AB) of the Insurance Act, and subsections 230B(1AA) and 230B(1AB) of the Life Insurance Act]*

3.17 The amendments reflect the various circumstances in which the conduct of a subsidiary of a regulated entity or authorised NOHC may necessitate APRA giving a direction to the regulated entity or authorised NOHC. The amended triggers in paragraph 3.14 also provide grounds for APRA to give directions directly to subsidiaries (see 3.21).



### ***Directions to subsidiaries***

3.18 APRA currently does not have power under the Industry Acts to issue a direction directly to subsidiaries of regulated entities or subsidiaries of authorised NOHCs.

3.19 APRA can instead indirectly influence the activities of other entities in the group by giving directions to the regulated entity or authorised NOHC to give instructions to their respective subsidiaries.

3.20 However, there is a risk of delay in the directions being acted on by the subsidiary, particularly if the board of the subsidiary in question is uncooperative or slow to comply with instructions. Time may be of the essence in resolving a failing regulated entity. It may therefore be important to avoid delays that could compromise the resolution of a regulated entity. Having the ability for APRA to issue a direction directly to a relevant subsidiary in certain circumstances could help avoid delay and improve the effectiveness of APRA's directions power.

3.21 The Bill amends the Industry Acts to enable APRA to issue a direction to a body corporate that is a subsidiary of the regulated entity, or of an authorised NOHC.

3.22 APRA may issue such a direction only if it has already given, or would otherwise be entitled to give, the regulated entity or authorised NOHC a direction under the subsections identified above in paragraph 3.14 due to one or more of the grounds having been satisfied in respect of the subsidiary. *[Schedule 1, item 30, Schedule 2, item 110, Schedule 3, item 81, subsection 11CA(1AC) of the Banking Act, subsection 104(1AC) of the Insurance Act, and subsection 230B(1AC) of the Life Insurance Act]*

3.23 The Bill enables regulations to be made under the Industry Acts to specify that a particular body corporate that is a subsidiary cannot be given such a direction. For example, regulations might carve out entities that are regulated under other legislation and subject to a separate directions powers regime. *[Schedule 1, item 30, Schedule 2, item 110, Schedule 3, item 81, subsection 11CA(1AD) of the Banking Act, subsection 104(1AD) of the Insurance Act, and subsection 230B(1AD) of the Life Insurance Act]*

3.24 The Bill also amends the Industry Acts to clarify that the different subsections setting out the triggers for directions do not limit each other. *[Schedule 1, item 30, Schedule 2, item 110, Schedule 3, item 81, subsection 11CA(1AE) of the Banking Act, subsection 104(1AE) of the Insurance Act, and subsection 230B(1AE) of the Life Insurance Act]*

### ***Catch-all directions power***

3.25 The general directions powers in the Industry Acts provide a non-exhaustive list of the different kinds of directions that APRA may

give to a regulated entity or authorised NOHC where the relevant pre-conditions are met.

3.26 Since the circumstances under which APRA may need to make a direction are difficult to identify before the event, the list currently also includes a ‘catch-all’ power for APRA to make a direction to do ‘anything else as to the way in which the affairs of the body corporate are to be conducted or not conducted’ (current paragraph 11CA(2)(p) of the Banking Act) or ‘to do, or refrain from doing, an act that relates to the way in which the affairs of the body corporate are to be conducted or not conducted’ (current paragraphs 104(3)(u) of the Insurance Act and 230B(2)(v) of the Life Insurance Act).

3.27 These ‘catch-all’ directions powers are intended to provide APRA with the flexibility to make directions about other matters regarding the affairs of the regulated entity that are not contemplated by the other kinds of general directions listed in the Industry Acts.

3.28 However, the reference to ‘the way’ in which the affairs of the body corporate are to be conducted could be interpreted narrowly to mean that directions under the ‘catch-all’ power are limited to the general manner in which a regulated entity carries on its business (for example, the regulated entity’s systems and processes). On this narrow interpretation, the ‘catch-all’ might not necessarily extend to directions regarding specific transactions involving the regulated entity.

3.29 The Bill therefore amends the ‘catch-all’ directions power under the Industry Acts by deleting the reference to ‘the way’. [*Schedule 1, item 33, Schedule 2, item 113, Schedule 3, item 84, paragraph 11CA(2)(r) of the Banking Act, paragraph 104(3)(w) of the Insurance Act, and paragraph 230B(2)(x) of the Life Insurance Act*]

3.30 This amendment is intended to put beyond doubt that APRA has the power to make directions about particular matters or transactions of a regulated entity (as well as directions as to the ‘way’ in which such matters are conducted generally).

#### ***Pre-positioning directions power***

3.31 APRA’s supervision of regulated entities includes working with them to ensure that viable contingency plans are in place for managing a crisis affecting the relevant ADI or insurer, and the group of which it may be part. Along with a wide and flexible set of crisis management powers, planning for resolution during normal times is an integral part of ensuring appropriate crisis preparedness. Consistent with the amendments in the Bill, APRA has indicated its intention to further develop its framework for resolution planning, including formally reflecting this in its prudential framework through standards and guidance, following appropriate consultation (see Chapter 10).

3.32 Resolution planning will include an assessment of whether APRA's crisis management powers can be used to resolve a relevant entity or group in a credible and orderly manner, and whether APRA considers there to be any existing obstacles to resolution. In cases where obstacles to resolution are identified through the planning process, APRA's supervision of regulated entities would include working with the relevant entity to address these obstacles in an appropriate way.

3.33 In order to provide an appropriate legislative basis for the resolution planning process, it is necessary for APRA to have a clear power to make prudential standards on resolution (see 10.16) and the power to enforce these prudential standards or otherwise require actions to facilitate resolution, through directions where necessary. As such, the Bill clarifies that APRA's directions powers allow it to require a regulated entity to implement appropriate pre-positioning measures to address obstacles to resolution.

3.34 The Bill amends the Industry Acts to empower APRA to give a direction to a regulated entity, authorised NOHC and subsidiaries to do any one or more of the following:

- to make changes to the body corporate's systems, business practices or operations; or
- to reconstruct, amalgamate or otherwise alter all or part of the business, structure or organisation of the body corporate or of the group constituted by the body corporate and its subsidiaries. [*Schedule 1, item 33, Schedule 2, item 113, Schedule 3, item 84, paragraphs 11CA(2)(p) and 11CA(2)(q) of the Banking Act, paragraphs 104(3)(u) and 104(3)(v) of the Insurance Act, and paragraphs 230B(2)(v) and 230B(2)(w) of the Life Insurance Act*]

3.35 These amendments are intended to clarify that, where an appropriate precondition for the exercise of APRA's general directions power is met (for example, breach of a prudential standard), APRA can direct a regulated entity, authorised NOHC or their subsidiaries to take the necessary actions required to facilitate resolution. The wording is intended to cover a wide range of potential pre-positioning measures that APRA could direct, for example including changes to business processes or the operational structure of a group in order to facilitate continuity of critical functions of the regulated entity, or the continued provision of critical intra-group shared services, during a resolution. Such a direction could be given, in line with the prudential framework for resolution planning noted above, during normal times or in response to an emerging stress.

3.36 The Bill also amends the Industry Acts to clarify that:

- the kinds of direction that may be given are not limited by any other provision in the respective Parts (apart from

subsection 11CA (2AA) of the Banking Act, which affords protection to holders of covered bonds); and

- the kinds of direction that may be given under a particular paragraph are not limited by any other paragraph in that subsection. [*Schedule 1, item 34, Schedule 2, item 114, Schedule 3, item 85, subsections 11CA(2AAA) and 11CA(2AAB) of the Banking Act, subsections 104(4B) and 104(4C) of the Insurance Act, and subsections 230B(3B) and 230B(3C) of the Life Insurance Act*]

### ***Power to give directions despite external support being in place***

3.37 The *Financial Sector Legislation Amendment (Prudential Refinements and Other Measures) Act 2010* inserted subsections 11CA(1B) and (1C) in the Banking Act to ensure that APRA may give a direction to an ADI or authorised NOHC despite any external support being in force. This was intended to ensure that the provision of external support to a stressed entity, for example some form of temporary public support, would not fetter the ability of APRA to determine that the preconditions are met for giving a direction to the entity.

3.38 However, corresponding amendments were not made to the Insurance and Life Insurance Acts for this purpose, even though the directions powers under the Industry Acts are generally aligned.

3.39 The Bill amends the Insurance and Life Insurance Acts to clarify that APRA may disregard external support for an insurer in giving a direction. These amendments ensure consistency in the directions powers across the Industry Acts. [*Schedule 2, item 112, Schedule 3, item 83, subsection 104(2A) of the Insurance Act, and subsection 230B(1AAA) of the Life Insurance Act*]

3.40 The Bill also enables regulations to be made under the Insurance and Life Insurance Acts to specify that a particular form of support is not external support. This enables the regulations to clarify any types of external support that are not to be disregarded by APRA in deciding to give a direction under the Insurance and Life Insurance Acts. This is consistent with the approach in the equivalent provision of the Banking Act. [*Schedule 2, item 112, Schedule 3, item 83, subsection 104(2B) of the Insurance Act, and subsection 230B(1AAB) of the Life Insurance Act*]

## **Recapitalisation directions powers**

### ***Scope***

3.41 The current Part II, Division 2, Subdivision AA of the Banking Act, Part IX, Division 1 of the Insurance Act, and Part 10A, Division 2, Subdivision A of the Life Insurance Act empower APRA to direct a

regulated entity that is not subject to statutory or judicial management to increase its level of capital.

3.42 Presently, where APRA has given such a direction to a regulated entity, it could not use the recapitalisation directions powers to issue a corresponding direction to the regulated entity's authorised NOHC or other relevant holding companies.

3.43 In cases where a regulated entity is a subsidiary of an authorised NOHC, APRA's inability to issue a recapitalisation direction to the authorised NOHC or other relevant holding companies could significantly restrict the effectiveness of the recapitalisation direction power in facilitating the resolution of the regulated entity.

3.44 In particular, this becomes an issue where the direction would have the effect of requiring the regulated entity to seek additional capital from its holding company and these funds were unavailable at the holding company. The regulated entity's authorised NOHC, and any subsidiary of the authorised NOHC which is also a holding company of the regulated entity, would not be able to rely on the relevant provisions in the Industry Acts (including, for example the provisions overriding contracts and listing rules) to facilitate raising additional capital with which to recapitalise the regulated entity.

3.45 The Bill amends the Industry Acts to extend the definition of 'recapitalisation direction' to allow APRA to issue a recapitalisation direction to an authorised NOHC and any other intermediate holding company of the regulated entity. *[Schedule 1, item 9, Schedule 2, item 8, Schedule 3, item 98, subsection 5(1) of the Banking Act, subsection 3(1) of the Insurance Act, and the Schedule Dictionary of the Life Insurance Act]*

*Definitions – NOHC/NOHC subsidiary*

3.46 The Bill inserts a new definition of 'NOHC/NOHC subsidiary' in the Industry Acts to mean a body corporate that is any of the following:

- an authorised NOHC; or
- a subsidiary of an authorised NOHC. *[Schedule 1, item 7, Schedule 2, item 6, Schedule 3, item 97, subsection 5(1) of the Banking Act, subsection 3(1) of the Insurance Act, and the Schedule Dictionary of the Life Insurance Act]*

3.47 The Bill amends the Industry Acts to ensure that the recapitalisation provisions apply to the NOHC/NOHC subsidiary in the same way that it does for a regulated entity. *[Schedule 1, item 56, Schedule 2, item 92, Schedule 3, item 63, subsection 13D(3) of the Banking Act, subsection 103A(3) of the Insurance Act and 230AA(3) of the Life Insurance Act]*

3.48 The result of these amendments is that the prevailing sections governing valuation requirements, compliance and non-compliance, supply of information and exceptions to Part IV of the *Competition and Consumer Act 2010*, amongst other things, apply in respect of the new power to direct a NOHC/NOHC subsidiary to facilitate the recapitalisation of a regulated entity.

*Recapitalisation direction by APRA to a NOHC/NOHC subsidiary*

3.49 The precondition for issuing a recapitalisation direction to a NOHC/NOHC subsidiary is that APRA has firstly given a recapitalisation direction to a regulated entity, which is the ‘primary recapitalisation direction’.

3.50 For the purposes of facilitating compliance with the primary recapitalisation direction, APRA may then give the NOHC/NOHC subsidiary (or, if appropriate, several entities, for example a NOHC and a holding company of the ADI that is a subsidiary of the NOHC) a recapitalisation direction that requires it to do anything that is specified in the direction, provided that:

- the regulated entity to which the primary recapitalisation direction was given is a subsidiary of the NOHC/NOHC subsidiary; and
- the NOHC/NOHC subsidiary is registered as a company under the Corporations Act, and has share capital; and
- the business of the NOHC/NOHC subsidiary is not under the control of a statutory manager. [*Schedule 1, item 57, Schedule 2, item 94, Schedule 3, item 65, subsections 13E(1A) and 13E(1B) of the Banking Act, subsections 103B(1A) and 103B(1B) of the Insurance Act, and subsections 230AB(1A) and 230AB(1B) of the Life Insurance Act*]

*Additional contents of a recapitalisation direction*

3.51 The Bill amends the Industry Acts to facilitate down streaming of the capital raised by the NOHC/NOHC subsidiary to the regulated entity.

3.52 To achieve this, the recapitalisation direction may direct the NOHC/NOHC subsidiary to do any of the following:

- issue shares, or rights to acquire shares, in the NOHC/NOHC subsidiary, or other capital instruments in the NOHC/NOHC subsidiary of a kind specified in the direction; or

- acquire shares, or rights to acquire shares, in the regulated entity, or other capital instruments in the regulated entity of a kind specified in the direction; or
- acquire shares, or rights to acquire shares, in a NOHC/NOHC subsidiary which is its subsidiary and of which the regulated entity is a subsidiary, or other capital instruments in that body corporate of a kind specified in the direction. [*Schedule 1, item 59, Schedule 2, item 97, Schedule 3, item 68, subsection 13F(1A) of the Banking Act, subsection 103C(1A) of the Insurance Act, and subsection 230AC(1A) of the Life Insurance Act*]

### ***Harmonisation of recapitalisation directions powers with general directions powers***

3.53 The *Financial Sector Legislation Amendment (Prudential Refinements and Other Measures) Act 2010* empowered APRA to issue a recapitalisation direction to an ADI or insurer. However, certain provisions relating to general directions powers were not extended to recapitalisation directions powers, even though these provisions are equally relevant.

3.54 The Bill amends the Industry Acts to replicate existing subsections from the general directions powers in the recapitalisation directions powers, so that APRA is able to give a recapitalisation direction which can:

- deal with some or a particular class of matters;
- specify time for compliance;
- be varied by notice in writing if APRA considers that the variation is necessary and appropriate; and
- be later revoked if APRA considers that the direction is no longer necessary or appropriate. [*Schedule 1, items 58 and 59, Schedule 2, items 96 and 97, Schedule 3, items 67 and 68, subsections 13E(5)-(7) and 13F(1C) of the Banking Act, subsections 103B(4)-(6) and 103C(1C) of the Insurance Act, and subsections 230AB(4)-(6) and 230AC(1C) of the Life Insurance Act*]

## **Immunities**

### ***Protection from liability when complying with an APRA direction***

3.55 In recognition of the seriousness of situations in which directions may be given, the Industry Acts provide that non-compliance with a direction gives rise to criminal sanction. Consequently, directors and other officers of a regulated entity must take reasonable steps to ensure their entity complies with a direction.

3.56 The Corporations Act imposes certain duties and obligations on company directors and other officers, including being required to exercise their powers and discharge their duties in the best interests of the company and for a proper purpose.

3.57 In addition to directors' and officers' duties and liabilities under the Corporations Act, common law and equity, there may be other legislation that imposes both civil and criminal personal liability on company directors and officers for some actions of their companies. Some of these provisions may impose sanctions on a strict liability basis; others may deem a director liable for breaches by the company.

3.58 Given the range of duties imposed on directors and other officers, there is a risk (or at least perceived risk) that directors and other officers could be held liable for actions they take to ensure that regulated entities comply with directions from APRA. This could result in reluctance to comply with an APRA direction if there is a concern that, in doing so, they could potentially breach their duties, including those under the Corporations Act.

3.59 These potential conflicts of duty could cause delay in the implementation of an APRA direction, which could be particularly problematic in a stress scenario.

3.60 Section 70A of the Banking Act provides that a person is not subject to any liability to any person in respect of anything done, or omitted to be done, in good faith and without negligence in the exercise or performance, of powers, functions or duties under the Act. However, an officer's actions in complying with an APRA direction will often involve a choice of possible courses and as such may not necessarily constitute actions that are in the performance of duties or functions under the Act for the purposes of section 70A, and therefore may not provide clear protection from liability under the Corporations Act or other law. There is no equivalent provision of section 70A in the Insurance or Life Insurance Acts.



*Protection from liability*

3.61 The Bill amends the Industry Acts to provide protection from liability for directors and other officers (including senior managers) when complying with an APRA direction.

3.62 To benefit from protection, a ‘person’ is defined as any of the following:

- an officer or senior manager of the body corporate or its subsidiary, or of an authorised NOHC or its subsidiary, with ‘officer’ having the same meaning as in section 9 of the Corporations Act; or
- an employee or agent of the body corporate or its subsidiary, or of an authorised NOHC or its subsidiary, with ‘employee’ being further defined to include a person engaged to provide advice or services. [*Schedule 1, item 115, Schedule 2, item 118, Schedule 3, item 92, section 70AA of the Banking Act, section 127C of the Insurance Act, and section 246B of the Life Insurance Act*]

3.63 The amendments provide that any reasonable steps taken by such a person, acting in good faith, for the purpose of either complying with a direction (see 3.10), or the provisions related to the confidentiality of certain directions under the Industry Acts (see 3.82 to 3.87), will not expose that person to any civil or criminal liability. The ‘reasonableness’ standard applies to the course of action taken by the person to facilitate the direction.

3.64 The amendments also clarify that this immunity is not limited by, and does not itself limit, any of the other immunities in the Industry Acts, nor section 58 of the APRA Act. [*Schedule 1, item 115, Schedule 2, item 118, Schedule 3, item 92, section 70AB of the Banking Act, section 127D of the Insurance Act, and section 246C of the Life Insurance Act*]

***Harmonise the protection from liability provisions in the Industry Acts***

3.65 The Industry Acts currently provide protection from liability for certain persons when they exercise powers or discharge functions under the Acts. However, the provisions differ among the Acts in terms of scope and level of protection.

3.66 For example, as noted in paragraph 3.60, section 70A of the Banking Act provides protection from liability where a person acts in good faith and without negligence in the exercise of duties under the Act. These protections cover, for example, auditors who are under an obligation to provide information to APRA about the ADIs to which they have been appointed.

3.67 Under the Insurance and Life Insurance Acts there is no provision equivalent to section 70A of the Banking Act. However, section 49C of the Insurance Act does offer some protection for auditors and actuaries (where they act in good faith and without negligence), but it is limited to the provision of information to APRA.

3.68 Similarly, the Life Insurance Act protects auditors and actuaries in circumstances limited to the voluntary provision of information to APRA. Further, sections 89 and 99 of that Act protect auditors and actuaries by specifically providing for the conferral of qualified privilege (which is mainly relevant in a defamation context) in respect of statements made by them in certain circumstances.

3.69 As noted in paragraph 3.59, providing appropriate protection from liability for persons exercising powers or discharging functions under the Acts is important in ensuring that the relevant powers and functions are effective, particularly in a crisis situation where delays could be most problematic.

3.70 The Bill achieves the intent of harmonising the general liability provisions in the Industry Acts by replicating section 70A of the Banking in the Insurance and Life Insurance Acts with appropriate modifications. *[Schedule 2, item 118, Schedule 3, item 92, section 127B of the Insurance Act, and section 246A of the Life Insurance Act]*

3.71 As a result, the Bill repeals section 49C of the Insurance Act, and subsections 88A(2) and 98A(2) of the Life Insurance Act, respectively, as these specific immunities are rendered redundant by the introduction of a general immunity provision that provides broader protection for auditors and actuaries. *[Schedule 2, item 20, Schedule 3, items 15 and 17, section 49C of the Insurance Act, and subsections 88A(2) and 98A(2) of the Life Insurance Act]*

3.72 The amendments also clarify that these immunities are not limited by, and do not themselves limit, any of the other immunities in the Industry Acts, nor section 58 of the APRA Act. *[Schedule 2, item 118, Schedule 3, item 92, section 127D of the Insurance Act, and section 246C of the Life Insurance Act]*

### **Confidentiality of certain directions**

3.73 The Industry Acts currently purport to include a secrecy requirement in relation to directions through a reference to Part 6 of the APRA Act. For example, section 11CF of the Banking Act provides that '[i]nformation relating to directions and revocation of directions is subject to the secrecy requirements in Part 6 of the [APRA Act], unless the information has been published in the *Gazette*...'. This reference appears to be erroneous because it does not operate to impose any confidentiality obligations on regulated entities or their employees, officers or contractors. Part 6 of the APRA Act operates to impose secrecy

obligations upon APRA and its employees, who are bound by these provisions in any event without the need for such a cross-reference.

3.74 The Bill therefore repeals the following provisions:

- section 11CF, and subsections 13P(9), 29(9) and 31F(9) of the Banking Act;
- subsection 103L(9) and section 107 of the Insurance Act; and
- subsection 230AK(9) and section 230E of the Life Insurance Act;

to correct this error and instead introduce a new secrecy regime for regulated entities. [*Schedule 1, items 39, 69, 104 and 106, Schedule 2, items 107 and 116, Schedule 3, items 78 and 87, section 11CF, and subsections 13P(9), 29(9) and 31F(9) of the Banking Act, subsection 103L(9) and section 107 of the Insurance Act, and subsection 230AK(9) and section 230E of the Life Insurance Act*]

#### ***Application***

3.75 The secrecy provision applies if APRA has firstly given an entity (the ‘directed entity’) a direction under an Industry Act (see 3.10).

3.76 APRA may then make a determination that the direction is covered by the secrecy provision if APRA considers that such a determination is necessary to protect depositors/policyholders or to promote financial system stability in Australia.

3.77 This reflects the fact that in certain circumstances it may be appropriate to keep the giving of a direction confidential for a limited period in order to meet the aforementioned objectives. APRA may subsequently revoke the determination once it is no longer required.

3.78 As soon as practicable after making it, APRA must give the directed entity a copy of the determination.

3.79 The Bill provides that such determinations made by APRA are not legislative instruments. The provision is included to assist readers, as such a determination would not be a legislative instrument within the meaning of subsection 8(1) of the *Legislation Act 2003*. [*Schedule 1, item 40, Schedule 2, item 117, Schedule 3, item 88, section 11CH of the Banking Act, section 109 of the Insurance Act, and section 231 of the Life Insurance Act*]

3.80 APRA must also consider whether it is appropriate in the circumstances to make an additional determination to allow further disclosure within the regulated entity under the ‘Disclosure allowed by APRA’ exception ( see 3.90).

3.81 In the unlikely circumstances that a determination contains personal information, which may put the secrecy provision in potential conflict with the *Privacy Act 1988*, APRA would consider additional safeguards.

***Offence provision***

3.82 The Bill amends the Industry Acts to provide for a criminal offence, punishable by imprisonment for two years, if a ‘person’ discloses information and the information reveals the fact that the direction was made.

3.83 A ‘person’ is defined as either:

- the directed entity;
- an officer, employee or contractor of the directed entity at a time on or after APRA gave the direction to the directed entity; or
- any other person who in the course of their employment has acquired information that reveals the fact that the direction was made.

3.84 The offence provision applies if APRA has made a determination that the direction is covered by the secrecy provision (see 3.76). Fault liability applies to the offence, meaning that in order to commit the offence it must be shown that a fault (or mental) element exists for each physical element. In relation to this offence, the person must have intended to disclose information. They must also have been aware that a determination had been made in relation to that information or reckless as to that possibility.

3.85 However, the offence provision does not apply if:

- the disclosure is authorised by another section of the secrecy provision (detailed below); or
- the disclosure is required by an order or direction of a court or tribunal. [*Schedule 1, item 40, Schedule 2, item 117, Schedule 3, item 88, section 11CI of the Banking Act, section 109A of the Insurance Act, and section 231A of the Life Insurance Act*]

3.86 There is no exception to the offence for people bound by the secrecy provision who are authorised to disclose information under Commonwealth law. In order to avoid a potential conflict between different laws, a person covered by the secrecy provision may approach APRA to seek a variation of the determination.

3.87 For clarity, paragraph 14.1(2)(b) of the *Criminal Code Act 1995* (standard geographical jurisdiction) would capture regulated entities operating internationally within the scope of the secrecy provision to the extent that their disclosure of information overseas has an impact in Australia, such as by precipitating market concerns about the financial soundness of the entity.

***Authorised disclosure***

3.88 The Bill inserts various grounds into the Industry Acts to allow the disclosure of information that reveals the fact that a direction is covered by the secrecy provision was made, which are articulated below.

*Disclosure of publicly available information*

3.89 The Bill amends the Industry Acts to allow a person captured by the secrecy provision to disclose information that reveals the fact that the direction was made if the information has already been lawfully made available to the public. [*Schedule 1, item 40, Schedule 2, item 117, Schedule 3, item 88, section 11CJ in of the Banking Act, section 109B of the Insurance Act, and section 231B of the Life Insurance Act*]

*Disclosure allowed by APRA*

3.90 The Bill amends the Industry Acts to allow a person captured by the secrecy provision to disclose information that reveals the fact that the direction was made if APRA has made a determination allowing such disclosure.

3.91 In making such a determination, APRA can allow a specified person, in relation to a specified direction, or class of directions, to disclose specified information. As soon as practicable after making it, APRA must give the directed entity, and the specified person, a copy of the determination.

3.92 The Bill provides that such determinations made by APRA are not legislative instruments. The provision is included to assist readers, as such a determination would not be a legislative instrument within the meaning of subsection 8(1) of the *Legislation Act 2003*.

3.93 APRA may also make a determination, by legislative instrument, for a specified *class* of persons, to disclose specified information in relation to a direction or a specified class of directions.

3.94 In giving a determination to allow disclosure, APRA may include conditions relating to any of the following:

- the kind of entities to which the disclosure may be made;
- the way in which the disclosure is to be made; or

- any other matter that APRA considers appropriate. *[Schedule 1, item 40, Schedule 2, item 117, Schedule 3, item 88, section 11CK of the Banking Act, section 109C of the Insurance Act, and section 231C of the Life Insurance Act]*

*Disclosure to legal representative for purpose of seeking legal advice*

3.95 The Bill amends the Industry Acts to allow a person captured by the secrecy provision to disclose information that reveals the fact that the direction was made if:

- the disclosure is to the person's legal representative; and
- the purpose of disclosing such information is for the legal representative to provide legal advice, or another legal service, in relation to the direction. *[Schedule 1, item 40, Schedule 2, item 117, Schedule 3, item 88, section 11CL of the Banking Act, section 109D of the Insurance Act, and section 231D of the Life Insurance Act]*

*Disclosure allowed by APRA Act secrecy provision*

3.96 The Bill amends the Industry Acts to allow a person captured by the secrecy provision to disclose information that reveals the fact that the direction was made if:

- the person is an APRA member, an APRA staff member, or a Commonwealth officer within the meaning of the *Crimes Act 1914* who has received information about the direction in the course of their employment and is therefore an 'officer' within paragraph (c) of the definition of that term in section 56 of the APRA Act; and
- the information is protected information, or is contained in a protected document within the meaning of section 56 of the APRA Act (APRA's secrecy provision); and
- the disclosure is in accordance with subsections 56(3), (4), (5), (5AA), (6), (6A), (7), (7A), (7B) or (7C) of the APRA Act.

3.97 The Bill also clarifies that disclosure of information in relation to a direction is not an offence under section 56 of the APRA Act if the disclosure is authorised by a particular section under the secrecy provision. *[Schedule 1, item 40, Schedule 2, item 117, Schedule 3, item 88, section 11CM of the Banking Act, section 109E of the Insurance Act, and section 231E of the Life Insurance Act]*

*Disclosure in circumstances set out in the regulations*

3.98 The Bill inserts a regulations-making power into each of the Industry Acts to allow a person captured by the secrecy provision to disclose information if it is made in circumstances specified in the regulations. *[Schedule 1, item 40, Schedule 2, item 117, Schedule 3, item 88, section 11CN of the Banking Act, section 109F of the Insurance Act, and section 231F of the Life Insurance Act]*

*Disclosure for purpose*

3.99 The Bill amends the Industry Acts to allow a person covered by the secrecy provision to disclose information that reveals the fact that the direction was made if:

- another person covered by the regime disclosed that information in accordance with the allowable grounds; and
- the disclosure by the relevant person is for the same purpose. *[Schedule 1, item 40, Schedule 2, item 117, Schedule 3, item 88, section 11CP of the Banking Act, section 109G of the Insurance Act, and section 231G of the Life Insurance Act]*

3.100 As an example, this ground would allow disclosure by a solicitor who discloses to a barrister for the purposes of getting legal advice.

*Exceptions operate independently*

3.101 The Bill amends the Industry Acts to ensure that the grounds allowing disclosure under the secrecy provision do not limit each other. *[Schedule 1, item 40, Schedule 2, item 117, Schedule 3, item 88, section 11CQ of the Banking Act, section 109H of the Insurance Act, and section 231H of the Life Insurance Act]*

## Consequential amendments

*Directions to subsidiaries*

3.102 The Bill makes consequential amendments required because of the extension of the directions power to subsidiaries. *[Schedule 1, item 31, Schedule 2, item 111, Schedule 3, item 82, paragraph 11CA(1A)(b) of the Banking Act, paragraph 104(2)(b) of the Insurance Act and paragraph 230B(1A)(b) of the Life Insurance Act]*

3.103 Further consequential amendments are made to section 65 of the Banking Act to capture subsidiaries, with the result being that subsidiaries may also be directed to comply with the Banking Act. *[Schedule 1, items 231-236, subsections 65(1)-(4) of the Banking Act]*

*Recapitalisation directions power*

3.104 The Bill makes consequential amendments to the Industry Acts to capture a recapitalisation direction given to a NOHC/NOHC subsidiary. *[Schedule 1, items 60 and 61, Schedule 2, items 98 and 99, Schedule 3, items 69 and 70, subsections 13F(2) and 13F(3) of the Banking Act, subsections 103C(2) and 103C(3) of the Insurance Act, and subsections 230AC(2) and 230AC(3) of the Life Insurance Act]*

3.105 Further consequential amendments are made to the Industry Acts to ensure that references to depositors, policyholders and policy owners, respectively, are correct. *[Schedule 1, items 66 and 67, Schedule 2, items 104 and 105, Schedule 3, items 75 and 76, subsections 13H(1A) and 13H(4) of the Banking Act, subsections 103E(1A) and 103E(4) of the Insurance Act, and subsections 230AE(1A) and 230AE(4) of the Life Insurance Act]*



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## **Chapter 4**

### **Transfer powers**

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#### **Outline of chapter**

4.1 Schedule 4 to this Bill amends the Transfer Act to enhance the operation and scope of APRA's compulsory transfer powers.

#### **Context of amendments**

4.2 The Transfer Act (Part 4) provides for compulsory transfers of business between regulated entities. Following amendments to the Act in 2008 and 2010, the compulsory transfer of business provisions now extend to ADIs (and related parties of ADIs), general insurers, and life companies.

4.3 Compulsory transfer of business powers are an important tool in the package of resolution options available to APRA. The Transfer Act enables some or all of the business of a regulated entity (including assets, liabilities, legal rights and obligations, data and systems) to be transferred to another regulated entity in the same category, which could include transfers to a newly established bridge entity or asset management vehicle.

4.4 APRA may effect a compulsory transfer without the need for the approval of owners, shareholders, creditors, or the separate novation (by private contractual means) of liabilities. The power to implement transfers in this way could be used, in the course of resolution, to facilitate the sale of all or part of the business of a distressed entity to one or multiple buyers, depending on the situation. This may be particularly relevant in ensuring the continuity of an entity's critical functions in resolution, where part or all of the regulated business of a regulated entity might be transferred to another existing regulated entity or a newly established bridge entity for this purpose.

4.5 By international standards, the existing Transfer Act provides a comprehensive framework for compulsory transfers of business in resolution. However, there are certain areas in which the provisions could be enhanced to provide APRA with greater flexibility and certainty when arranging a compulsory transfer in a resolution.

4.6 For example, in some situations, rather than transferring all of the assets and liabilities comprising the business of a failed regulated entity, it would be more expedient for APRA to be able to transfer ownership of the shares in the entity. Allowing for this, as well as other proposed amendments to ensure compulsory transfer of business powers apply to certain related entities of a regulated entity, will further align the Transfer Act with international best practice. The Key Attributes note that resolution authorities should have at their disposal a broad range of resolution powers, including those necessary to effect transfers of business from a failed entity (and, in certain circumstances, its related entities), and the power to transfer the ownership of shares in a failed entity.

### Summary of new law

- 4.7 Schedule 4 to this Bill amends the Transfer Act to:
- enable APRA to compulsorily transfer the shares in a failing regulated entity to another body corporate;
  - widen the scope of Part 4 to apply to related entities of insurers; and
  - remove the requirement for complementary State or Territory legislation to be in place in relation to transfers of business.

### Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<i>Compulsory transfer of shares</i>	
In certain circumstances aligned with the preconditions for a compulsory transfer of business under the Transfer Act, APRA may transfer the shares in a failing regulated entity from the existing shareholders to a body corporate.	Under the Transfer Act, APRA has no power to transfer the shares in a failing regulated entity to another body corporate.
<i>Widening the scope to include related entities of insurers</i>	
In addition to what APRA may determine under the current law, APRA may determine that there is to be a total or partial transfer of business from a body corporate that is related to a general or life insurer (but is not itself an ADI, general insurer or life insurer) to another	Under the Transfer Act, APRA may determine that there is to be a total or partial transfer of business from a body corporate that is related to an ADI (but is not itself an ADI, general insurer or life insurer) to another body corporate under certain circumstances. There are no

body corporate under certain circumstances.	equivalent provisions in the Transfer Act in respect of a body corporate related to an insurer.
<i>Removing the requirement for complementary State or Territory legislation to be in place</i>	
APRA may give effect to transfers of business even in the absence of State or Territory legislation being in place to facilitate transfers of business.	For a transfer of business to occur, APRA must be satisfied that legislation to facilitate the transfer is in place in the State or Territory in which the transferring and receiving bodies are established.

## Detailed explanation of new law

### Compulsory transfer of shares

4.8 APRA's powers under the Transfer Act enable it to compulsorily transfer all of the assets and liabilities of a failing regulated entity to another regulated entity, however there is no explicit power to transfer the failing entity's shares to another body corporate as a means of achieving the same outcome. This is because shares in an entity are not assets of the failing entity but rather are assets of the shareholders. The interest of a shareholder in a share is not 'business' that is transferrable under the Transfer Act.

4.9 The ability to transfer the shares of a failing regulated entity could in some circumstances provide a more efficient and simpler means of achieving an orderly resolution, than effecting a full transfer of all of the assets and liabilities of the entity.

4.10 The amendments in the Bill rely to a large extent on the existing architecture and mechanics of the Transfer Act to enable a compulsory transfer of shares in certain circumstances, with the majority of amendments being minor consequential changes to existing definitions and supporting provisions, as articulated below.

#### ***Title***

4.11 The Bill amends the long title of the Transfer Act by inserting 'to provide for transfers of shares and other interests in some kinds of financial institutions'. [*Schedule 4, item 1, Title of the Transfer Act*]

4.12 The Bill also amends the short title of the Transfer Act, which may be cited as the *Financial Sector (Transfer and Restructure) Act 1999*. [*Schedule 4, item 2, section 1 of the Transfer Act*]

4.13 These amendments reflect the expanded operation of the Act, which now provides for compulsory transfers of shares.

### ***Definitions***

4.14 The Bill amends a variety of definitions under subsection 4(1) of the Transfer Act to enable a compulsory transfer of shares.

4.15 Firstly, the Bill amends subparagraph (b), and includes a new subparagraph (c), in the definition of ‘certificate of transfer’ to mean the following, respectively:

- in relation to a compulsory transfer of business – a certificate issued under section 33; and
- in relation to a compulsory transfer of shares – a certificate issued under section 33. [*Schedule 4, item 3, subsection 4(1) of the Transfer Act*]

4.16 The Bill amends the definitions of ‘partial transfer’ and ‘total transfer’, to mean, respectively:

- a partial transfer means a transfer a business described in subsection 8(2); and
- a total transfer means a transfer of business described in subsection 8(3). [*Schedule 4, items 6 and 12, subsection 4(1) of the Transfer Act*]

4.17 The Bill amends the definition of ‘compulsory transfer determination’, to mean:

- a compulsory transfer of business determination; or
- a compulsory transfer of shares determination.

4.18 The Bill further defines these two new terms as:

- ‘compulsory transfer of business determination’ means a determination under section 25; and
- ‘compulsory transfer of shares determination’ means a determination under section 25AA. [*Schedule 4, items 4 and 5, subsection 4(1) of the Transfer Act*]

4.19 These amendments clarify that there are now two potential options available to APRA under which to determine a compulsory transfer.

4.20 The Bill expands the definition of ‘receiving body’ to clarify that in relation to a transfer of shares under Part 4, the receiving body is a body corporate to which shares in another body corporate are to be transferred, or have been transferred under that Part. [*Schedule 4, item 7, subsection 4(1) of the Transfer Act*]

4.21 This amendment is to differentiate a receiving body in the context of the two different types of compulsory transfers.

4.22 The Bill also expands the definition of ‘transferring body’ to clarify that in relation to a transfer of shares under Part 4, the transferring body is a body corporate, shares in which are to be transferred, or have been transferred, to another body corporate under that Part’. *[Schedule 4, item 13, subsection 4(1) of the Transfer Act]*

4.23 This amendment is to ensure that the existing architecture and mechanics of the Transfer Act can apply in the context of a share transfer. Although, it is recognised that in the case of a transfer of shares, the actual transfer of ownership will be from the holders of the shares, not from the body corporate itself.

4.24 Separately, the Bill extends the definition of ‘regulated body’ to include a general insurer, and subsequently extends the definition of ‘regulated business’ to include a general insurer’s business (within the meaning of the Insurance Act). *[Schedule 4, items 8 and 9, subsection 4(1) of the Transfer Act]*

4.25 These amendments correct technical errors in the Transfer Act, which did not previously include a general insurer in the definitions, despite the compulsory transfer provisions applying equally to general insurers as a result of amendments to the Act in 2010. They will not bring general insurers within the voluntary transfer of business provisions in Part 3 of the Transfer Act.

4.26 The Bill extends the meaning of ‘share’ to mean:

- a legal or equitable right or interest in a share; and
- an interest in a share that is an interest of a kind specified in the regulations. *[Schedule 4, item 76, section 36AD of the Transfer Act]*

4.27 The adoption of a broad definition for ‘share’, including the ability to specify additional interests in regulations, ensures that the powers in the Transfer Act can operate to transfer all relevant ownership interests in the shares of the regulated entity.

#### ***Substantive transfer of shares amendments***

4.28 The Bill amends the overview provisions under section 8 of the Transfer Act to include a transfer of shares as a kind of transfer that is permitted under the Act. This is achieved by inserting a new subsection noting that the Act also provides for compulsory transfers of shares in regulated entities. *[Schedule 4, item 18, subsection 8(1A) of the Transfer Act]*

4.29 For a compulsory transfer of shares to take effect, APRA must:

- make a determination (the compulsory transfer of shares determination) that there is to be a transfer of shares in a body (the transferring body) to another body corporate (the receiving body) under section 25AA of the Act; and
- issue a certificate (the certificate of transfer) stating that the transfer is to take effect under section 33 of the Act.

4.30 For clarity, the transfer of shares takes effect when the certificate of transfer comes into force. [*Schedule 4, item 21, subsection 8(5A) of the Transfer Act*].

4.31 Separately, the Bill inserts notes into the Transfer Act to clarify that regulated entities making applications under the voluntary provisions in Part 3 cannot be general insurers. [*Schedule 4, items 19 and 22, subsections 8(4) and 9(1) of the Transfer Act*]

4.32 This is because the Insurance Act instead provides the mechanism for facilitating a voluntary transfer of a general insurer's business.

#### ***Preconditions for a transfer of shares***

4.33 The Bill amends the Transfer Act to specify the existing preconditions under the Act that must be satisfied for a compulsory transfer of shares to be determined.

4.34 APRA may only make a compulsory transfer of shares determination if any of the following preconditions are met:

- for an ADI, either the Minister has declared under section 25A that a transfer of shares should occur, or APRA is satisfied that any of the existing conditions in subparagraphs 25(1)(a)(i),(ii),(iii), (iv) or (v) have been satisfied;
- for a life insurance company, APRA is satisfied that any of the existing conditions in subparagraphs 25(1C)(a)(i),(ii),(iii) or the new (iv) have been satisfied; or
- for a general insurer, APRA is satisfied that any of the existing conditions in subparagraphs 25(1E)(a)(i),(ii),(iii) or the new (iv) have been satisfied; and
- APRA has considered the interests of depositors or policy owners (as applicable) of the transferring body (when viewed as a group) and considers that, having regard to their interests, it would be appropriate for the transfer to be made; and

- if the receiving body is an ADI, life company or general insurer, APRA is satisfied that the transfer is appropriate, having regard to the interests of depositors or policy owners of the receiving body (as applicable) when viewed as a group; and
- the conditions in subsection (4) exist. These conditions relate to the consent of the receiving body, the interests of the financial system as a whole and other relevant matters, and the consent of the Minister (or a decision by the Minister that their consent is not required).

4.35 The amendments provide that APRA cannot make a compulsory transfer of shares determination if the transferring body is any of the following:

- a foreign ADI (has the same meaning as in the Banking Act);
- a foreign general insurer (has the same meaning as in the Insurance Act); or
- an eligible foreign life insurance company (has the same meaning as in the Life Insurance Act).

4.36 APRA, in making a determination, must include particulars of the transfer, including the names of the transferring body and the receiving body, as well as a statement of the reasons detailing why the determination has been made.

4.37 The Bill provides that such determinations made by APRA are not legislative instruments. The provision is included to assist readers, as such a determination would not be a legislative instrument within the meaning of subsection 8(1) of the *Legislation Act 2003*. [*Schedule 4, item 53, section 25AA of the Transfer Act*]

#### ***Ministerial declaration***

4.38 The Bill extends the scope of section 25A in the Transfer Act to allow the Minister to also declare that a compulsory transfer of shares in a specified ADI to another specified body corporate can occur.

4.39 The Bill provides that such declarations made by the Minister are not legislative instruments. The provision is included to assist readers, as such a determination would not be a legislative instrument within the meaning of subsection 8(1) of the *Legislation Act 2003*. [*Schedule 4, item 54, section 25A of the Transfer Act*]

4.40 The Bill extends the scope of section 29 in the Transfer Act to also provide that a Minister's consent to a compulsory transfer of shares under paragraph 25AA(4)(g) is not required if the Minister has determined

prior that his or her consent is not required in relation to the transfer.  
*[Schedule 4, items 59 and 60, subsection 29(1) of the Transfer Act]*

4.41 The Bill further clarifies the status of determinations made under subsection 29(1) to bring consistency and certainty to the legislation. As a result, for a determination dealing with the consent for a particular transfer, the Bill clarifies that this is not a legislative instrument. Alternatively, for a determination that consent is not required in relation to a class of transfers, the Bill clarifies that this is a legislative instrument.  
*[Schedule 4, item 61, subsections 29(2) and 29(3) of the Transfer Act]*

#### ***Content of a compulsory transfer of shares determination***

##### *Agreements about matters connected with the transfer*

4.42 The Bill extends the scope of section 30 in the Transfer Act to also include a compulsory transfer of shares. In this instance, the transferring and receiving bodies may provide APRA with a written statement specifying a mechanism for determining things that are to happen, or that are to be taken to happen, in relation to a transfer of shares. *[Schedule 4, item 62, subsection 30(1) of the Transfer Act]*

4.43 This mechanism, read in conjunction with subsection 35(3) of the Transfer Act, can be used to ensure that legal and practical issues arising from the transfer of shares are dealt with, resolved or satisfied, or this is taken to the case. This might be relevant, for example, where registration requirements need to be addressed following a transfer of shares.

##### *Certificate of transfer*

4.44 The Bill extends the scope of section 33 in the Transfer Act to also include a compulsory transfer of shares, so that APRA can rely on the existing machinery to specify provisions within the certificate of transfer to help facilitate a transfer of shares. *[Schedule 4, item 70, subsection 33(3) of the Transfer Act]*

4.45 This amendment affords APRA flexibility to include provisions specifying, or specifying a mechanism for determining, things that are to happen, or that are taken to be the case, in relation to shares that are to be transferred, or in relation to the transfer of shares that is to be effected.

#### ***Process for a compulsory transfer of shares determination***

4.46 The Bill amends the Transfer Act to specify the timing and effect once a compulsory transfer of shares has been determined.

4.47 In this instance, when the certificate of transfer comes into force, the receiving body becomes the successor in law of the persons that held shares in the transferring body just before the certificate of transfer comes into force, to the extent of the transfer.



4.48 As a result, all the shares in the transferring body, wherever those shares are located, become (respectively) shares held by the receiving body without any transfer, conveyance or assignment, and free from any trust, liability or other encumbrance. *[Schedule 4, item 73, section 35A of the Transfer Act]*

#### ***Ancillary provisions***

##### *Regulations*

4.49 The Bill inserts a regulations-making power in the Transfer Act to allow special provisions to be made in regard to a compulsory transfer of shares. As such, the regulations may provide in relation to any of the following matters:

- the payment by the receiving body to the holder of shares in the transferring body of a purchase price for those shares;
- the resolution of disputes between the receiving body and the holder of shares in the transferring body (including the resolution of such disputes by an administrative tribunal or a court);
- the publication of information relating to the compulsory transfer of shares by APRA, the transferring body and the receiving body;
- the freeing of shares in the transferring body from any trust, liability or other encumbrance when they become shares held by the receiving body; and
- any matter incidental to the compulsory transfer of shares, or proposed compulsory transfer of shares, or any of the other matters mentioned in this subsection. *[Schedule 4, item 76, subsection 36AE(1) of the Transfer Act]*

4.50 A broad regulations-making power will allow further matters to be provided for in relation to transfers of shares. This is particularly important to address issues that may arise subsequently to the transfer, such as to provide appropriate mechanisms to ensure that any proceeds received from the receiving body can be passed on to the holders of shares.

4.51 For clarity, the regulations may provide that some or all of the provisions of the Transfer Act apply with the modifications specified in the regulations. Further, nothing in this subsection limits the operation of those provisions. *[Schedule 4, item 76, subsection 36AE(3) of the Transfer Act]*

4.52 This amendment provides that regulations can be made on any of these issues in relation to a transfer of shares, but it does not limit the matters that can be dealt with via other instruments made under the Act, such as an approved section 30 statement or certificates of transfer.

4.53 The intention is that most of the machinery relating to the transfer of shares will be adequately dealt with in the new provisions set out above, the regulations and the capacity to approve section 30 statements and determine matters in the certificate of transfer under subsection 33(3).

4.54 However, there may be unforeseen situations where an existing provision of the Transfer Act requires modification for it to properly apply to a transfer of shares, given the Transfer Act was originally drafted to only deal with transfers of assets, and shares are subject to a range of legislative and practical requirements outside the Transfer Act.

4.55 This power to apply other provisions of the Transfer Act, subject to modifications, would be available to address situations where a general provision of the Transfer Act may assist in the facilitation of the transfer of shares but due to its language of focus does not deal with share transfers in a manner that is consistent with commercial practice and legal requirements applying to share transfers.

#### *Information sharing*

4.56 The Bill extends the scope of section 42 in the Transfer Act to allow APRA to provide information (including personal or confidential commercial information) to the receiving body in connection with:

- the transferred shares; and
- the business of the transferring body. [*Schedule 4, item 78, paragraph 42(b) of the Transfer Act*]

4.57 For clarity, information about the business of the transferring body would be covered by the secrecy provision under section 56 of the APRA Act, so this amendment would allow APRA to share information with the receiving body without breaching the secrecy provision.

### **Widening the scope to include related entities of insurers**

4.58 Currently, under subsection 25(1B) of the Transfer Act, APRA may determine that there is to be a total or partial compulsory transfer of business from a body corporate related to an ADI, which is not itself an ADI, general or life insurer, to another body corporate in certain circumstances.

4.59 This may be necessary, for example, where an ADI's assets and liabilities are being transferred under the Transfer Act as part of a

resolution, and a related entity of the ADI provides critical intra-group services essential to the ADI's continued operation. The same rationale applies to insurers but there is no equivalent to subsection 25(1B) in respect of a body corporate related to an insurer.

4.60 The Bill amends the Transfer Act to enable APRA to make a determination concerning a transfer from a body corporate related to an insurer to another body. *[Schedule 4, items 45 and 50, subsections 25(1DA) and 25(1G) of the Transfer Act]*

4.61 The Bill also amends existing subsections 25(1D) and 25(1F) in the Transfer Act by omitting 'only the business' and substituting 'only business'. *[Schedule 4, items 43 and 48, subsections 25(1D) and 25(1F) of the Transfer Act]*

4.62 Accordingly, instead of reading 'APRA may make a written determination that there is to be a transfer of *only the business* that is not regulated business from [an insurer] to a body corporate that is not [an insurer]' these subsections will provide 'APRA may make a written determination that there is to be a transfer of *only business* that is not regulated business from [an insurer] to a body corporate that is not [an insurer]'.

4.63 These amendments clarify that a transfer of unregulated business of a regulated entity to a non-regulated entity does not have to be a transfer of all the unregulated business of the transferor.

### **Removing the requirement for complementary State or Territory legislation to be in place**

4.64 To give effect to transfers of business, the Transfer Act currently imposes the precondition that APRA be satisfied that legislation to facilitate the transfer must be in place in the State or Territory in which the transferring and receiving bodies are established.

4.65 A number of other Commonwealth transfer regimes, for instance those under the Insurance and Life Insurance Acts, do not impose preconditions of this nature. Although this is a matter which APRA and other relevant bodies would expect to address in the ordinary course, the absence of such State or Territory legislation would not prevent APRA from making a transfer of business under the Transfer Act.

4.66 The Bill therefore amends the Transfer Act so that APRA may make a voluntary or compulsory transfer determination, even in the absence of relevant State or Territory legislation. *[Schedule 4, items 27, 28, 29, 30, 51, 52, 57 and 58, paragraph 11(1)(d), subsection 11(1A), section 14, paragraph 25(2)(f), subsection 25(2A), and section 28 of the Transfer Act]*

## **Consequential amendments**

### **Compulsory transfer of shares**

4.67 The Bill makes consequential amendments to the Transfer Act to update references in multiple provisions to reflect the addition of a compulsory transfer of shares, and to help differentiate between the two different types of compulsory transfer available under the Act. *[Schedule 4, items 15, 16, 17, 20, 31, 33, 34, 35, 36, 37, 55, 56, 63, 64, 65, 66, 67, 68, 69, 77, 79, 80, and 81, paragraph 8(1)(a), paragraph 8(1)(b), subsection 8(1), subsection 8(5), paragraph 24(1)(a), subsections 24(2)-(5), section 26, subsection 27(1), subsection 31(1), paragraph 31(1)(a), paragraph 31(1)(b), section 32, paragraph 33(1)(c), paragraph 33(2)(b), paragraph 33(2)(c), paragraphs 37(1)(c),(d),(e) subsection 43(4), subsection 43(9), and paragraph 43(9A)(a) of the Transfer Act]*

4.68 The Bill makes consequential amendments to the *Income Tax Assessment Act 1997*, Insurance Act, Life Insurance Act and PSN Act to update references to reflect the new short title of the Transfer Act. *[Schedule 7, items 4, 5, 6 and 7, Schedule 2, item 51, Schedule 3, items 44 and 58, Schedule 5, item 2, paragraphs 202-47(1)(a), 325-305(a), 615-35(a), 703-37(4)(a), section 320-300 and subsection 703-37(1) of the Income Tax Assessment Act 1997, paragraph 62ZI(2)(aa) of the Insurance Act, paragraph 175(2)(aa) and subsection 190(5) of the Life Insurance Act, and section 5 of the PSN Act]*

4.69 The Bill makes consequential amendments to the Insurance and Life Insurance Acts to include a compulsory transfer of shares as a possible course of action that a judicial manager can recommend in its report. *[Schedule 2, item 52, Schedule 3, item 45, paragraph 62ZI(2)(ab) of the Insurance Act, and paragraph 175(2)(ab) of the Life Insurance Act]*

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## **Chapter 5**

# **Conversion and write-off of capital instruments**

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### **Outline of chapter**

5.1 Schedules 1-3 and 7 to this Bill amend the Industry Acts and the Corporations Act to provide certainty that capital instruments can be converted or written off as provided for in APRA's prudential standards.

### **Context of amendments**

5.2 APRA's prudential standards require regulated entities to maintain minimum levels of regulatory capital. The prudential standards currently establish three categories of regulatory capital – 'Common Equity Tier 1' (CET1), 'Additional Tier 1' (AT1), and 'Tier 2' (T2) capital. AT1 and T2 capital instruments comprise securities (preference shares and subordinated notes, for example) that satisfy the eligibility criteria for AT1 and T2 capital set out in APRA's prudential standards.

5.3 In relation to AT1 and T2 capital, the prudential standards include particular requirements on the capacity of an instrument to 'absorb' losses experienced by a regulated entity through the conversion or write-off of these instruments in certain circumstances.

5.4 Under APRA's current prudential standards, the terms of AT1 and T2 instruments must provide that they absorb losses in the event of a 'non-viability trigger event'.<sup>3</sup>

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<sup>3</sup> Non-viability trigger events are described in Prudential Standard APS 111 Capital Adequacy – Measurement of Capital, Prudential Standard GPS 112 Capital Adequacy – Measurement of Capital, and Prudential Standard LPS 112 Capital Adequacy – Measurement of Capital. For example, for a capital instrument issued by an ADI incorporated in Australia, a non-viability trigger event is:

- (a) the issuance of a notice in writing by APRA to the ADI that conversion or write-off of capital instruments is necessary because, without it, APRA considers that the regulated entity would become non-viable; or
- (b) a determination by APRA, notified to the regulated entity in writing, that without a public sector injection of capital, or equivalent support, the regulated entity would become non-viable.

5.5 Further, in order for AT1 instruments that are accounted for as liabilities to be considered as regulatory capital of an ADI, they must also convert or be written off where the ADI holds CET1 capital equal to or less than 5.125% of its risk weighted assets (as calculated using the relevant capital requirements set by APRA's prudential standards).

5.6 APRA's prudential framework provides for two mechanisms by which AT1 and T2 capital instruments may absorb losses: conversion of those instruments into ordinary shares (or equivalent for mutually-owned ADIs); or the write-off of the instruments.

5.7 While such provisions in AT1 and T2 capital instruments are expected to function in accordance with their terms, APRA and market participants have identified some potential legal impediments to the effective operation of conversion or write-off provisions in AT1 and T2 capital instruments in certain circumstances.

5.8 It is important that contractual conversion and write-off provisions in AT1 and T2 capital instruments operate as intended in the event that the circumstances of a regulated entity meet the relevant conditions.

5.9 In June 2014, the Treasury released a consultation paper on proposals to make certain the effective operation of contractual loss absorption provisions in regulatory capital instruments. The amendments described in this chapter follow from that consultation.

5.10 The amendments are applied to capital instruments other than those issued as AT1 or T2 capital to provide flexibility in the event of future changes to the regulatory capital framework. In order for the amendments to apply, any such instrument will need to be issued with terms included for the purposes of conversion and write-off provisions in APRA's prudential standards at the time.

## **Summary of new law**

5.11 The Bill amends the Industry Acts to provide increased certainty in relation to the conversion and write-off of capital instruments, including amendments to provide that:

- conversion or write-off can happen despite any impediment there may be in:
  - any domestic or foreign law (other than, for conversion, any laws specified in the amendments or regulations made for that purpose, including laws applying to holdings in companies under Chapter 6 of the Corporations Act or under the *Financial Sector (Shareholdings) Act 1998*);

- the constitution of the entity that has issued the instrument and, for conversion, the constitution of the entity into whose shares the instrument converts (if different);
  - any contract or arrangement to which the issuing entity is a party and, for conversion, to which the entity into whose shares the instrument converts (if different) is a party; and
  - any listing rules of a financial market in whose official list the issuing entity and, for conversion, any listing rules of a financial market in whose official list any conversion entity is included; the entity into whose shares the instrument converts (if different), is included.
- a stay provision applies to contractual close-out rights that may arise as a result of the conversion or write-off of a capital instrument or the occurrence of an event (such as the making of a determination by APRA) that results in a requirement for the conversion or write-off of a capital instrument.

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
It is clarified that the terms of capital instruments that provide for the instrument to absorb losses by converting or being written off are effective despite potential legal impediments.	In some situations it is unclear that certain capital instruments will absorb losses – either by conversion or write off – due to potential legal impediments.

## Detailed explanation of new law

### Conversion and write-off of capital instruments

#### *Definitions*

5.12 The Bill amends the Industry Acts to incorporate several new definitions for the purpose of the amendments to provide certainty for the conversion and write-off of capital instruments.

5.13 The new term ‘conversion and write-off provisions’ refers to the provisions in APRA’s prudential standards that require certain capital instruments to be converted into ordinary shares or mutual equity interests, or to be written off, in certain circumstances described in the

prudential standards. *[Schedule 1, item 27, Schedule 2, item 19, Schedule 3, item 61, section 11CAA of the Banking Act, section 36A of the Insurance Act, and section 230AAB of the Life Insurance Act]*

5.14 Presently, the provisions in the prudential standards that set these requirements are referred to as the ‘loss absorption requirements’ and requirements for ‘loss absorption at the point of non-viability’.<sup>4</sup> The concept of ‘conversion and write-off provisions’ is intended to refer to these, while also leaving room for future changes to APRA’s prudential standards, including changes that might refer to instruments that are not currently considered capital under the prudential standards.

5.15 The new term ‘converts’ describes any process by which capital instruments may be converted into ordinary shares or mutual equity interests. This term is broadly defined in order to accommodate current and future contractual approaches to how instruments are converted into ordinary shares or mutual equity interests. *[Schedule 1, item 27, Schedule 2, item 19, Schedule 3, item 61, section 11CAA of the Banking Act, section 36A of the Insurance Act, and section 230AAB of the Life Insurance Act]*

5.16 The new term ‘conversion entity’ is relevant in circumstances where a capital instrument includes terms that provide for it to convert into ordinary shares of a different entity. Where such a conversion takes place, the capital instrument of the issuing entity converts into ordinary shares or mutual equity interests of the conversion entity. *[Schedule 1, item 27, Schedule 2, item 19, Schedule 3, item 61, section 11CAA of the Banking Act, section 36A of the Insurance Act, and section 230AAB of the Life Insurance Act]*

5.17 The new term ‘mutual equity interests’ is incorporated into the Banking Act conversion and write-off provisions, and refers to such interests as defined in APRA’s prudential standards. This term is relevant to circumstances where a capital instrument has been issued by a mutually-owned ADI, or by an entity described in subsection 11CAB(1) with respect to a mutually-owned ADI. *[Schedule 1, item 27, section 11CAA of the Banking Act]*

5.18 The term ‘related subsidiary’ refers to a subsidiary of a holding company of a regulated entity. Note that ‘holding company’ is now defined in the Industry Acts (see Chapter 10). This term is used to provide for circumstances where a related subsidiary issues capital instruments that count as regulatory capital for a conversion entity. The amendments provide certainty that those instruments will absorb losses despite potential legal impediments. *[Schedule 1, item 27, Schedule 2, item 19,*

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<sup>4</sup> See for example Prudential Standard APS 111 Capital Adequacy – Measurement of Capital, Attachments F and J.



***Schedule 3, item 61, section 11CAA of the Banking Act, section 36A of the Insurance Act, and section 230AAB of the Life Insurance Act]***

5.19 The term ‘specified law’ is used in paragraph 11CAB(2)(a), which provides that an instrument may be converted despite any law ‘other than a specified law’. The term refers to the following:

- the Financial Sector (Shareholdings) Act 1998;
- the Foreign Acquisitions and Takeovers Act 1975;
- Chapter 6 of the *Corporations Act 2001* (takeovers);

5.20 The amendments provide that conversion of regulatory capital instruments is effective despite any law except those that are specified laws. The specified laws in the Acts listed at 5.19 are still intended to apply to the conversion of a regulatory capital instrument. The same would apply in respect of any law prescribed in the regulations for this section.

5.21 The Bill also amends the Industry Acts to define the terms ‘financial market’ and ‘listing rules’ according to their definition in section 761A of the Corporations Act. ***[Schedule 1, item 6, Schedule 2, item 5, Schedule 3, item 97, section 5(1) of the Banking Act, section 3(1) of the Insurance Act, and Schedule Dictionary of the Life Insurance Act]***

***Scope of instruments to which these amendments apply***

5.22 The Bill amends the Industry Acts to describe the scope of instruments to which the amendments apply.

5.23 The amendments apply to instruments that include terms for the purposes of the conversion or write-off provisions in the prudential standards. ***[Schedule 1, item 27, Schedule 2, item 19, Schedule 3, item 61, subsection 11CAB(1) of the Banking Act, subsection 36B(1) of the Insurance Act, and subsection 230AAC(1) of the Life Insurance Act]***

5.24 The amendments apply to such instruments that are issued by:

- a regulated entity;
- a holding company of a regulated entity;
- a subsidiary or a related subsidiary of a regulated entity (see 5.18 for the definition of a related subsidiary); or
- an entity prescribed by the regulations for the purposes of these amendments. ***[Schedule 1, item 27, Schedule 2, item 19, Schedule 3, item 61, subsection 11CAB(1) of the Banking Act, subsection 36B(1) of the Insurance Act, and subsection 230AAC(1) of the Life Insurance Act]***

5.25 The amendments include a regulation-making power to prescribe other kinds of entities that might issue capital instruments that include terms for conversion or write-off. This is intended to allow flexibility to accommodate potential future capital raising structures.

5.26 Where a regulated entity is a subsidiary of one or more holding companies, the amendments are intended to cover any instrument issued to the market by a holding company, and corresponding intra-group instruments issued by the regulated entity or any intermediate holding company, in order to meet the regulatory capital requirements of the regulated entity. In this case, all of those instruments will be able to convert in accordance with their terms despite the potential legal impediments listed at 5.27.

***Conversion despite other laws etc.***

5.27 The Bill amends the Industry Acts to ensure that in-scope instruments can be converted according to their terms despite any impediments there may be in:

- any domestic or foreign laws, except for those specified in the amendments and any regulations made for this purpose;
- the constitution of the entity that has issued the instrument or any conversion entity for the instrument;
- any contract or arrangement to which the issuing entity, or any conversion entity for the instrument, is a party; and
- any listing rules of a financial market in whose official list the issuing entity, or any conversion entity for the instrument, is included. [*Schedule 1, item 27, Schedule 2, item 19, Schedule 3, item 61, subsection 11CAB(2) of the Banking Act, subsection 36B(2) of the Insurance Act, and subsection 230AAC(2) of the Life Insurance Act*]

***Write off despite other laws etc.***

5.28 The Bill amends the Industry Acts to ensure that in-scope instruments can be written off according to their terms despite any impediments there may be in:

- any domestic or foreign law;
- the constitution of the entity that has issued the instrument;
- any contract or arrangement to which the issuing entity is a party; and

- any listing rules of a financial market in whose official list the issuing entity is included. *[Schedule 1, item 27, Schedule 2, item 19, Schedule 3, item 61, subsection 11CAB(2) of the Banking Act, subsection 36B(2) of the Insurance Act, and section 230AAC(2) of the Life Insurance Act]*

## Consequential amendments

### *Definitions of ‘financial market’ and ‘listing rules’*

5.29 As the terms ‘financial market’ and ‘listing rules’ are now defined terms in the Industry Acts (see 5.21), consequential amendments to remove duplicate references have been made to the following:

- paragraphs 13G(3)(d), 14A(5B)(d), and 14AA(4)(d) of the Banking Act; *[Schedule 1, items 65, 72 and 75, paragraphs 13G(3)(d), 14A(5B)(d), and 14AA(4)(d) of the Banking Act]*
- paragraph 62Z(4)(d), subparagraph 62ZJ(3)(b)(iv), and paragraph 103D(3)(d) of the Insurance Act; *[Schedule 2, items 48, 54 and 103, paragraph 62Z(4)(d), subparagraph 62ZJ(3)(b)(iv), and paragraph 103D(3)(d) of the Insurance Act]* and
- paragraph 168A(4)(d), subparagraph 176(3)(b)(iv), and paragraph 230AD(3)(d) of the Life Insurance Act. *[Schedule 3, items 41, 47 and 74, sections 168A(4)(d), 176(3)(b)(iv), and 230AD(3)(d) of the Life Insurance Act]*

### *New notes in the Corporations Act*

5.30 The Bill amends certain sections of the Corporations Act to include a new note in each of the sections confirming the effect of the amendments. *[Schedule 7, items 1-3, sections 256B(1), 437F(8), and 468A(8) of the Corporations Act]*

5.31 The note explains that reductions in share capital (in subsection 256B of the Corporations Act), or alterations in the status of members of a company made during either the administration of the company or after the commencement of winding up by the Court (in subsections 437F(8) and 468A(8) of the Corporations Act, respectively), are effective despite these sections if they result from an instrument being converted or written off for the purposes of the conversion and write-off provisions.

5.32 The inclusion of these notes in certain sections of the Corporations Act is only for the purpose of clarifying the effect of conversion and write-off of non-equity capital instruments only and is not intended to limit the application of the amendments more widely.



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## **Chapter 6**

### **Stays**

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#### **Outline of chapter**

6.1 Schedules 1 to 5 to this Bill enhance the stay provisions in the Industry Acts and Transfer Act, and makes consequential amendments to the PSN Act.

#### **Context of amendments**

6.2 An important aspect of Australia's resolution regime for ADIs and insurers is the operation of the stay provisions located in the various Industry Acts and the Transfer Act. In general, the existing provisions prevent counterparties from:

- denying an obligation;
- accelerating a debt;
- closing-out any transaction; or
- enforcing a security,

under a contract with a regulated entity, where the basis for taking such action is that APRA has exercised a specified regulatory power in relation to that entity (e.g. a general directions power, a direction to recapitalise an ADI or insurer, appointment of statutory or judicial manager or a compulsory transfer of business power). The stay provisions are important in ensuring that pre-emptive actions by counterparties do not impede the ability for APRA to implement an orderly resolution of a regulated entity.

6.3 The existing stay provisions do not, however, apply to contracts entered into by companies related to the entity to which the power is applied (e.g. an authorised NOHC or a subsidiary of an authorised NOHC or subsidiary of an ADI/insurer). This omission gives rise to the possibility that a power exercised by APRA in relation to an entity could trigger termination rights (or other legal rights) in contracts entered into by companies related to that entity.

6.4 The triggering of termination rights under contracts of other group entities could have material, adverse effect on a financial group and

on APRA's ability to implement an orderly resolution of the regulated entity. This may particularly be the case where the related company in question provides essential services to an ADI, insurer or group, and relies on contractual arrangements with third parties to perform those services. More broadly, the exercise of termination rights in any contract entered into by a member of a financial group could significantly undermine confidence in APRA's efforts to stabilise a distressed regulated entity.

6.5 Extending the relevant stay provisions to address the issues above is consistent with the expanded scope of APRA's powers pursuant to the other amendments in the Bill.

6.6 A further important element of the resolution regime is the interaction of the stay provisions with the PSN Act. The PSN Act overrides a range of laws in order to ensure the validity of certain provisions relating to netting and the payments systems covered by the PSN Act. Consequential amendments are made to the PSN Act to take into account the enhancements to the stay provisions, the moratorium provisions for statutory and judicial management, and the extension of certain powers to group entities. This is intended to ensure that current protections under the PSN Act are retained and the rights of counterparties to close-out netting contracts are clear.

## **Summary of new law**

1.54 Schedules 1 to 5 to this Bill amend the Industry Acts and Transfer Act to enhance the stay provisions, and makes consequential amendments to the PSN Act, including amendments to:

- ensure that an exercise of a power in relation to an entity does not give rise to termination rights or other rights (that is, denying an obligation, accelerating a debt, closing-out on a transaction, or enforcing a security) in contracts of entities within the same group;
- ensure that the current protections afforded to counterparties to certain close-out netting contracts under the PSN Act are retained (with appropriate amendments to take into account stays applying to cross-default rights);
- set out the relationship between the enhanced moratorium provisions for statutory and judicial management and the PSN Act, as appropriate.

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<p>The stay provisions in the Industry Acts and the Transfer Act are expanded to apply to bodies corporate related to an ADI, general insurer and life company (that is, an authorised NOHC or subsidiaries of an authorised NOHC or the ADI/insurers).</p>	<p>The existing stay provisions in the Industry Acts and the Transfer Act only apply where an ADI, general insurer or life company is both the party to a contract and the entity in relation to which regulatory action is taken. They do not apply to authorised NOHCs or subsidiaries of the authorised NOHC or ADI/insurers.</p>
<p>The existing stay provisions in the Industry Acts and the Transfer Act have been enhanced so that an exercise of power made in respect of:</p> <ul style="list-style-type: none"> <li>• a body corporate (which now could be an ADI/insurer, or an authorised NOHC of an ADI/insurer, or a subsidiary of an authorised NOHC or ADI/insurer),</li> </ul> <p>cannot be grounds for:</p> <ul style="list-style-type: none"> <li>• a counterparty to that body corporate; or</li> <li>• a counterparty to a body corporate related to that body corporate,</li> </ul> <p>to deny an obligation, accelerate a debt, close-out on a transaction, or enforce a security.</p>	<p>The existing stay provisions in the Industry Acts and the Transfer Act operate so that an exercise of power made in respect of:</p> <ul style="list-style-type: none"> <li>• an ADI/insurer,</li> </ul> <p>cannot be grounds for:</p> <ul style="list-style-type: none"> <li>• a counterparty to a contract with the ADI/insurer,</li> </ul> <p>to deny an obligation, accelerate a debt, close-out on a transaction, or enforce a security.</p>
<p>The PSN Act includes express provisions dealing with the application of resolution actions to authorised NOHCs or subsidiaries of an authorised NOHC or ADI/insurer. It also caters for stays on actions under cross-default clauses and incorporates into its terms and definitions the amended and new stay and moratorium provisions provided for in the Bill.</p>	<p>The PSN Act deals with the interaction of certain provisions relating to netting and the payments system with the existing stay provisions in the Industry Acts and the Transfer Acts. However, it does not expressly deal with the application of relevant resolution actions to authorised NOHCs or subsidiaries of the authorised NOHC or ADI/insurers, or cater for stays on actions under cross-default clauses, or for the application of the amended and new stay and moratorium provisions provided for in the Bill.</p>

## **Detailed explanation of new law**

### **Extend stay provisions to contracts entered into by a related body corporate**

#### *Enhance existing stay provisions in the Industry Acts and the Transfer Act*

6.7 The Bill amends the existing stay provisions in the Industry Acts and the Transfer Act to ensure that the exercise of a power in relation to an entity does not give rise to termination rights or other rights (that is, denying an obligation, accelerating a debt, closing-out on a transaction, or enforcing a security) in the contracts of entities within the same group (related bodies corporates of the entity against which the regulatory action was taken).

6.8 The relevant stay provisions are:

- subsection 11CD(1A) of the Banking Act (direction is not grounds for denial of obligations etc);
- subsection 13N(2) of the Banking Act (recapitalisation direction is not grounds for denial of obligations etc);
- subsections 14AC(2) of the Banking Act, @14AC(2)-IA of the Insurance Act and @14AC(2)-LIA of the Life Insurance Act (a recapitalisation facilitated by a statutory manager is not grounds for denial of obligations etc);
- subsections 15C(2) of the Banking Act, @15C(2)-IA of the Insurance Act and @15C(2)-LIA of the Life Insurance Act (a statutory manager being in control is not grounds for denial of obligations etc);
- subsection 36AA(2) of the Transfer Act (a compulsory transfer under the Transfer Act is not grounds for denial of obligations etc);
- subsection 62V(2) of the Insurance Act (a judicial manager being in control is not grounds for denial of obligations etc);
- subsection 62ZB(2) of the Insurance Act (a recapitalisation facilitated by a judicial manager is not grounds for denial of obligations etc) ;
- subsection 103K(2) of the Insurance Act (a recapitalisation direction is not grounds for denial of obligations etc);



- subsection 105(1A) of the Insurance Act (a direction is not grounds for denial of obligations etc);
- subsection 165B(2) of the Life Insurance Act (judicial manager being in control is not grounds for denial of obligations etc);
- subsection 168C(2) of the Life Insurance Act (a recapitalisation facilitated by a judicial manager is not grounds for denial of obligations etc);
- subsection 230AJ(2) of the Life Insurance Act (a recapitalisation direction is not grounds for denial of obligations etc);
- subsection 230C(1A) of the Life Insurance Act (a direction is not grounds for denial of obligations etc). *[Schedule 1, items 38, 68, 79, 87, Schedule 2, items 59, 43, 49, 106, 115, Schedule 3, items 18, 36, 42, 77, 86, Schedule 4, item 75, subsections 11CD(1A), 13N(2), 14AC(2), 15C(2) of the Banking Act, subsections @14AC(2)-IA, @15C(2)-IA, 62V(2), 62ZB(2), 103K(2) and 105(1A) of the Insurance Act, subsections @14AC(2)-LIA, @15C(2)-LIA, 165B(2), 168C(2), 230AJ(2) and 230C(1A) of the Life Insurance Act, and subsection 36AA(2) of the Transfer Act]*

6.9 In summary, the enhanced stay provisions now provide that where a body corporate is a party to a contract (whether the proper law of the contract is Australia law or law of a foreign country), a counterparty to that contract cannot:

- deny an obligation;
- accelerate a debt;
- close-out any transaction; or
- enforce a security,

on the ground that an exercise of power (as specified under the relevant stay provision in that case e.g. directions power, power to recapitalise an ADI or insurer, appointment of a statutory or judicial manager and compulsory business transfer power) occurred against either the contracting body corporate or a related body corporate of the contracting body.

6.10 Under these provisions, the body corporate against which the relevant regulatory action is taken could be an ADI or insurer, an authorised NOHC of the ADI/insurer, or a subsidiary of the ADI/insurer

or authorised NOHC. In order for the stay to apply, either that same body corporate, or a related body corporate, must be party to the relevant contract.

6.11 For example, if an ADI is party to a contract with a third party entity, and the contract includes a provision that purports to give the third party a right to terminate the contract with the ADI if APRA gives a direction to a related body corporate of the ADI, the relevant stay provision will operate to prevent action being taken under the contract on the basis of the direction.

6.12 It should be noted that the current stay provisions include an exception which preserves any right of the contracting body corporate itself to take action under the contract (e.g. close out) despite the stay provision. Under the amended provisions, the contracting body corporate will continue to be able to take action under the contract (e.g. close out) but only if the other party to the contract is *not* a related body corporate. If the other party to the contract is a related body corporate, neither will be able to close out. This ensures that there will be no conflict when the stay provision has several applications to an intra-group contract with cross default clauses; that is, generally none of the parties will be able to close out, which is the preferred position from a regulatory point of view when exercising enforcement powers in relation to a financial group. *[Schedule 1, items 38, 68, 79, 87, Schedule 2, items 59, 43, 49, 106, 115, Schedule 3, items 18, 36, 42, 77, 86, Schedule 4, item 75, subsections 11CD(1C), 13N(4), 14AC(4), 15C(4) of the Banking Act, subsections @14AC(3)-IA, @15C(2)-IA, 62V(4), 62ZB(4), 103K(4) and 105(1C) of the Insurance Act, and subsections @14AC(3)-LIA, @15C(2)-LIA, 165B(4), 168C(4), 230AJ(4) and 230C(1C) of the Life Insurance Act, and 36AA(5) of the Transfer Act]*

6.13 The Bill makes consequential amendments to the existing protections afforded to counterparties affected by an exercise of a directions power. Under the current law, if a counterparty is prevented from fulfilling its obligations under a contract with a body corporate (for example, an ADI), because of the giving of a direction given to that body corporate, the counterparty is relieved from all obligations owed to the body corporate under the contract, subject to any Federal Court order (see sections 11CD(2) of the Banking Act, 105(2) of the Insurance Act, and 230C(2) of the Life Insurance Act). The Bill extends this protection so that the counterparty is relieved of their obligations to the contracting body corporate (subject to any Federal Court order) if they are prevented from fulfilling its obligations under the contract because of a direction regardless of whether the direction is given to the contracting body corporate itself or to a related body corporate of the contracting body corporate. *[Schedule 1, item 38, Schedule 2, item 115, Schedule 3, item 86, subsection 11CD(2) of the Banking Act, subsection 105(2) of the Insurance Act, and subsection 230C(2) of the Life Insurance Act]*

***New stay provisions – Conversion or write-off etc. not grounds for denial of obligations***

**6.14** Chapter 5 of this EM describes how the Bill inserts new provisions into the Industry Acts to provide certainty that capital instruments can be converted or written down as required by APRA’s prudential standards. As a consequence of these new provisions in the Industry Acts (sections 11CAA, 11CAB of the Banking Act, 36A and 36B of the Insurance Act, 230AAB and 230AAC of the Life Insurance Act), corresponding stay provisions are added to the Industry Acts (sections 11CAC of the Banking Act, 36C of the Insurance Act and 230AAD of the Life Insurance Act), equivalent to the existing stay provisions (as enhanced by the Bill). *[Schedule 1, items 27, Schedule 2, item 19, Schedule 3, item 61, sections 11CAA, 11CAB, and 11CAC of the Banking Act, sections 36A and 36B, 36C of the Insurance Act, and sections 230AAB, 230AAC, and 230AAD of the Life Insurance Act]*

**6.15** In summary, the Bill ensures that counterparties of a contracting entity (the ‘first entity’) cannot:

- deny an obligation;
- accelerate a debt;
- close-out any transaction; or
- enforce a security,

under a contract with the first entity on the ground that a ‘relevant instrument’ is being or has been converted or written-off for the purposes of the conversion and write-off provisions, or in the ground of the occurrence of an event (which may be the making of a determination by APRA) that results in a relevant instrument being required to be converted or written off for the purposes of the conversion and write-off provisions. *[Schedule 1, items 27, Schedule 2, item 19, Schedule 3, item 61, section 11CAC of the Banking Act, section 36C of the Insurance Act, and section 230AAD of the Life Insurance Act]*

**6.16** A ‘relevant instrument’ is defined as an instrument:

- to which sections 11CAB of the Banking Act, 36B of the Insurance Act or 230AAC of the Life Insurance Act applies (that is, the instrument contains terms that are for the purpose of conversion and write-off provisions and is issued by a regulated entity, a holding company of a regulated entity, a subsidiary or related subsidiary of a regulated entity or an entity of a kind prescribed by the regulations); and
- either:

- the instrument was issued by the first entity (as noted above, the ‘first entity’ for these purposes is the relevant contracting party); or
- the first entity is a conversion entity in relation to the instrument (that is, the instrument converts into ordinary shares of the first entity); or
- if the first entity is a body corporate, the instrument was issued by a related body corporate of the first entity; or
- if the first entity is a body corporate, a related body corporate of the first entity is a conversion entity in relation to the instrument. [*Schedule 1, items 27, Schedule 2, item 19, Schedule 3, item 61, subsection 11CAC(5), subsection 36C(5) of the Insurance Act, and subsection 230AAD(5) of the Life Insurance Act*]

**6.17** In summary, consistent with the other amendments to enhance the existing stay provisions in the Industry Acts and Transfer Act, the new stay provisions in the Industry Acts also extend to where the issuing or conversion entity is a related body corporate of the first entity. [*Schedule 1, items 27, Schedule 2, item 19, Schedule 3, item 61, subsection 11CAC, subsection 36C of the Insurance Act, and subsection 230AAD of the Life Insurance Act*]

***Consequential amendments to the PSN Act to encompass ‘related bodies corporate’***

*Background*

6.18 Amendments are required to the PSN Act to take into account, first, the enhancements to the stay provisions and, secondly, the extension of certain regulatory powers to related bodies of ADIs and insurers. This is because these amendments mean that the stay provisions will apply where regulatory action is taken against an entity that is not an ADI or insurer (that is, it may be an authorised NOHC or a subsidiary of an ADI, insurer or authorised NOHC). Secondly, the extension of the stay provisions so that they apply where the contracting party is not the party against which regulatory action was taken means that amendments are required.

6.19 In broad terms, the PSN Act overrides a range of laws in order to ensure the validity of certain provisions relating to netting and the payments system covered by the PSN Act. For present purposes the protection afforded by section 14 (‘Effectiveness of close-out netting contracts’) to close-out netting contracts, which include over the counter (OTC) derivatives and securities lending contracts, is particularly relevant.

6.20 The PSN Act differentiates between ‘specified provisions’, ‘specified stay provisions’ and ‘direction stay provisions’. Section 14 (‘Effectiveness of close-out netting contracts’), and provisions in the PSN Act relating to other netting and payment systems arrangements, uphold the validity of close out, netting of obligations, and payments despite any other law, including a ‘specified provision’.

6.21 However, subsection 14(3) of the PSN Act provides an exception by stating that the protections in relation to close-out netting contracts have effect ‘subject to a specified *stay* provision that applies to the contract’. Accordingly, if a stay provision falls within this definition, then the rights to close out and rights in relation to relevant securities in section 14 cannot be exercised if the specified stay provision applies.

6.22 The PSN Act further distinguishes between specified stay provisions that are ‘direction stay provisions’ and those that are not. If a specified stay provision is a ‘direction stay provision’ then it operates on a permanent and continuing basis; in other words, the action (giving of a direction) that gave rise to the ostensible close-out right cannot itself be relied on as a basis for close-out at any time. If the specified stay provision is *not* a direction stay provision, and the contract in question is a derivative or securities lending contract of a kind covered by section 15A of the PSN Act, the stay will operate temporarily, under Division 2 of Part 4 of the PSN Act (‘Ceasing non-direction stays for derivatives contracts’), although it may be made permanent if the relevant body corporate (e.g. an ADI or insurer) is resolved during the ‘resolution period’ as defined in the PSN Act.

6.23 Having regard to the above, amendments are required to the PSN Act to:

- cater for the fact that, under the Bill, resolution actions and directions, to which stay provisions apply, may be taken against not only ADIs and insurers, but also in relation to authorised NOHCs and subsidiaries of ADIs/insurers and authorised NOHCs. This has implications for Division 2 of Part 4 of the PSN Act (‘Ceasing non-direction stays for derivatives contracts’) in particular;
- address the implications of the stay provisions applying on a cross-default basis. This also has implications for Division 2 of Part 4;
- provide for appropriate treatment of the new stay provisions relating to actions under conversion and write-off provisions. As discussed below, these will be categorised as ‘direction stay provisions’, with the result that they will not be subject to Division 2 of Part 4;

- ensure that the new moratorium provisions for statutory and judicial management are treated appropriately under the PSN Act. In general terms they will be treated as ‘specified provisions’, with the result that the provisions of the PSN Act in relation to netting arrangements and payment systems will apply despite the moratorium provisions, with a limited exception in relation to certain kinds of close-out netting contracts.

6.24 To support these objectives a number of amendments will be made to the PSN Act.

*Amendments*

**6.25** A new definition of ‘related body corporate’ is inserted into the PSN Act. For the purposes of the PSN Act, the question of whether a body corporate is related to another body corporate is to be determined in the same way as that question is determined for the purposes of the Corporations Act. The inclusion of this definition is necessary for the purposes of amendments to Part 4 of the PSN Act (‘Close-out netting contracts’) relating to the interaction between stay provisions and the protections given to close-out netting contracts. [*Schedule 5, item 17, section 5AA of the PSN Act*]

6.26 The expansion of the statutory management regime and directions powers to group entities (that is, related bodies corporate of ADIs and insurers - see Chapter 2 and Chapter 3 ) means that the definition of ‘regulated body’ in the PSN Act had to be expanded beyond ADIs, general insurers, life companies and private health insurers, to include:

- an authorised NOHC of an ADI/insurer; and
- a subsidiary of an authorised NOHC or an ADI/insurer.  
[*Schedule 5, item 8, section 5 of the PSN Act*]

6.27 The existing stay provisions in the Industry Act and the Transfer Act are all listed as ‘specified stay provisions’ under the PSN Act. Since the Bill applies the statutory management regime to the Insurance Act and Life Insurance Act, the following new stay provisions are added to the definition of ‘specified stay provision’ in the PSN Act:

- subsection @14AC(2)-IA of the Insurance Act (a recapitalisation facilitated by a statutory manager is not grounds for denial of obligations etc);
- subsection @15C(2)-IA of the Insurance Act (a statutory manager being in control is not grounds for denial of obligations etc);

- subsection @14AC(2)-LIA of the Life Insurance Act (a recapitalisation facilitated by a statutory manager is not grounds for denial of obligations etc); and
- subsection @15C(2)-LIA of the Life Insurance Act (a statutory manager being in control is not grounds for denial of obligations etc). [*Schedule 2, item 59, Schedule 3, item 18, subsections @14AC(2)-IA and @15C(2)-IA of the Insurance Act, and subsections @14AC(2)-LIA and @15C(2)-LIA of the Life Insurance Act*]

6.28 The insertion of the new conversion and write-off stay provisions into the Industry Acts meant that the following provisions were also added to the definition of ‘specified stay provision’ and ‘direction stay provision’ in the PSN Act :

- subsection 11CAC(2) of the Banking Act (conversion or write-off etc. not grounds for denial of obligations);
- subsection 36C(2) of the Insurance Act (conversion or write-off etc. not grounds for denial of obligations);
- subsection 230AAD(2) of the Life Insurance Act (conversion or write-off etc. not grounds for denial of obligations). [*Schedule 5, items 3, 4, 5, 12, 13, 14, and 15, subsection 5 of the PSN Act*]

6.29 As explained above this will mean that section 14 of the PSN Act (‘Effectiveness of close-out netting contracts’) applies subject to the stay provisions listed at 6.27 and 6.28 (see subsection 14(3) of the PSN Act). However, those two sets of provisions will be treated differently under Division 2 of Part 4 of the PSN Act. The resolution stays regime in Division 2 of Part 4 (‘Ceasing non-direction stays for derivatives contracts’) will apply to the ‘specified stay provisions’ listed at 6.27 as they are not ‘direction stay provisions’ (broadly speaking, they relate to resolution in the context of statutory management, and therefore fall within Division 2 of Part 4, like the corresponding stay provisions in the Banking Act). However, Division 2 of Part 4 will *not* apply to the ‘specified stay provisions’ relating to conversion and write off listed at 6.28 because they will be ‘direction stay provisions’ (so they will apply permanently in relation to a given trigger for action under a contract).

6.30 The existing sections 15A (‘Ceasing non-direction stays for derivatives contracts’) and 15B (‘When APRA may declare that non-direction stays cease’) in Division 2 of Part 4 of the PSN Act are amended by expanding their application to not only close-out netting contracts to which an ADI or insurer is a party, but to close-out netting contracts to which other group entities are party, and to cater for the complexities of

cross default situations. [*Schedule 5, items 20, to 26, subsections 15A and 15B of the PSN Act*]

6.31 The current position is that section 15A of the PSN Act provides for a relevant (non-direction) stay provision to apply on a temporary basis to a derivatives or securities lending contract of a kind covered by section 15A of the PSN Act while action is taken to resolve the regulated entity in question. Section 15A and the other provisions in Division 2 of Part 4 are only relevant where the stay provision relates to the appointment of a statutory manager, a judicial manager or a compulsory transfer of business (sometimes referred to as ‘resolution stay provisions’), and this will continue to be the case.

6.32 The amendments under the Bill will mean that section 15A of the PSN Act applies to keep a stay on foot for at least the resolution period even where the relevant resolution action (e.g. appointment of a statutory manager) was taken against an authorised NOHC or subsidiary for example, rather than (or as well as) an ADI or insurer.

6.33 Secondly the amendments will ensure that section 15A applies if the contracting party is a related body corporate of the body against which the resolution action was taken (the trigger body), rather than the trigger body itself.

6.34 Section 15B of the PSN Act currently gives APRA power to declare, before the end of the resolution period, that the stay is to come to an end, and consequential amendments are made to ensure the section reflects the new application of the stay provisions to related bodies corporate.

6.35 Section 15C of the PSN Act currently explains what must be done to resolve an ADI or insurer in order for APRA to make the stay provision permanent. The broad policy objectives of this section are unchanged but amendments have been made to cater for the complexities of group resolution, the operation of cross default clauses and the interaction of such clauses with the amended stay provisions.

6.36 In relation to the existing section 15C of the PSN Act (‘When APRA may declare that non-direction stays continue’), the expansion of the statutory management regime and directions powers to group entities (see Chapter 1 and Chapter 2 of this Explanatory Memorandum) means the entity to which a trigger event occurs (the ‘trigger body’) may not always be the party to the close-out netting contract (the ‘trigger contract’). For example, APRA could give a direction (trigger event) to an ADI (trigger body) where the party to the relevant close-out netting contract is a subsidiary of the ADI.

6.37 To address this issue, section 15C will continue to cover the simple case where the entity subject to the regulatory action giving rise to the stayed trigger event is party to the contract in question. There will be



two new provisions, sections 15D and 15E, dealing with where the entity subject to the regulatory action is not the same as the contracting entity.

*[Schedule 5, items 27 to 31, subsections 15C, 15D and 15E of the PSN Act]*

6.38 Accordingly, section 15C of the PSN Act is amended to make it clear that it specifically covers where the trigger body is also the contracting body, which is the simplest scenario and similar to the way section 15C currently works. A number of amendments are required to section 15C to reflect the fact that the trigger body will not necessarily be an ADI or insurer. This is relevant because the test for whether the stay can be made permanent, which broadly requires APRA to make a determination as to whether the body has been resolved, will differ depending on whether it is an ADI or insurer, on the one hand, or a related body corporate that does not have depositors or policyholders. If the trigger body is an ADI or insurer, and it is resolved without a transfer of business, then the resolution test will require APRA to consider (among other things) whether the body has the each material authorisation for its regulated business. If the body is not an ADI or insurer, this requirement will not apply. Section 15C as amended will cater for these two situations. The section will also be amended to make it clear that it will only be necessary to consider whether minimum capital requirements are met if they actually apply to the party. Section 15C is also amended to take into account the fact that the resolution action giving rise to the contractual trigger and stay may be the appointment of a statutory manager to an insurer. *[Schedule 5, items 27 to 30, subsections 15C of the PSN Act]*

6.39 To address the position where the trigger body and the contracting body are not the same (that is, where they are related bodies corporate), a new s15D ('When APRA may declare that non-direction stays continue – related body corporate of regulated body is party to trigger contract') is inserted. In broad terms, before APRA can make a determination that the stay be made permanent, it will be necessary to apply certain tests set out in subsection 15D(3) to:

- the trigger body (the entity in relation to which the triggering regulatory action has been taken), where resolution occurs without a transfer of business; or
- the receiving body, where resolution occurs through a total transfer of business; or
- either or both of those bodies, where resolution involves a partial transfer of business.

In each case, APRA will be required to assess whether the matters in subsection 15D(3), which broadly set out a 'resolution test' in similar terms to the one in subsection 15C(3), are satisfied in relation to the trigger body or any receiving body to which relevant business has been transferred.

6.40 New section 15E contains further detail on the position where there has been a transfer of business from the trigger entity to a receiving body. If there has been a partial transfer, APRA will have a discretion, under subparagraph 15D(1A)(b)(ii) read with subsection 15E(3), to apply the ‘resolution test’ in subsection 15D(3) to either or both of the trigger body or the receiving body. In addition, section 15E ensures that, whether the transfer is total or partial, APRA must not make a declaration making the stay permanent unless APRA is satisfied that the declaration will not have a detrimental effect on any counterparty to a close out netting contract to which the declaration would apply. *[Schedule 5, item 31, subsections 15D and 15E of the PSN Act]*

6.41 Further detail on the amendments to section 15C, and the new section 15D (and section 15E, which supports section 15D) of the PSN Act, are set out below.

*Amended section 15C of the PSN Act: expanding it to authorised NOHCs and subsidiaries, when the trigger body and the contracting body are the same*

6.42 To protect the legitimate interests of counterparties to relevant close-out netting contracts, the amended section 15C provides that a specified stay provision may only be declared to continue if the specified circumstances set out below exist. It should be noted that in this provision the amended term ‘regulated body’ has the broad meaning discussed at 6.26, namely it includes not only ADIs, insurers and PHIs (as is currently the case), but also authorised NOHCs of ADIs and insurers, and subsidiaries of an ADI/insurer or authorised NOHC. The specified circumstances are:

- a trigger event to which a specified stay provision (other than a direction stay provision) applies is an event that involves a regulated body (the ‘trigger body’) and the trigger event happens in relation to a close-out netting contract (the ‘trigger contract’) to which that same regulated body is a party;
- APRA is satisfied that all the matters set out in subsection 15C(3) will be satisfied in relation to the party in respect of which the declaration may be made (which will be either or both of the regulated/trigger body or a receiving body if there has been a transfer of business):
  - if a certificate of transfer will come into force under the Transfer Act, just after that coming into force; or
  - in all other cases, at the time the declaration will be made;

- the party in respect of which the declaration may be made is not in external administration (as defined in the PSN Act) (other than statutory management or judicial management); and
- APRA has not already made a declaration under section 15B that the specified stay provision ceases to apply in relation to the trigger event. This is to provide certainty, so that APRA cannot make a declaration extending the application of the relevant stay if it has previously made a declaration that the stay ceases to apply. [*Schedule 5, items 27 to 30, subsections 15C(1) of the PSN Act*]

6.43 If these conditions are satisfied, APRA may declare that the specified stay provision is to continue to apply to:

- if a certificate of transfer for a total transfer will come into force under the Transfer Act, all close out netting contracts to which the regulated body is a party (and to which the receiving body (within the meaning of the Transfer Act) will become a party immediately after the transfer), and all securities given over financial property in respect of obligations under those close-out netting contracts;
- if a certificate of transfer for a partial transfer will come into force under the Transfer Act, either or both of the following:
  - all close out netting contracts to which the regulated body is a party (and to which the regulated body will remain a party immediately after the transfer), and all securities given over financial property in respect of obligations under those close-out netting contracts;
  - all close out netting contracts to which the regulated body is a party (and to which the receiving body (within the meaning of the Transfer Act) will become a party immediately after the transfer), and all securities given over financial property in respect of obligations under those close-out netting contracts; or
- in all other cases, all close out netting contracts to which the regulated body is a party and all securities given over financial property in respect of obligations under those close-out netting contracts. [*Schedule 5, item 28, subsection 15C(2) of the PSN Act*]

6.44 In order for a specified stay provision to continue to apply, APRA must be satisfied that all the matters set out in subsection 15C(3)

will be satisfied in relation to the party (the regulated body and/or receiving body) in respect of which the declaration may be made at the time the declaration will be made (or just after the coming into force of a certificate of transfer, if applicable).

6.45 The conditions of which APRA must be satisfied are as follows

- that the party is able to meet all its liabilities under:
  - close out netting contracts to which it is a party as and when they become due and payable (including all payment and delivery obligations); and
  - all securities given over financial property in respect of obligations under those close-out netting contracts;
- that the party is solvent (within the meaning of the Corporations Act); and
- if the party is an ADI, general insurer or life company, that they have the material authorisation (however described) necessary for their regulated business. The term ‘regulated business’ in s 5 of the PSN Act is repealed and replaced with:
  - in relation to an ADI—means the ADI’s banking business (within the meaning of the Banking Act); and
  - in relation to a general insurer—means the general insurer’s insurance business (within the meaning of the Insurance Act); and
  - in relation to a life company—means the life company’s life insurance business (within the meaning of the Life Insurance Act).
- (If the party is not an ADI, general insurer or life company, then the subsection 15C(3) condition will not need to be satisfied.) [*Schedule 5, item 29, subsection 15C(3)(c) of the PSN Act*]
- if minimum capital requirements under the Banking Act, the Insurance Act or the Life Insurance Act apply to the party, that either of the following is satisfied:
  - the party’s level of capital complies with the minimum capital requirements that apply to it under the Banking Act, the Insurance Act or the Life Insurance Act (as the case requires) and the applicable prudential

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standards made under the relevant Act; or *[Schedule 5, item 29, subsection 15C(3)(d) of the PSN Act]*

- arrangements are in place to ensure that the party performs all its obligations under (i) close out netting contracts to which it is a party and (ii) all securities given over financial property in respect of obligations under those close-out netting contracts as and when they are due to be performed. Those arrangements must remain in place until at least the earliest day on which:
  - the party’s level of capital complies with the applicable minimum capital requirements;
  - if a Banking Act statutory manager is in control of the party’s business—APRA makes an ultimate termination of control under subsection 13C(3) of the Banking Act;
  - if an Insurance Act statutory manager is in control of the party’s business—APRA makes an ultimate termination of control under subsection @13C-IA(3) of the Insurance Act;
  - if a Life Insurance Act statutory manager is in control of the party’s business—APRA makes an ultimate termination of control under subsection @13C-LIA(3) of the Life Insurance Act;
  - if the management of the party is vested in a judicial manager under the Insurance Act—an order under section 62ZF of that Act cancelling the judicial management comes into force; or
  - if the management of the party covered under subsection 15D(1A) is vested in a judicial manager under the Life Insurance Act—an order under section 172 of that Act cancelling the judicial management comes into force.

*[Schedule 5, item 30, subsections  
15C(5)(b) of the PSN Act]*

6.46 The existing subsections 15C(6), (7) and (8) remain unchanged, so that:

- a declaration made under section 15C cannot be varied or revoked;
- a declaration made under section 15C is not a legislative instrument; and
- regulations may do any of the following:
  - prescribe requirements relating to how declarations made by APRA are to be made (including requirements relating to the content or form of declarations);
  - prescribe requirements relating to the notification or publication of declarations;
  - include provisions that apply to determining, either generally or for a particular purpose, the time when declarations are taken to be made.

*New section 15D of the PSN Act: Applies where the trigger body and the contracting body are different*

6.47 The new section 15D provides that a specified stay provision may only be declared to continue if the following specified circumstances exist:

- a trigger event to which a specified stay provision (other than a direction stay provision) applies is an event that involves a regulated body (the ‘trigger body’) and the trigger event happens in relation to one or more close-out netting contracts (each of which is a ‘trigger contract’) to which a related body corporate of the trigger body (the ‘contracting body’) is a party;
- APRA is satisfied that all the matters set out in subsection 15D(3) will be satisfied in relation to each entity covered under s 15D(1A) (this will be the trigger body or a receiving body or both, as explained below) in respect of which the declaration may be made;
  - if a certificate of transfer will come into force under the Transfer Act, just after that coming into force; or

- 
- in all other cases, at the time the declaration will be made;
  - each entity covered under s15D(1A) is not in external administration (as defined in the PSN Act) (other than statutory or judicial management); and
  - APRA has not already made a declaration under section 15B that the specified stay provision ceases to apply in relation to the trigger event. This is to provide certainty, so that APRA cannot make a declaration extending the application of the relevant stay if it has previously made a declaration that the stay ceases to apply. *[Schedule 5, item 31, subsection 15D(1) of the PSN Act]*

6.48 An entity is covered under s15D(1A) if it is:

- if section 15E does not apply (in other words, there has been no relevant transfer of business) —the trigger body; or
- if section 15E applies because a transfer of business has occurred under the Transfer Act from the trigger body to a receiving body:
  - in the case of a total transfer of business—the receiving body; or
  - in the case of a partial transfer of business—an entity specified in a determination under subsection 15E(3). *[Schedule 5, item 31, subsection 15D(1A) of the PSN Act]*

6.49 If these conditions are satisfied, APRA may declare that the specified stay provision is to continue to apply to each trigger contract specified in the declaration, and to all securities given over financial property in respect of obligations under each trigger contract specified in the declaration. APRA may specify either or both of the following in such a declaration:

- one or more trigger contracts;
- one or more classes of trigger contracts. *[Schedule 5, item 31, subsection 15D(2) and (2A) of the PSN Act]*

6.50 The Bill inserts a note under s15D(2A) to see subsection 15E(2) for a restriction on when APRA may make a declaration under subsection 15D(2) in the case of a transfer of business from the trigger body to a receiving body. (That restriction is discussed at 6.56 below.) *[Schedule 5, item 31, subsection 15D of the PSN Act]*

6.51 One of the specified circumstances which must be satisfied in order for a specified stay provision to continue to apply is that APRA must be satisfied that all the matters set out in subsection 15D(3) will be satisfied in relation to the entity covered under s15D(1A) in respect of which the declaration may be made. These matters must be satisfied at the time the declaration will be made (or just after the coming into force of a certificate of transfer, if applicable). *[Schedule 5, item 31, subsection 15D(1)(b) of the PSN Act]*

6.52 The conditions of which APRA must be satisfied are as follows:

- that the entity covered under s15D(1A) is able to meet all its liabilities under:
  - close out netting contracts to which it is a party as and when they become due and payable; and
  - securities given over financial property in respect of obligations of the entity under those contracts as they become due and payable); and
- that the entity covered under s15D(1A) is solvent (within the meaning of the Corporations Act); and
- if the entity covered under s15D(1A) is an ADI, general insurer or life company, that they have the material authorisation (however described) necessary for its regulated business. The term ‘regulated business’ in s 5 of the PSN Act is repealed and replaced with:
  - in relation to an ADI—means the ADI’s banking business (within the meaning of the Banking Act); and
  - in relation to a general insurer—means the general insurer’s insurance business (within the meaning of the Insurance Act); and
  - in relation to a life company—means the life company’s life insurance business (within the meaning of the Life Insurance Act).
- (If the entity covered under s15D(1A) is not an ADI, general insurer or life company, then this) condition does not apply n) *[Schedule 5, item 31, subsection 15D(3)(c) of the PSN Act]*
- if minimum capital requirements under the Banking Act, the Insurance Act or the Life Insurance Act apply to the entity



covered by subsection 15D(1A), that either of the following is satisfied:

- the entity’s level of capital complies with those minimum capital requirements; or
- arrangements are in place to ensure that the entity performs all its obligations under: (i) close out netting contracts to which it is a party as and when they are due to be performed ;and (ii) securities given over financial property in respect of obligations given to the entity under those contracts as and when they are due to be performed. Those arrangements must remain in place until at least the earliest day on which:
  - the entity’s level of capital complies with the applicable minimum capital requirements;
  - if a Banking Act statutory manager is in control of the entity’s business— APRA makes an ultimate termination of control under subsection 13C(3) of the Banking Act;
  - if an Insurance Act statutory manager is in control of the entity’s business— APRA makes an ultimate termination of control under subsection @13C-IA(3) of the Insurance Act;
  - if a Life Insurance Act statutory manager is in control of the entity’s business —APRA makes an ultimate termination of control under subsection @13C-LIA(3) of the Life Insurance Act;
  - if the management of the entity is vested in a judicial manager under the Insurance Act—an order under section 62ZF of that Act cancelling the judicial management comes into force; or
  - if the management of the entity is vested in a judicial manager under the Life Insurance Act—an order under

section 172 of that Act cancelling the judicial management comes into force. *[Schedule 5, item 31, subsection 15D(3)(d), (4) and (5) of the PSN Act]*

6.53 Subsections 15D(6), (7) and (8) mirror the equivalent existing 15C provisions, so that.

- a declaration made under section 15D cannot be varied or revoked;
- a declaration made under section 15D is not a legislative instrument (this provision is included to assist readers, as the instrument is not a legislative instrument within the meaning of subsection 8(1) of the *Legislation Act 2003*); and
- the regulations may do any of the following:
  - prescribe requirements relating to how declarations made by APRA are to be made (including requirements relating to the content or form of declarations);
  - prescribe requirements relating to the notification or publication of declarations;
  - include provisions that apply to determining, either generally or for a particular purpose, the time when declarations are taken to be made. *Schedule 5, item 31, subsections 15D(6), (7) and (8) of the PSN Act]*

*New section 15E of the PSN Act: ‘Declaration under subsection 15D(2) – total or partial transfer of business’*

6.54 New section 15D refers to new section 15E for determining which entity is covered by subsection 15D(1A). This, and other functions of section 15E, are discussed below. *Schedule 5, item 31, section 15D and 15E of the PSN Act]*

6.55 Section 15E applies if:

- paragraph 15D(1)(a) is satisfied in relation to a trigger event (that is a trigger event has happened to a trigger body and this has triggered rights in relation to a close-out netting contract with a related body corporate of that trigger body); and
- a certificate of transfer will come into force under the Transfer Act for:

- a total transfer of business from the trigger body to a receiving body; or in
- a partial transfer of business from the trigger body to a receiving body. *Schedule 5, item 31 subsection 15E(1) of the PSN Act*

6.56 Section 15E sets out a general condition on APRA's ability to declare that a specified stay provision is to continue to apply to a trigger contract where there is a transfer of business, whether that transfer is total or partial. It provides that APRA must not make a declaration to make a specified stay provision continue in respect of some or all of the trigger contracts in relation to the trigger event unless APRA is satisfied that the declaration will not have a detrimental effect on any counterparty to a close-out netting contract to which the declaration would apply. *[Schedule 5, item 31, subsection 15E(2) of the PSN Act]*

6.57 As noted above, subsection 15D(1A) specifies the body to which the subsection 15D(3) tests must be applied, depending on how the trigger body has been resolved. If there is no transfer, the tests are applied to the trigger entity. If there was a total transfer from the trigger body, the tests are applied to the receiving body. If there has been a partial transfer of business from a trigger body to a receiving body, subparagraph 15D(1A)(b)(ii) provides that the subsection 15D(3) tests are to be applied to an entity specified in a determination under subsection 15E(3). Subsection 15E(3) provides that APRA may make a written determination specifying either or both of the following to be the entity covered by subsection 15D(1A), namely the entity to be tested under subsection 15D(3):

- the trigger body;
- the receiving body. *[Schedule 5, item 31, subsection 15E(3) of the PSN Act]*

6.58 The written determination cannot be varied or revoked. *[Schedule 5, item 31, subsection 15E(4) of the PSN Act]*

6.59 A determination under s15E is not a legislative instrument. The provision is included to assist readers and is merely declaratory of the law, as the instrument is not a legislative instrument within the meaning of section 5 of the Legislative Instruments Act 2003. *[Schedule 5, item 31, subsection 15E(5) of the PSN Act]*

6.60 The Bill allows for regulations to be made. The regulations may do any of the following:

- prescribe requirements relating to how determinations under s15E(3) (that is, written determination specifying which entity or entities are covered by s15D(1A)) are to be made by

APRA (including requirements relating to the content or form of declarations);

- prescribe requirements relating to the notification or publication of determinations under s15E(3);
- include provisions that apply to determining, either generally or for a particular purpose, the time when determinations under subsection 15E(3) are taken to be made. [*Schedule 5, item 31, subsection 15E(6) of the PSN Act*]

### **Incorporating the widened moratorium provisions for statutory and judicial management into the PSN Act**

6.61 Consequential amendments need to be made to the PSN Act to ensure that the enhanced moratorium provisions related to statutory and judicial management (see Chapter 2 for further detail) do not disturb the protections afforded to counterparties to relevant close-out netting contracts under the PSN Act.

6.62 In summary, the purpose of the amendments described below is two-fold.

6.63 First, it is intended that the provisions of the PSN Act relating to RTGS settlement systems, multilateral netting arrangements and market netting arrangements operate according to their tenor despite the new moratorium provisions.

6.64 Secondly, section 14 of the PSN Act ('Effectiveness of close-out netting contracts') will override the application of the moratorium provisions in relation to the kinds of close-out netting contracts that are subject to the regime in Division 2 of Part 4 (derivatives and securities lending contracts). However there is an exception in relation to a close out netting contract that is *not* of that kind (is not subject to Division 2 of Part 4). Such a contract will be subject to the moratorium provisions that prevent action being taken in relation to property and securities while a statutory or judicial manager is control.

6.65 It should also be noted that the litigation moratorium provisions (section 15B of the Banking Act and its counterparts in the statutory and judicial management provisions in the Insurance and Life Insurance Acts) will operate according to their tenor and will not be subject to any express reference in the amendments to the PSN Act.

6.66 Therefore the Bill inserts a new definition of 'specified moratorium provision' to the PSN Act. It lists the following in its definition:

- section 15BA of the Banking Act;

- section 15BB of the Banking Act;
- section 15BC of the Banking Act;
- section 62PA of the Insurance Act;
- section 62PB of the Insurance Act;
- section 62PC of the Insurance Act;
- section @15BA-IA of the Insurance Act;
- section @15BB-IA of the Insurance Act;
- section @15BC-IA of the Insurance Act;
- section 161A of the Life Insurance Act;
- section 161B of the Life Insurance Act;
- section 161C of the Life Insurance Act;
- section @15BA-LIA of the Life Insurance Act;
- section @15BB-LIA of the Life Insurance Act; and
- section @15BC-LIA of the Life Insurance Act. *Schedule 5, item 10, section 5 of the PSN Act]*

6.67 These moratorium provisions are, as noted above, broadly intended to prevent action being taken in relation to securities given by, and other property of, a body that is under statutory or judicial management.

6.68 The new concept of ‘specified moratorium provision’ is added in to the definition of ‘specified provisions’ in the PSN Act. This affects the meaning of the existing sections 6(2), 6A(2), 10(3) and 14(3) of the PSN Act (located in in Parts 2 (RTGS Payment systems), Part 3 (approved netting arrangements) and Part 5 (market netting contracts) of the PSN Act) because they refer to ‘specified provisions’. The effect of this is to make clear that the existing PSN Act provisions override those new moratorium sections (that is, the provisions listed under ‘specified moratorium provisions’ definition of the PSN Act), other than as provided in new section 14(3A) (see 6.71). [*Schedule 5, item 11, subsection 5(fc) of the PSN Act]*

6.69 As noted above, the amended section 15B of the Banking Act (Moratorium-effect of Banking Act statutory management on court and tribunal proceedings), and its equivalents in the Insurance Act (@15B-IA,

62P) and Life Insurance Act (@15B-LIA, 161), are not included in the ‘specified provisions’ list in the PSN Act. This preserves the status quo under which the existing section 15B (and its equivalents in the Insurance Acts) are not listed under the ‘specified provisions’ list, and there is no conflict between the existing section 14 of the PSN Act and the existing (and amended) section 15B of the Banking Act (or its Insurance Act equivalents). *[Schedule 1, item 86, Schedule 2, items 30 and 59, Schedule 3, items 18 and 24, subsection 15B of the Banking Act, subsection @15B-IA and 62P of the Insurance Act, and @15B-LIA and 161 of the Life Insurance Act]*

6.70 Section 15BD of the Banking Act (‘Moratorium-effect of Banking Act statutory management on supply of essential services’) and 15BF of the Banking Act (‘Moratorium – effect of Banking Act statutory management on annual general meeting’), and their equivalent provisions in the Insurance Act (@15BD-IA, 62PD, 62PE) and the Life Insurance Act (@15BD-LIA, 161D, 161E), do not relate to financial contracts, and so it is not necessary to make consequential amendments in the PSN Act to clarify the relationship between those sections and the PSN Act. *[Schedule 1, item 86, Schedule 2, items 59 and 30, Schedule 3, items 18 and 24, subsection 15BD and 15BF of the Banking Act, subsection @15BD-IA and 62PD, 62PE of the Insurance Act, and @15BD-LIA, 161D and 161E of the Life Insurance Act]*

6.71 Subsection 14(3) of the PSN Act provides, and will continue to provide, that the protection afforded to close-out netting contracts in section 14 of the PSN Act operates despite any ‘specified provision’ (which, as noted above, will include the new ‘specified moratorium provisions’). However, this general rule will be subject to new subsection 14A(3). The new section 14(3A) clarifies the relationship between the new moratorium provisions listed under ‘specified moratorium provision’ and paragraphs 14(1)(ca) and (2)(fa) of the PSN Act. It will be relevant where the close-out netting contract is not of a kind covered by subsection 15A(1) – in other words, broadly, if the contract is something other than a derivatives or securities lending contract. If the contract is not of that kind, and there is a security relating to that contract, the moratorium provisions will still apply in relation to that security, despite paragraphs 14(1)(ca) and (2)(fa) of the PSN Act. This reflects the fact that the protections given in paragraphs 14(1)(ca) and (2)(fa) are intended to protect securities in relation to ‘eligible obligations’ (that is, securities relating to derivatives and securities lending arrangements). *[Schedule 5, item 19, subsection 14(3A) of the PSN Act]*.

## **Consequential amendments**

6.72 The definition of ‘related’ in the Transfer Act (s4(1)) was repealed and replaced with a new definition of ‘related body corporate’. The new definition (s4A) defines related body corporate to mean, in

relation to a body corporate, a body corporate that is related to the first-mentioned body, as determined in accordance with section 4A. [*Schedule 4, items 10 and 11, subsection 4(1) of the Transfer Act*]





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## **Chapter 7**

### **Foreign branches**

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#### **Outline of chapter**

7.1 Schedules 1 to 4 to this Bill amend the Industry Acts, and the Transfer Act to expand APRA's crisis management powers with respect to the Australian branches of foreign regulated entities.

#### **Context of amendments**

7.2 Foreign ADIs in Australia provide a range of important services, such as corporate lending, trade finance, wholesale lending (including to and from other ADIs), the provision of risk hedging to ADIs and corporate clients (for example, through interest rate and currency swaps and options), and securities trading.<sup>5</sup>

7.3 Foreign insurers also provide important services in the Australian financial services system, including providing a significant amount of reinsurance capacity to the Australian general insurance market.

7.4 Some of APRA's existing crisis resolution powers apply to Australian branches of foreign regulated entities. For example, APRA already has power to apply to the Court for a judicial manager to be appointed to a foreign insurer. However, some important crisis resolution powers either do not apply to foreign branches or their application is currently unclear. In particular:

- APRA cannot appoint a statutory manager to assume control of the Australian business (or any other business) of a foreign regulated entity;
- it is unclear whether APRA may invoke the voluntary or compulsory transfer of business powers available in the Transfer Act in respect of a foreign regulated entity; and
- there is some ambiguity as to whether APRA can apply for the winding up of a foreign ADI's Australian business.

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<sup>5</sup> Note that foreign ADIs are not permitted to accept retail deposits in Australia, which generally prevents them from accepting initial deposits smaller than \$250,000 from individuals.

7.5 Given the risks that a distressed foreign regulated entity could pose to depositors or policyholders, or to financial system stability in Australia, this Bill enhances APRA’s crisis management powers with respect to foreign ADIs and foreign insurers operating in Australia. These enhancements address the gaps in APRA’s powers described above at 7.4.

7.6 These enhancements broadly reflect the international standard on resolution powers over branches, as set out in the Key Attributes. The powers would operate within the context of the challenges that may arise in the resolution of an entity with significant cross-border operations.

7.7 Where appropriate, APRA will be able to give due consideration to using the powers to facilitate the resolution of the relevant entity by its home resolution authority. In other circumstances, APRA may consider using the powers in instances where foreign authorities are unable or unwilling to intervene, or intervene in a manner that is inconsistent with the interests of Australian depositors or policyholders, or with financial system stability in Australia.

## **Summary of new law**

7.8 Schedules 1 to 4 to this Bill amend the Industry Acts and the Transfer Act to:

- provide APRA with powers to appoint a statutory manager to the Australian branch of a foreign regulated entity;
- clarify APRA’s powers to apply to wind up the Australian branch of a foreign regulated entity;
- harmonise the power to direct a foreign regulated entity not to transfer assets out of Australia across the Industry Acts;
- clarify APRA’s powers to implement a voluntary or compulsory transfer of business of the Australian branch of a foreign regulated entity; and
- provide APRA with an explicit power to revoke the authorisation of a foreign regulated entity in Australia if the entity’s authorisation is revoked by its home jurisdiction.

## **Comparison of key features of new law and current law**

<i>New law</i>	<i>Current law</i>
<i>Definition of Australian business assets and liabilities of a foreign regulated</i>	

<i>entity</i>	
The Australian business assets and liabilities of a foreign regulated entity is defined in the Industry Acts to mean the assets and liabilities of the foreign regulated entity in Australia and any other assets and liabilities arising as result of its operations in Australia.	Although the Industry Acts refer to 'business carried on in Australia' or 'business carried on outside Australia' in relation to a foreign regulated entity, these concepts are not clearly defined.
<i>Appointing a statutory manager to the Australian business assets and liabilities of a foreign regulated entity</i>	
A statutory manager can be appointed to the Australian business assets and liabilities of a foreign regulated entity where certain pre-conditions are met.	A statutory manager cannot be appointed to the Australian business of a foreign ADI, and there is no existing statutory management regime in the Insurance or Life Insurance Acts.
<i>Clarify APRA's ability to apply to the Court for the winding up of a foreign regulated entity</i>	
APRA may apply for the winding up of a foreign regulated entity on certain grounds.	It is unclear whether APRA may apply for the winding up of a foreign ADI.
<i>Enable APRA to revoke the authorisation of a foreign regulated entity if the entity's authorisation is revoked by a foreign regulator</i>	
APRA may revoke the authorisation of a foreign regulated entity in Australia if that entity's authorisation is revoked by a foreign regulator.	APRA does not have an explicit power to revoke the authorisation of a foreign regulated entity on the basis that its authorisation has been revoked by a foreign regulator.
<i>Harmonise the power to direct a foreign regulated entity to not transfer assets out of Australia across the Industry Acts</i>	
The Insurance and Life Insurance Acts include equivalent provisions to those under the Banking Act that explicitly provide APRA with the power to direct that a foreign regulated entity transfer, or not transfer, assets or liabilities either to or out of Australia.	The Banking Act explicitly provides for APRA to direct a foreign ADI to: (1) return assets to the control of the Australian business; or (2) not transfer them out of the control of the Australian business; or (3) ensure that liabilities ceases to be the responsibility of the Australian business; or (4) not act in a way that results in them becoming the responsibility of the Australian business .
<i>Implementing a voluntary or compulsory transfer of the Australian business assets and liabilities of a foreign regulated entity</i>	
APRA may implement a voluntary or compulsory transfer of the	It is unclear whether the Transfer Act allows APRA to implement a

Australian business assets and liabilities of a foreign regulated entity where certain pre-conditions are met.	voluntary or compulsory transfer of business of a foreign regulated entity.
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## Detailed explanation of new law

### General provisions

#### *Definition of Australian business assets and liabilities*

7.9 The Bill amends the Industry Acts to include a new definition, ‘Australian business assets and liabilities’, which is defined as:

- the assets and liabilities of the foreign regulated entity in Australia;
- any other assets and liabilities that the foreign regulated entity has as a result of its operations in Australia. [*Schedule 1, items 2 and 42, Schedule 2, items 2 and 67, Schedule 3, items 4 and 94, sections 5(1) and 11E of the Banking Act, sections 3(1) and section 62ZVB(2) of the Insurance Act, and section 16ZE(3) and Schedule Dictionary of the Life Insurance Act*]

7.10 This definition determines the scope of assets and liabilities of a foreign regulated entity that may be placed under statutory or judicial management, or the subject of voluntary or compulsory transfer under Part 4 of the Transfer Act.

7.11 For the purposes of the new definition of ‘Australian business assets and liabilities’, the terms ‘asset’ and ‘liability’ are also defined in each of the Industry Acts by reference to the way these terms are currently defined in section 4 of the Transfer Act. [*Schedule 1, item 2, Schedule 2, item 2, Schedule 3, item 4, subsection 5(1) of the Banking Act, subsection 3(1) of the Insurance Act, and subsection 16ZE(3) of the Life Insurance Act*]

7.12 Note that, in the Industry Acts, these terms are defined in this way *only* for the purposes of the definition of ‘Australian business assets and liabilities’. References to ‘asset’ or ‘liability’, or the location of an asset or liability, in other parts of the Industry Acts, whether in respect of domestically incorporated and/or foreign entities (for example, section 11F of the Banking Act, or sections 62ZZC and 116A of the Insurance Act) retain their original meaning.

### **Appointing a statutory manager to the Australian business of a foreign regulated entity (DI 3.1.1)**

#### *Application of legislative provisions to foreign regulated entities*

7.13 The Bill amends the Industry Acts to incorporate the application of certain powers to foreign regulated entities.

7.14 The Bill amends sections 11E of the Banking Act and 16ZE of the Life Insurance Act, and creates a new section 62ZVB of the Insurance Act, to apply provisions in the Industry Acts regarding statutory management, judicial management, and certain provisions on external administration to foreign regulated entities. These provisions include:

- Sections 12, 13BA, 13C, and Subdivision B of Division 2 of the Banking Act (relating to statutory management of ADIs and target bodies corporate);
- subsections 13A(1) to (2) of the Banking Act, to the extent that those subsections relate to statutory management;
- sections 62B, 62C, 62D and 62E of the Banking Act (relating to external administration of ADIs);
- Part VB of the Insurance Act (relating to statutory and judicial management of general insurers and target bodies corporate, as well as to external administration of general insurers); and
- Part 8 of the Life Insurance Act (relating to statutory and judicial management of life insurers and target bodies corporate, as well as to external administration of life insurers). [*Schedule 1, item 42, Schedule 2, item 67, Schedule 3, item 4, section 11E of the Banking Act, section 62ZVB of the Insurance Act, and section 16ZE of the Life Insurance Act*]

7.15 To the extent that these powers do apply to foreign regulated entities, the amendments limit the scope of the powers to the ‘Australian business assets and liabilities’ of the foreign regulated entity and, where relevant, to the management of the foreign regulated entity as it relates to its Australian business assets and liabilities.

7.16 The Insurance Act and Life Insurance Act currently include foreign insurers within the scope of the judicial management. However, the business outside of Australia of those foreign insurers is currently excluded from the scope of judicial management. Depending on the circumstances, these amendments may therefore expand the scope of assets and liabilities that a judicial manager may be appointed to control.

***Grounds for taking control of a foreign regulated entity***

7.17 The Bill amends the Industry Acts to provide that the statutory management regime applicable to domestically-incorporated entities is also applicable to foreign regulated entities with respect to their Australian business assets and liabilities. The grounds for such an appointment are the same as those on which a statutory manager may be appointed to a domestically-incorporated regulated entity. *[Schedule 1, item 42, Schedule 2, item 67, Schedule 3, item 4, section 11E of the Banking Act, section 62ZVB of the Insurance Act, and section 16ZE of the Life Insurance Act]*

7.18 The Bill also amends the Industry Acts to add further specific grounds for appointing a statutory or judicial manager to a foreign regulated entity where an external administrator has been appointed to that entity (or other similar appointment) overseas or there has been an application for the external administration of that entity, or for a similar procedure with respect that entity overseas. These grounds are also discussed at 2.64 and 2.65. *[Schedule 1, item 48, Schedule 2, item 59, Schedule 3, item 18, paragraph 13A(1)(e) of the Banking Act, paragraph @13A(1A)(e)-IA of the Insurance Act, and paragraph @13A(1A)(e)-LIA of the Life Insurance Act]*

7.19 In the case of a foreign regulated entity, the new grounds for appointing a statutory manager or judicial manager also refer to processes similar to external administration, or applications for processes similar to external administration, that may be instituted overseas in respect of that entity. Such a process would include an action by a resolution authority in another jurisdiction to administer or otherwise take control (whether directly or indirectly) of the business of a foreign regulated entity.

***Effect of statutory management on directors and management of a foreign regulated entity***

7.20 The Bill amends the Industry Acts to provide for the effects of statutory management on the governance arrangements for a foreign regulated entity. *[Schedule 1, item 85, Schedule 2, item 59, Schedule 3, item 18, subsections 15(3A)-(3C) of the Banking Act, subsections @15(2)-(3C)-IA of the Insurance Act, and subsections @15(2)-(3C)-LIA of the Life Insurance Act]*

7.21 These amendments recognise that, while the appointment of a statutory manager to a domestically-incorporated entity causes its directors to cease to hold office, this would not be appropriate for a foreign regulated entity which will have other operations outside Australia that are not within the scope of statutory management in Australia.

7.22 The amendments provide that the directors of the foreign regulated entity are prevented from acting in relation to the Australian business assets and liabilities of a foreign regulated entity once it is under statutory management. *[Schedule 1, item 85, Schedule 2, item 59, Schedule 3, item 18, subsections 15(3B)-(3C) of the Banking Act, subsections @15(3B)-*

***(3C)-IA of the Insurance Act, and subsections @15(3B)-(3C)-LIA of the Life Insurance Act]***

7.23 The Bill also provides that the agent in Australia of a foreign general insurer and the Compliance Committee members of a foreign life insurer cease to hold their appointment once a statutory manager takes control of the entity's Australian business assets and liabilities, and may not be reappointed for the duration of statutory management. It is intended that the statutory manager have the powers and functions of the agent in Australia or Compliance Committee members for the duration of statutory management. *[Schedule 2, item 59, Schedule 3, item 18, subsections @15(2)-(2B)-IA of the Insurance Act, and subsections @15(2)-(2B)-LIA of the Life Insurance Act]*

***Termination of statutory management of a foreign regulated entity***

7.24 The Bill amends the Insurance and Life Insurance Acts to implement specific provisions for the termination of statutory management of foreign insurers. In particular, the amendments change the matters to be addressed by APRA before the ultimate termination of control of a foreign insurer under the Insurance and Life Insurance Acts.

7.25 The harmonised statutory management regime under each of the Industry Acts requires APRA to take certain steps before it can terminate the statutory management of a regulated entity. These steps are to ensure that the regulated entity has directors in place; either by ensuring that directors are validly appointed as per the entity's constitution or by the statutory manager appointing directors to the entity; or by ensuring that the regulated entity is being wound up.

7.26 The amendments include different requirements where APRA is terminating the statutory management of a foreign insurer under the Insurance or Life Insurance Acts. Before ending the statutory management of a foreign insurer, APRA must ensure that an agent in Australia is appointed in the case of a foreign general insurer, or a Compliance Committee established in the case of a foreign life insurer. Otherwise, it must ensure that a liquidator has been appointed to the Australian business assets and liabilities of the foreign insurer. *[Schedule 2, item 59, Schedule 3, item 18, subsection @13C(2)-IA of the Insurance Act, and subsection @13C(2)-LIA of the Life Insurance Act]*

7.27 These amendments are intended to ensure foreign insurers have functional local governance structures to continue operations in Australia after statutory management.

***Effect of judicial management on agents in Australia and Compliance Committees of foreign insurers***

7.28 The Bill amends the Insurance and Life Insurance Acts to provide that, on the appointment of a judicial manager to a foreign insurer,

the powers and functions of an agent in Australia for a foreign general insurer, and of the members of a Compliance Committee for a foreign life insurer, are removed for the period that the foreign insurer is under judicial management. *[Schedule 2, item 36, Schedule 3, item 30, subsection 62T(1) of the Insurance Act, and subsection 165(1) of the Life Insurance Act]*

7.29 The Insurance Act requires all foreign general insurers and subsidiaries of foreign general insurers to have an agent in Australia. Similarly, the Life Insurance Act requires all foreign life insurers to have a Compliance Committee. Agents in Australia and Compliance Committees have a number of powers and functions with respect to the Australian operations of a foreign insurer. However, the current law does not clarify the effect of judicial management on them.

7.30 These amendments interact with the amendments to the judicial management provisions in the Insurance and Life Insurance Acts (explained in Chapter 1 – see 2.113 to 2.119) that ensure that persons with the powers and functions of an officer of an insurer cease to have those powers and functions for the duration of judicial management.

7.31 The amendments put beyond doubt that agents in Australia and members of Compliance Committees cannot exercise powers and functions, given that this would conflict with a judicial manager's control of a foreign insurer with respect to its Australian business assets and liabilities.

### **Clarify that APRA may apply to the Court for the winding up of a foreign regulated entity**

7.32 The Bill amends the Industry Acts to include specific provisions relating to the winding up of a foreign regulated entity. These amendments clarify that APRA may apply to the Federal Court of Australia for the winding up of a foreign regulated entity.

7.33 Regarding foreign ADIs, the Bill includes a new section 11EA that provides three grounds on which APRA may apply for the winding up of a foreign ADI;

- where the foreign ADI is unable to meet its liabilities in Australia, or in one or more foreign countries, as and when they become due and payable;
- where application for the winding up or other external administration of the foreign ADI, or for a similar procedure in respect of the foreign ADI, has been made in one or more foreign countries; or

7.34 an external administrator has been appointed to the foreign ADI, or a similar appointment in respect of the foreign ADI has been made, in



one or more foreign countries. *[Schedule 1, item 44, section 11EA of the Banking Act]* It is important for APRA to have the powers to respond to the application for, or commencement of, procedures in foreign jurisdictions, such as a foreign resolution authority implementing a resolution action in respect of a foreign regulated entity. In particular, these amendments allow APRA to act quickly to secure the assets of a distressed foreign ADI in order to meet its liabilities in Australia.

7.35 Upon APRA applying for the winding up of a foreign ADI under the Banking Act, the new subsection 11EA(3) of the Banking Act provides that the winding up of the foreign ADI is to be conducted in accordance with the Corporations Act. *[Schedule 1, item 44, subsection 11EA(3) of the Banking Act]*

7.36 The Bill also includes amendments to section 181 of the Life Insurance Act in relation to foreign life insurers that adapt the new provisions in the Banking Act described at 7.33. *[Schedule 3, item 51, section 181 of the Life Insurance Act]*

7.37 The current law (sections 62ZU and 62ZV of the Insurance Act) already provides that APRA may apply for the winding up of a general insurer (including a foreign general insurer) under the Insurance Act (under section 62ZU) or under the Corporations Act (under section 62ZV). As such, analogous amendments to the Insurance Act of the kind made to the Banking Act are not necessary because APRA may apply for the winding up of a foreign general insurer under the Corporations Act in circumstances similar to those described at 7.33.

7.38 As a minor amendment, a note has been added to section 62ZV to explain the relationship between sections 62ZU and 62ZV of the Insurance Act and sections 459P and 462 of the Corporations Act. *[Schedule 2, item 66, section 62ZV of the Insurance Act]*

### **Enable APRA to revoke the authorisation of a foreign-regulated entity if the entity's authorisation is revoked by its home regulator**

7.39 The Bill amends the Industry Acts to enable APRA to revoke the authorisation of a foreign regulated entity to carry on banking or insurance business if the entity's authorisation is revoked or withdrawn in a foreign country.

7.40 The amendments provide APRA with the power to revoke a foreign regulated entity's authorisation in Australia if its authorisation has been revoked or withdrawn in a foreign country, without having to satisfy further grounds for revocation. This may be important where the entity's conduct in a foreign country has been of such prudential concern as to warrant the revocation of its authorisation to conduct banking or insurance business in Australia.

7.41 To this end, the Bill includes this new power within the new paragraphs 9A(2)(h) of the Banking Act, 15(1)(fa) of the Insurance Act, and 26(1)(h) of the Life Insurance Act. *[Schedule 1, item 15, Schedule 2, item 13, Schedule 3, item 6, section 9A of the Banking Act, section 15 of the Insurance Act, and section 26 of the Life Insurance Act]*

7.42 Note that a reference to a ‘foreign country’ is intended to include any jurisdictions within a foreign country. For example, where a foreign regulated entity has its licence revoked by an authority within a state of a foreign jurisdiction.

### **Harmonise the power to direct that a foreign regulated entity not transfer assets out of Australia across the Industry Acts**

7.43 The Bill amends the Insurance and Life Insurance Acts to provide APRA with an explicit direction powers in respect of the transfer of assets and liabilities of a foreign insurer in or out of Australia.

7.44 The Banking Act already includes a specific power for APRA to make a direction to a foreign ADI to require that it transfer, or not transfer, assets or liabilities either to or out of Australia. In general terms subsection 11CA(2B) of the Banking Act gives APRA power to direct a foreign ADI to:

- return assets to the control of the Australian business;
- not transfer them out of the control of the Australian business;
- ensure that liabilities ceases to be the responsibility of the Australian business; or
- not act in a way that results in them becoming the responsibility of the Australian business.

7.45 These amendments add equivalent provisions to the Insurance and Life Insurance Acts so that APRA can make a direction of this kind to a foreign insurer. *[Schedule 2, item 114, Schedule 3, item 85, section 104 of the Insurance Act, and section 230B of the Life Insurance Act]*

7.46 These provisions are not intended to limit the scope of APRA’s other directions powers, which are also applicable to foreign regulated entities.

7.47 Minor stylistic amendments have been made to clarify the language of paragraphs 11CA(2B)(a) and 11CA(2B)(b) of the Banking Act, and these amendments have been copied into the new provisions of the Insurance and Life Insurance Acts.

### **Implementing a voluntary or compulsory transfer of Australian business assets and liabilities of a foreign regulated entity**

7.48 The Bill amends the Transfer Act to include specific provisions for the transfer of Australian business assets and liabilities of a foreign regulated entity.

7.49 While the Transfer Act does not explicitly exclude the possibility of voluntary or compulsory transfers of business from foreign regulated entities, it does not address the practicalities of such a transfer.

7.50 In particular, the Transfer Act does not establish the scope of assets and liabilities of a foreign regulated entity that might be transferred under the powers in that Act.

**7.51** The Bill includes new definitions of ‘eligible foreign life insurance company’, ‘foreign ADI’, and ‘foreign general insurer’ that correspond to the equivalent definitions in the Industry Acts, as well as a definition of ‘Australian business assets and liabilities’ which aligns with the equivalent definition added to the Industry Acts under the amendments described at 7.9 to 7.15. *[Schedule 4, item 5, subsection 4(1) of the Transfer Act]*

7.52 Further, the Bill inserts a new section 43A that states that, for the purposes of a voluntary or compulsory transfer of business from a foreign regulated entity, the Australian business assets and liabilities of the foreign regulated entity are to be treated as if they comprised the entire business for the purposes of the relevant provisions in the Transfer Act. *[Schedule 4, item 82, section 43A of the Transfer Act]*

7.53 These amendments do not affect the existing provisions for the voluntary transfer of business of a general insurer or life insurer (including a foreign insurer) under Part III, Division 3A of the Insurance Act or Part 9 of the Life Insurance Act.

7.54 This is intended to remove any ambiguity in Australian law about which assets and liabilities are covered under a transfer of business from a foreign regulated entity under Part 3 or Part 4 of the Transfer Act.



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## **Chapter 8**

# **Financial Claims Scheme**

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### **Outline of chapter**

8.1 Schedules 1 and 2 to this Bill amend the Banking and Insurance Acts to make certain enhancements to the efficiency and operation of the FCS.

### **Context of amendments**

8.2 The FCS was established by the Government in 2008 as two separate schemes. One is applicable to locally-incorporated ADIs and the other is applicable to general insurers. The FCS is administered by APRA.

8.3 The FCS provides an important backstop within Australia's resolution regime. While its primary function is to protect retail depositors and policyholders by providing prompt access to their funds, the FCS also contributes to financial stability, for example by limiting the propensity for a destabilising 'run' on deposits in the case of ADIs, and more generally by promoting confidence in the financial system.

8.4 The FCS for ADIs provides depositors with a guarantee of their deposits up to a pre-determined limit, which is currently set at \$250,000 per account-holder, per ADI. In the case of general insurers, the FCS provides compensation for most claims up to \$5,000 against a failed general insurer, with claims above \$5,000 also covered for eligible policyholders and certain third parties.

8.5 While the legislative framework for the FCS is broadly consistent with international standards, particularly the IADI Core Principles for Effective Deposit Insurance Schemes, some of the provisions would benefit from further enhancements.

8.6 Some changes to the ADI FCS framework were the subject of the then Government's consultation paper released in May 2011 entitled 'Financial Claims Scheme: Consultation Paper'. The enhancements proposed in this Bill build upon those changes, as well as certain proposals in relation to the FCS for general insurers from the 2012 Consultation Paper.

8.7 To date, the FCS has been declared once in respect of a small general insurer and APRA's experience in administering the FCS for that

general insurer also serves as a basis for some of the enhancements in this Bill.

## Summary of new law

8.8 Schedules 1 and 2 to this Bill amend the Banking and Insurance Acts to:

- 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;
- ensure 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, upon appointment of a statutory manager; and
- reduce the reporting burden regarding withholding tax in relation to interest on amounts paid under the FCS.

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<i>Enable FCS entitlements to be satisfied by transfer of deposits or policyholder claims</i>	
<p>The Banking and Insurance Acts allow FCS funds to be used to support a compulsory transfer of business under the Transfer Act comprising:</p> <ul style="list-style-type: none"> <li>• in the case of a declared ADI, all the protected accounts of the ADI (or all such accounts subject to a limit applied on a per-</li> </ul>	<p>FCS funds cannot be used to support a compulsory transfer of business under the Transfer Act, in order to meet the entitlements of protected account-holders and policyholders under the FCS by transferring their accounts or policies to a receiving body.</p>

<p>account-holder basis to reflect the cap that applies per account-holder under section 16AG of the Banking Act); or</p> <ul style="list-style-type: none"> <li>in the case of a declared general insurer, at least one protected policy of the general insurer,</li> </ul> <p>to meet the entitlements of protected account-holders or relevant policyholders by transferring their accounts or policies to a receiving body.</p>	
<p><i>Enable APRA to obtain information from third parties in relation to the FCS</i></p>	
<p>APRA may obtain information from any other person (in addition to those specified in the current law) relevant to determining and paying amounts under the FCS.</p>	<p>APRA may obtain only from specified persons (for example, a statutory manager of an ADI) information relevant to determining and paying amounts under the FCS.</p>
<p><i>Ensure the effective payout of FCS entitlements to third-party claimants of the policyholder of a failed general insurer when the policyholder is in liquidation</i></p>	
<p>Payments made by APRA under the FCS to an insolvent corporate policyholder and which are the subject of claims by any third party claimants against the insolvent policyholder are to be paid in liquidation according to the priority provided for under section 562 of the Corporations Act.</p>	<p>If APRA makes payment under the FCS to an insolvent corporate policyholder, it is uncertain whether a third party claiming against the insolvent policyholder will be accorded priority in liquidation, under section 562 of the Corporations Act, for the amount claimed and paid to the insolvent policyholder.</p>
<p><i>Enable APRA to make interim payments to claimants under the FCS</i></p>	
<p>APRA may, in accordance with regulations, determine the total amount of interim claims made by a claimant of a protected policy, and to make payments in response to those interim claims.</p>	<p>It is uncertain whether APRA can make a series of interim determinations allowing additional payments under the insurance FCS. This may be desirable where, for example, the losses insured by a protected policy materialise, and become payable, on multiple occasions over a period of time or where it is expedient to make an initial payment of an undisputed amount and further payments following assessors' reports.</p>
<p><i>Granting the Treasurer discretion to declare the FCS at an earlier time</i></p>	

The Treasurer may now declare the FCS in relation to an ADI or general insurer once a statutory manager has taken control of the ADI or general insurer, in addition to the existing preconditions in the law.	The Treasurer may declare the FCS in relation to an ADI only when APRA has applied to wind up the ADI, and in relation to a general insurer only when it is under judicial management or an external administrator has been appointed.
<i>Reducing the reporting burden in relation to withholding tax</i>	
APRA is no longer required to report to the ATO any interest paid and withholding tax applicable on amounts paid out to account-holders or policyholders protected under the FCS.	APRA is required to report to the ATO any interest paid and withholding tax applicable on amounts paid out to account-holders or policyholders protected under the FCS.

## Detailed explanation of new law

### Enable FCS entitlements to be satisfied by transfer of deposits or policyholder claims

8.9 The Banking and Insurance Acts currently provide APRA with various methods to meet an account-holder’s or policyholder’s entitlement under the FCS, such as by opening a new account for an account-holder, or paying the amount to the policyholder or applying the amount for the person’s benefit.

8.10 The May 2011 Consultation Paper recommended an additional payment mechanism to facilitate the transfer of protected deposit accounts from a failed ADI to a receiving ADI. This new mechanism would enable the account to be transferred with all direct debit and credit facilities in a way that would allow it to continue to be used seamlessly as if it were still with the failed ADI. APRA would determine whether the transfer option would provide a cost-effective and efficient option based on the circumstances in each case. A similar proposal in respect of the FCS applicable to general insurers was included in the September 2012 consultation paper.

8.11 APRA already has extensive powers under the Transfer Act to effect a transfer of business from one ADI to another. This is also the case with a transfer of business from one general insurer to another.

8.12 Transfer of an ADI’s protected accounts may have the advantage of preserving arrangements such as direct debit facilities, and therefore be less disruptive than the alternative of APRA making direct FCS payments to the account-holders. In the context of general insurers, a transfer of business, especially long-tail insurance claims, may be either the only



practical or the most cost-effective means of maintaining an insured policyholder's protection.

8.13 The Bill therefore amends the Banking and Insurance Acts to create an additional payment mechanism for the FCS by allowing APRA to use FCS funds to facilitate a transfer of business from a declared ADI or from a declared general insurer to a receiving body.

***Transferred liabilities determination***

8.14 The Bill amends the Banking and Insurance Acts to allow APRA to make a transferred liabilities determination, which will facilitate the transfer of business and the meeting of FCS entitlements.

8.15 APRA may only make a transferred liabilities determination if all of the following apply:

- the Minister has made a declaration under section 16AD of the Banking Act in relation to an ADI (the 'declared ADI'), or a declaration under section 62ZZC of the Insurance Act in relation to a general insurer (the 'declared general insurer');
- APRA has made, or proposes to make, a compulsory transfer determination under section 25 of the Transfer Act that there is to be a total or partial transfer from the declared ADI or general insurer to a receiving body;
- where the transferring body is a declared ADI, the transfer of business will transfer the liabilities in respect of every protected account kept by an account holder with the ADI (or the liabilities of the declared ADI in respect of every protected account-holder up to their FCS limit – note that if this approach is taken APRA will need to apportion the FCS liability between protected accounts where there are multiple accounts for the account holder which, in aggregate, exceed the FCS limit, as explained below);
- where the transferring body is a declared general insurer, the transfer of business will transfer the liabilities of the general insurer in respect of one or more protected policies issued by the general insurer;
- APRA is satisfied that it will be able to identify each of those protected accounts or policies;
- APRA has worked out a reasonable estimate of the total amount to which account-holders and policyholders of those protected accounts or policies will be entitled to under the FCS (defined as the FCS amount);

- APRA has worked out a payment amount with respect to the FCS amount above (see below at X.XX); and
- APRA considers it reasonable to make the determination.

8.16 Note, that the new subparagraph 16AIA(1)(ba)(ii) of the Banking Act allows APRA to make this determination where the scope of the transfer of business will only extend to the amount to which each account-holder would be entitled to under the FCS. In any scenario under this determination, the FCS entitlement of each account-holder would be reduced to nil as outlined in the following two examples:

- Example 1: if an account holder has a single protected account with a balance over the FCS limit of \$250,000 (say \$400,000), then, applying the current limit under section 16AG, only \$250,000 of that account would be transferred to the receiving body with the remainder (\$150,000 in the example) left behind to be claimed in the insolvency of the declared ADI.
- Example 2: if an account-holder has two or more protected accounts with an aggregate balance of over \$250,000, then their balances totalling \$250,000 would be transferred to the receiving ADI with APRA having the discretion to split the accounts to achieve this purpose. The remainder of the balance of the accounts would be left behind to be claimed in the insolvency of the declared ADI.

8.17 The amendments also require that this determination is made in writing, and that various details (including the declared ADI or general insurer, the receiving body, and any other information that APRA considers appropriate) are specified in the determination.

8.18 The Bill provides that such determinations made by APRA are not legislative instruments. The provision is included to assist readers, as such a determination would not be a legislative instrument within the meaning of subsection 8(1) of the *Legislation Act 2003*. [*Schedule 1, item 95, Schedule 2, item 81, section 16AIA of the Banking Act, and section 6ZZMA of the Insurance Act*]

8.19 The Bill defines a ‘transferred liability determination’ in the Banking and the Insurance Acts to refer to determinations made under sections 16AIA of the Banking Act or 6ZZMA of the Insurance Act (as appropriate). [*Schedule 1, item 10, Schedule 2, item 9, subsection 5(1) of the Banking Act, and subsection 3(1) of the Insurance Act*]

***Determining a payment amount***

8.20 As part of making a transferred liability determination, the Bill amends the Banking and Insurance Acts to allow APRA to calculate a 'payment amount' that will be paid to the receiving body of the protected accounts or policies. This amount is an amount equal to or less than the FCS amount that APRA considers to be appropriate and is to be made from the appropriation in the Financial Claims Scheme Special Account established in Division 2 of Part 5 of the APRA Act.

8.21 When determining an appropriate payment amount, APRA must consider:

- the total value of the assets that will be transferred to the receiving body in accordance with the transfer of business;
- the total value of the liabilities that will be transferred from the declared ADI or general insurer to the receiving body in accordance with the transfer of business; and
- any other matter that APRA considers appropriate. [*Schedule 1, item 95, Schedule 2, item 81, subsection 16AIB(2) of the Banking Act, and subsection 62ZZMB(2) of the Insurance Act*]

8.22 These amendments ensure that APRA has discretion to determine how much to pay to a receiving body of liabilities consisting of protected accounts or policies. The amount can be no more than the total FCS liability in respect of the declared ADI, or of the general insurer in respect of the relevant protected policies, and could be less than this amount which may provide a better financial outcome for the Commonwealth.

***Effect of a transferred liabilities determination***

8.23 The Bill amends the Banking and Insurance Acts to enable the receiving body, in respect of a transferred liabilities determination, to receive the payment amount specified in the determination (see 8.20) once APRA has issued the relevant certificate of transfer under section 33 of the Transfer Act.

8.24 These amendments provide that, once APRA has made a transferred liabilities determination, and has issued certificate of transfer, the receiving body is entitled to be paid by APRA an amount equal to the payment amount. The declared ADI or general insurer is then liable to pay APRA an amount equal to the payment amount. [*Schedule 1, item 95, Schedule 2, item 81, subsections 16AIC(1) and (2) of the Banking Act, and subsections 62ZZMC(1) and (2) of the Insurance Act*]

8.25 Note that the Bill also amends subsection 13A(3) of the Banking Act to provide that the assets of an insolvent ADI are available to meet an

amount owed to APRA under sections 16AI or 16AIC before any other liabilities. *[Schedule 1, item 52, paragraph 13A(3)(a) of the Banking Act]*

8.26 This is because the payment amount determined by APRA is effectively the entitlement under the FCS of the protected account-holders of the insolvent ADI and should be treated in the same way in the winding up of the insolvent ADI.

8.27 There is no equivalent of subsection 13A(3) of the Banking Act in the Insurance Act. Subsection 116(3) of the Insurance Act requires that assets in Australia of an insurer be applied first to liabilities in Australia in the winding up of the insurer. Amounts paid by APRA under the FCS, including those paid in connection with a transferred liabilities determination, will (under section 62ZZL) become liabilities of the insurer to APRA. They will be primarily payable in Australia, and will fall within the protection of subsection 116(3).

8.28 The Bill also ensures that the protected account-holder or policyholder is no longer entitled to any amount under the FCS with respect to any protected account in the case of a declared ADI, or with respect to the relevant transferred policy in the case of a declared general insurer. *[Schedule 1, item 95, Schedule 2, item 81, subsection 16AIC(3) of the Banking Act, and subsection 62ZZMC(3) of the Insurance Act]*

8.29 This is because, as a result of the transferred liabilities determination, the protected account-holder or policyholder has been paid their entitlement under the FCS through the transfer of their account or policy to the receiving body and the payment of the payment amount to the receiving body.

### **Enable APRA to obtain information from third parties in relation to the FCS**

8.30 APRA may currently under the Banking or Insurance Acts require certain persons to give specified information in relation to the FCS. Those persons are:

- an ADI or general insurer; or a statutory manager or liquidator appointed to the ADI;
- a judicial manager or liquidator appointed to a general insurer; or
- an insurance claimant (under section 62ZZR of the Insurance Act).

8.31 However, these provisions do not enable APRA to require information to be sought from other persons who may hold information that facilitates the administration of the FCS.

8.32 In the ADI context, these persons may include third party service providers to whom APRA may delegate FCS functions under section 16AN of the Banking Act, or any other persons (for example, providers of data warehouse facilities, data processing facilities and IT services) who may have provided or may still be providing certain services to the failed ADI.

8.33 In the general insurance context, one issue that has emerged from experience in administering the FCS is that third parties may hold the relevant information, such as claims files. These third parties may include a co-insurer, insurance broker, claims manager or another general insurer to whom liabilities may have been purportedly transferred by the failed general insurer without complete novation.

8.34 The Bill amends sections 16AK of the Banking Act and 62ZZP of the Insurance Act to ensure that, in addition to the persons currently listed, APRA may obtain information from any other person. [*Schedule 1, item 98, Schedule 2, item 85, paragraph 16AK(1)(d) of the Banking Act, and paragraph 62ZZP(1)(e) of the Insurance Act*]

8.35 These amendments extend the scope of persons that APRA can obtain information from regarding the determination and payment of entitlements under the FCS.

8.36 The Bill also extends the current civil penalty provision, punishable by 200 penalty units, to capture any other person. [*Schedule 1, item 103, Schedule 2, item 90, subsection 16AL(8) of the Banking Act, and subsection 62ZZQ(11) of the Insurance Act*]

### **Ensure the effective payout of FCS entitlements to third party claimants of a policyholder of a failed general insurer where the policyholder is in liquidation**

8.37 The Insurance Act currently provides for different types of claimants under the FCS framework. Persons who may claim under the FCS are those entitled to claim under insurance cover provided under a protected policy (for example, the policyholder or someone to whom the policy is expressed to apply), and those permitted to recover an amount from a general insurer under legislation such as the *Insurance Contracts Act 1984* and the Corporations Act. Given the scope of persons who may claim under the FCS, it is possible that a claimant may not be a policyholder of a failed general insurer but, rather, a person claiming against such a policyholder.

8.38 The Bill inserts a regulations-making power into the Insurance Act to enable the specification, for the purposes of section 62ZZJ, of any other law providing cut-through rights for third party insurance claimants in addition to those already specified in section 62ZZJ (that is, section 51 of the *Insurance Contracts Act 1984* and section 601AG of the

Corporations Act). [*Schedule 2, item 78, paragraph 6ZZJ(4B)(c) of the Insurance Act*]

8.39 The reason for this amendment is that there may be other statutory third party rights in relation to insurers, including under State and Territory legislation, in addition to section 51 of the *Insurance Contracts Act 1984* and section 601AG of the Corporations Act.

8.40 Rather than specify them in the Insurance Act itself, it is desirable to do so in the regulations so as to be able to ensure that they are all capable of being captured and there is the flexibility to make amendments by regulation when, for example, the legislation prescribing the third party rights is amended or relocated in other legislation. The power may also be used to make payments to third party claimants rather than the policyholder in situations where APRA believes this would be a better outcome for third party claimants.

8.41 Section 562 of the Corporations Act provides that, where a company in liquidation had a policy covering liability to a third party, and the company or its liquidator has 'received' from the insurer an amount in respect of that liability, the amount must be paid by the liquidator (after deducting expenses of getting that amount) to the third party in priority to all payments under section 556 of the Corporations Act.

8.42 An example of such a circumstance would be where a company has taken out an insurance policy against the risk of compensation to members of the public, who have suffered loss as a result of negligence of the company, under a public liability policy, and the company is in liquidation with outstanding claims for such compensation at the time that the FCS is declared.

8.43 Existing section 6ZZM of the Insurance Act has the effect of ensuring that in the above scenario (and in relation to FCS payments generally) the FCS payment to the insolvent company (or other claimant) will discharge the liability of the general insurer to company. This means that the company, once it receives the payment under the FCS, cannot 'double dip' by claiming against the insurer for the same amount.

8.44 However, there is nothing in the current legislation putting the insolvent company or its liquidator under an obligation to pay the FCS amount to the third party in the same way that it would have to, under section 562, if the payment had been received from the insurer in this scenario. Upon receiving the FCS payment, the liquidator may feel obliged to treat the circumstances as falling outside section 562, because the money was not 'received' from the insurer. In that event the third party may have no section 562 rights and their claim against the insolvent company which would rank under section 556 of the Corporations Act with general creditors.

8.45 To overcome this, the Bill amends the Insurance Act to provide, for the avoidance of doubt, that for the purposes of subsection 562(1) of the Corporations Act, the FCS amount will be taken to have been 'received' by the person (that is, by the insolvent company) from the general insurer, and therefore the liquidator will be obliged to deal with it in accordance with section 562 as if it had been received from the insurer. *[Schedule 2, item 80, subsection 62ZZM(1A) of the Insurance Act]*

### **Enable APRA to make interim payments to claimants under the FCS**

8.46 Currently, under the FCS, where APRA becomes aware that a person has made a claim under insurance cover provided under a protected policy, section 62ZZI of the Insurance Act places an obligation upon APRA to determine whether a general insurer is liable to the person in respect of the claim and the amount of that liability. Once a determination is made, APRA may make payments to the person, subject to the person meeting the eligibility requirements for claims of \$5,000 or more.

8.47 APRA has encountered difficulties in administering these provisions where personal injury claims have been litigated. While the legal obligation to pay out under a claim may not arise until the quantum of the claim is determined, payments for personal injury claims are often made by general insurers to meet medical and legal costs arising in the interim. It is arguable that APRA has the ability to make such interim payments under the FCS, however it is not clear under the current legislation.

8.48 The Bill addresses this issue by amending the Insurance Act to allow APRA to determine, in accordance with regulations, a total amount of a person's interim claims for payment of part or parts of that liability.

8.49 Any regulations made may prescribe conditions that must be met before a payment of an interim claim is made. *[Schedule 2, items 72 and 75, subsections 62ZZF(3A) and 62ZZG(4) of the Insurance Act]*

### **Granting the Treasurer the discretion to declare the FCS at an earlier time**

8.50 The FCS is currently activated at the discretion of the Treasurer once APRA has formed the view that the ADI or general insurer is insolvent and, in the case of an ADI, has applied to the Federal Court for an ADI to be wound up, or in the case of a general insurer, is under judicial management or an external administrator has been appointed.

8.51 The May 2011 Consultation Paper noted the CFR's recommendation that it should be possible for the FCS to be activated earlier in the resolution process, where there is no prospect of the failing ADI being restored to a sound financial condition or being transferred to another ADI. Under the CFR proposal, rather than having to wait until an

application has been made by APRA to wind up a distressed ADI, the Treasurer would have discretion to activate the FCS as soon as APRA has appointed a statutory manager.

8.52 To this end, the Bill amends the Banking and Insurance Acts to include the statutory management of an ADI or a general insurer as preconditions that allow the Minister to declare the FCS. [*Schedule 1, item 92, Schedule 2, item 70, subsection 16AD(1) of the Banking Act, and subsection 6ZZZC(1) of the Insurance Act*]

8.53 The existing preconditions for the Minister to declare the FCS (that is, on APRA's application to wind up the ADI or where an external administrator or judicial manager has been appointed to the general insurer) has not changed. It is noted that a separate amendment in the Bill will enable APRA to apply for the winding-up of an ADI without first having to appoint a statutory manager (see Chapter 9).

8.54 These amendments will assist in managing the resolution of a distressed ADI or general insurer. In particular, in the case that a statutory manager is appointed, it would enable the nature of the intended resolution (if this is clear) to be announced, including the declaration of the FCS, at the same time as the statutory manager is appointed. This would provide depositors and policyholders with greater certainty as to the status of their deposits and ability to claim on their policies, and the intended arrangements with respect to accessing their deposits or making claims.

### **Reducing the reporting burden in relation to withholding tax**

8.55 Under section 16AHA of the Banking Act, APRA is required to report to the ATO any interest paid (and withholding tax applicable) on amounts paid to account-holders protected under the ADI FCS. A similar provision exists in section 6ZZZKA of the Insurance Act with respect to the FCS for general insurers. APRA's previous experience of administering the FCS identified these requirements as unnecessary and inefficient.

8.56 This reporting obligation imposes costs for ADIs and general insurers, which may have to pre-position to report these amounts to APRA under the FCS. Further, APRA's obligation to collect information on these amounts and report to the ATO duplicates the ATO's existing business processes in the annual investment income report (AIIR). This means that the FCS amounts can be reported to the ATO by the liquidator in due course using the AIIR, rather than by a separate report from APRA.

8.57 The Bill therefore amends the Banking and Insurance Acts to remove the obligation that APRA report to the ATO the amounts paid to and withheld from account-holders or policyholders protected under the FCS. [*Schedule 1, item 94, Schedule 2, item 79, subsection 16AHA(3) of the Banking Act, and subsection 6ZZZKA(3) of the Insurance Act*]



8.58 These amendments will improve the efficiency of administering the FCS.

8.59 The Bill also makes consequential amendments to the Banking and Insurance Acts to remove references to the reports. [*Schedule 1, item 100, Schedule 2, item 87, paragraph 16AK(4)(ea), and paragraph 62ZZP(4)(da) of the Insurance Act*]

## Consequential amendments

### *Objectives of the FCS*

8.60 The Bill makes consequential amendments to the Banking and Insurance Acts to include statutory management of an ADI or general insurer (as appropriate; see 8.50 to 8.54) as a precondition to the declaration of the FCS; as well as including the additional payment mechanism (see 8.9 to 8.29) as part of the objectives of the FCS. [*Schedule 1, items 90 and 91, Schedule 2, items 68 and 69, section 16AB of the Banking Act, and section 62ZW of the Insurance Act*]

### *Clarifying effect of a transferred liabilities determination under the Insurance Act*

8.61 The Bill makes consequential amendments to the Insurance Act to clarify that, where a transferred liabilities determination results in a receiving body receiving a payment amount (see 8.9 to 8.29), sections 62ZZK, 62ZZKA, 62ZZL, and 62ZZM (which relate to the method of paying entitlements) do not apply in relation to the entitlement of the receiving body. [*Schedule 2, item 81, section 62ZZMD of the Insurance Act*]

8.62 The Bill also amends the *Income Tax Assessment Act 1997* to exclude the additional payment mechanism (see 8.9 to 8.29) from the operation of these provisions. [*Schedule 7, items 8 and 9, paragraph 322-30(b) of the Income Tax Assessment Act 1997*]

### *Amending notes to the Insurance Act FCS provisions*

8.63 The Bill makes consequential amendments to the Insurance Act to reflect the expanded scope of laws that APRA may consider when determining whether to pay an amount under the FCS to a claimant (see 8.37). [*Schedule 2, items 73 and 74, subsections 62ZZG(2) and 62ZZG(3) of the Insurance Act*]



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## **Chapter 9**

### ***Wind-up and other matters***

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#### **Outline of chapter**

9.1 Schedules 1 to 3 to this Bill amend the Industry Acts to enhance the operation and scope of APRA's powers in the context of wind-up and other external administration. The Bill also enhances APRA's powers to impose conditions on, or revoke, a regulated entity's authorisation.

#### **Context of amendments**

9.2 APRA's winding up powers under the Industry Acts are an important part of the crisis management toolkit, enabling it to act in situations where a regulated entity is insolvent or about to become insolvent. The ability to initiate the winding up of a regulated entity in a timely manner may assist to prevent further financial deterioration, potentially improving outcomes for depositors and policyholders, and minimising impacts on the financial system more broadly.

9.3 In many cases, proceeding straight to the wind-up of a regulated entity will not be an appropriate way of protecting beneficiaries and minimising impacts on the financial system, even if the entity is or is likely to become insolvent. APRA will usually need to use its other crisis management powers, including potentially the appointment of a statutory or judicial manager to stabilise the entity's critical operations, in order to assess and execute an orderly resolution such as a recapitalisation or transfer. In some cases, with or without use of other powers such as statutory or judicial management, all or part of the failed entity's business could be put into wind-up, with declaration of the FCS as appropriate.

9.4 Although the external administration and winding up provisions in the Industry Acts generally operate satisfactorily, past experience in the application of some of these powers, for example in the general insurance sector, has identified further areas where the regime could be enhanced.

9.5 In particular, there is a lack of uniformity in APRA's powers in relation to provisional liquidators and administrators, and in the circumstances in which a person applying for the appointment of an external administrator to a regulated entity must provide APRA with notice.

9.6 Making enhancements to address these issues will create a more consistent and effective legislative basis for APRA's involvement in the winding up or other external administration of regulated entities.

9.7 In circumstances where a regulated entity is failing or likely to fail, APRA may also need to impose conditions on, or to revoke, the entity's authorisation under the Industry Acts. This may be an important step in minimising adverse impacts during resolution, and a complementary step to the winding up of a regulated entity. The Bill makes amendments to ensure that APRA has appropriate powers to impose conditions and revoke authorities if certain grounds are met.

## **Summary of new law**

- 9.8 Schedules 1 to 3 to this Bill amend the Industry Acts to:
- harmonise the Industry Acts with regard to APRA's involvement in external administration of regulated entities;
  - ensure that APRA's existing powers in the winding up of a regulated entity extend to where a provisional liquidator is appointed;
  - enable APRA to apply for the winding up of an ADI without the ADI having first been placed in statutory management;
  - provide APRA with notice of proposed applications for external administration of regulated entities;
  - ensure that the institution of offence proceedings is no bar to judicial management or winding up of a regulated entity;
  - enhance APRA's ability to impose, vary and revoke conditions of authorisation in certain circumstances; and
  - enable APRA to revoke authorisations on certain additional grounds under the Industry Acts.

## **Comparison of key features of new law and current law**

<i>New law</i>	<i>Current law</i>
<i>APRA's involvement in external administration</i>	
APRA's powers in the winding up of a regulated entity are extended to where a provisional liquidator is	It is uncertain that APRA has standing to apply to the Court in relation to the exercise of a

appointed.	provisional liquidator's powers in the same way that APRA has power to do so in relation to a liquidator in a substantive winding up.
<p>Under each of the Industry Acts:</p> <ul style="list-style-type: none"> <li>• APRA may apply to the Court for directions regarding any matter arising under the winding up (or proposed winding up) of a regulated entity;</li> <li>• liquidators (including provisional liquidators) are required to notify APRA in writing prior to making an application to the Court in relation to a winding up matter; and</li> <li>• APRA may request information from a liquidator (including provisional liquidators) regarding the winding up of a regulated entity.</li> </ul>	<p>Under the Insurance and Life Insurance Acts:</p> <ul style="list-style-type: none"> <li>• APRA may apply to the Court for directions regarding any matter arising under the winding up of a regulated entity;</li> <li>• liquidators must notify APRA in writing prior to making an application to the Court in relation to a winding up matter; and</li> <li>• APRA may request information from a liquidator regarding the winding up of a regulated entity.</li> </ul> <p>Conversely, under the Banking Act, only the second bullet point above applies.</p>
APRA's involvement in external administration is expanded to capture regulated entities, authorised NOHCS, and subsidiaries of regulated entities or authorised NOHCs.	APRA's involvement in external administration is limited to regulated entities only.
<i>APRA's ability to apply for winding up of ADI without it having been placed in statutory management</i>	
APRA may apply for the winding up of an ADI without the ADI having first been placed in statutory management on certain grounds.	APRA may apply for the winding up of an ADI only if a statutory manager has first been appointed to the ADI.
<i>Providing APRA with notice of proposed applications for external administration of regulated entities</i>	
A person applying to the Court, or using any other process, for the appointment of an external administrator to a regulated entity or authorised NOHC must provide APRA with notice prior to making the application.	A person applying to the Court for the appointment of an external administrator to an ADI or insurer must provide APRA with notice prior to making the application.

<i>Institution of offence proceedings no bar to judicial management or winding up</i>	
The institution of offence proceedings is no bar to judicial management (under the Insurance and Life Insurance Acts) or winding up of a regulated entity.	There is no equivalent provision of subsection 248(2) of the Life Insurance Act in the Banking or Insurance Acts, which provides that the institution of offence proceedings is no bar to the judicial management or winding up of a life company.
<i>Imposing, varying and revoking conditions of authorisation</i>	
Under each of the Industry Acts, APRA may impose, vary and revoke conditions of authorisation.  It is an offence for breach of a condition of registration under the Life Insurance Act.  Uniform penalties (based on section 14 of the Insurance Act) will apply.	The provisions in the Industry Acts differ in relation to APRA’s ability to impose, vary and revoke conditions of authorisation.  Under the Life Insurance Act, it is not an offence if a condition of registration is breached under that Act.  The penalty provisions for breach of authorisation differ significantly between the Industry Acts.
<i>Revoking an authorisation</i>	
Under each of the Industry Acts, APRA may revoke the authorisation of a regulated entity in certain circumstances.	The Banking and Insurance Acts allow APRA to revoke authorisations in certain circumstances. Equivalent grounds are not included in the Life Insurance Act, under which APRA may only cancel a life company’s registration if a life company has ceased to carry on a life insurance business in Australia or if the life company voluntarily requests for its registration to be cancelled.

## **Detailed explanation of new law**

### **APRA’s involvement in external administration**

9.9 APRA currently has the power to apply for a winding up order in respect of a regulated entity. In making such an application, it may be necessary for APRA to seek, in certain circumstances, to recommend that

the Court appoint a provisional liquidator pending the hearing of the winding up application.<sup>6</sup>

9.10 APRA may seek to appoint a provisional liquidator where there is a need to protect a regulated entity's assets from dissipation during this period and the entity's assets cannot be preserved by appropriate undertakings. For example, this may be the case where there is not already a statutory or judicial manager in place.

9.11 Further, the Industry Acts currently include provisions enabling APRA to be involved in the liquidation of a regulated entity. These include provisions:

- giving APRA power to apply to the Court for directions regarding any matter arising under the winding up of a regulated entity (under the Insurance and Life Insurance Acts);
- requiring a liquidator of a regulated entity to notify APRA in writing before they propose to make an application to the Court regarding the winding up of a regulated entity (under the Industry Acts); and
- giving APRA power to request information from a liquidator regarding the winding up of a regulated entity (under the Insurance and the Life Insurance Acts).

9.12 These existing powers reflect the significance of APRA's role in the liquidation of a regulated entity so as to ensure that the interests of depositors and policyholders, and the stability of the financial system, are protected.

### ***Definitions***

9.13 The Bill inserts a new definition of 'liquidator' into the Industry Acts to clarify that the definition includes a provisional liquidator. The Bill also amends the definition of 'external administrator' to remove the reference to 'provisional liquidator' as it will be redundant given its inclusion in the definition of 'liquidator'. [*Schedule 1, items 4 and 6, Schedule 2, items 3 and 5, Schedule 3, items 95 and 97, subsection 5(1) of the Banking Act, subsection 3(1) of the Insurance Act, and the Schedule Dictionary of the Life Insurance Act*]

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<sup>6</sup> As noted above, the fact that APRA has the ability to seek the appointment of a liquidator or provisional liquidator does not preclude it from exercising its other crisis management powers, including appointing or seeking the appointment of a statutory or judicial manager, in appropriate circumstances, even if the entity is insolvent.

9.14 These amendments provide the mechanism to extend APRA's powers in external administration to instances where provisional liquidators are appointed, as detailed in the sections below.

9.15 The Bill also extends the application of these powers by using the term 'entity', which covers the following:

- a regulated entity;
- an authorised NOHC; or
- a subsidiary of a regulated entity or authorised NOHC.  
*[Schedule 1, item 111, Schedule 2, item 62, Schedule 3, item 54, subsection 62C(4) of the Banking Act, subsection 62ZR(4) of the Insurance Act, and subsection 183(4) of the Life Insurance Act]*

#### ***Notice of application***

9.16 The Industry Acts currently require a liquidator of a regulated entity to notify APRA in writing before they propose to make an application to the Court regarding the winding up of a regulated entity and APRA has the right to be heard in such an application.

9.17 The Bill amends the Industry Acts to insert 'or the proposed winding-up' of an entity in a number of provisions. *[Schedule 1, item 110, Schedule 2, item 61, Schedule 3, items 53 and 55, subsection 62C(1) of the Banking Act, subsection 62ZR(1) of the Insurance Act, and section 183 and paragraph 183B(2)(a) of the Life Insurance Act]*

9.18 These amendments, when read with the new definition of 'liquidator', ensure that a provisional liquidator must also give APRA written notice if the provisional liquidator proposes to make an application to the court in relation to a matter regarding the entity.

#### ***Directions***

9.19 APRA currently has the power under the Insurance and Life Insurance Acts to apply to the Court for directions regarding any matter arising under the winding up of an insurer.

9.20 However, there are no equivalent provisions within the Banking Act. The Bill therefore amends the Banking Act to address this inconsistency and harmonise the position across the Industry Acts. *[Schedule 1, item 112, section 62D of the Banking Act]*

9.21 Further, the Bill also amends the Insurance and Life Insurance Acts to extend APRA's ability to apply to the Court for directions regarding the winding up, or proposed winding up, of an entity. *[Schedule 2, item 63, Schedule 3, item 56, subsection 62ZS(1) of the Insurance Act, and subsection 184(1) of the Life Insurance Act]*



9.22 These amendments when read with the new definition of ‘liquidator’, ensure that APRA may apply to the Court for directions when an entity is under the control of either a liquidator or a provisional liquidator.

***Information gathering***

9.23 APRA currently has the power under the Insurance and Life Insurance Acts to request information from a liquidator of a regulated entity regarding the winding up of a regulated entity.

9.24 However, there are no equivalent provisions within the Banking Act. The Bill therefore amends the Banking Act to address this inconsistency and harmonise the position across the Industry Acts. *[Schedule 1, item 112, section 62E of the Banking Act]*

9.25 Further, the Bill amends the Insurance and Life Insurance Acts to extend APRA’s ability to request specific information from a liquidator regarding the winding up, or proposed winding up, and the other affairs of the entity. *[Schedule 2, item 64, Schedule 3, item 57, subsection 62ZT(1) of the Insurance Act, and subsection 185(1) of the Life Insurance Act]*

9.26 These amendments when read with the new definition of ‘liquidator’, ensure that APRA may request information from a liquidator or a provisional liquidator.

**APRA’s ability to apply for winding up of an ADI without it having been placed in statutory management**

9.27 Section 14F of the Banking Act currently empowers APRA to apply to the Court for an ADI, where it is under statutory management, to be wound up where APRA considers that the ADI is insolvent, and cannot be restored to solvency within a reasonable period.

9.28 In certain situations, it would be desirable for APRA to first appoint a statutory manager before proceeding to a winding up, given that a statutory manager may assist APRA to assess the ADI’s solvency or to take actions required to facilitate the resolution of the ADI’s affairs.

9.29 However, where APRA has already formed the view that the ADI is insolvent, having to appoint a statutory manager first before applying for a winding up order may not always be the optimal course of action, particularly where APRA is satisfied that the entity can be wound-up without other resolution actions being required. (The approach taken will of course depend on an assessment of the circumstances and options for resolution, even if the ADI is insolvent).

9.30 The Bill repeals section 14F and inserts a new section 16AAA into the Banking Act to provide for APRA to apply for the winding up of a locally-incorporated ADI. For clarity, this section does not apply to a

foreign ADI as, under the Bill, there is a separate section applying to the winding up of a foreign ADI (see 7.33).

9.31 The only ground that must be satisfied before APRA applies for a winding up order under the new section 16AAA in the Banking Act is that APRA considers the ADI is insolvent and could not be restored to solvency within a reasonable period. This amendment clarifies APRA's existing power to apply for the winding up of a locally-incorporated ADI, without the ADI first having been placed under statutory management.

9.32 The Bill also clarifies that the application is to be made under section 459P of the Corporations Act which provides for certain persons, including APRA, to apply for a company to be wound up in insolvency. *[Schedule 1, item 89, section 16AAA of the Banking Act]*

### **Providing APRA with notice of proposed applications for external administration of regulated entities and authorised NOHCs**

9.33 Sections 62ZQ of the Insurance Act and 179C of the Life Insurance Act were amended by the *Financial Sector Legislation Amendment (Prudential Refinements and Other Measures) Act 2010* to compel a person applying to a Court for the appointment of an external administrator to an insurer to provide APRA with notice of the proposed application. This amendment aligned the Insurance and Life Insurance Acts with the Banking Act.

9.34 These provisions enable APRA to receive information about any prospective appointment of an external administrator to a regulated entity before the external administrator is appointed. This allows APRA to understand the circumstances giving rise to the proposed appointment and to take appropriate and timely action, if necessary, to protect the interests of depositors and policyholders, and to promote financial system stability.

9.35 However, there are certain circumstances in which an external administrator may be appointed without an application to the Court, for example, the appointment of a receiver or voluntary administrator via a non-court process under a deed or other instrument.

9.36 The rationale behind the current legislative provisions applies equally whether an external administrator is appointed via the court process or outside the court process.

9.37 The Bill therefore amends the Industry Acts to extend the requirement to capture additional modes of appointment outside court, for example where a receiver is appointed under a contractual power or a voluntary administrator is appointed under a statutory power.

9.38 As a result, a person must give written notice to APRA, at least two weeks before they make:

- a court application under Chapter 5 of the Corporations Act for the appointment of an external administrator of a regulated entity or an authorised NOHC; or
- another kind of application (whether or not to a court) for the appointment of an external administrator of a regulated entity or an authorised NOHC; or
- an appointment of an external administrator of a regulated entity or an authorised NOHC (otherwise than as the result of an application made by another person). *[Schedule 1, item 108, Schedule 2, item 60, Schedule 3, item 50, subsection 62B(1) of the Banking Act, subsection 62ZQ(1) of the Insurance Act, and subsection 179C(1) of the Life Insurance Act]*

9.39 The two week period will be shortened where APRA gives its consent to the person making the application or appointment.

9.40 The Bill extends the existing strict liability offence, punishable by 60 penalty units, to the three processes identified above, so that a person commits an offence if it fails to give APRA notice, in an approved form or otherwise, before making the application or appointment. *[Schedule 1, item 109, Schedule 2, item 60, Schedule 3, item 50, subsection 62B(4) of the Banking Act, subsection 62ZQ(5) of the Insurance Act, and subsection 179C(5) of the Life Insurance Act]*

### **Institution of offence proceedings no bar to judicial management or winding up**

9.41 Subsection 248(2) of the Life Insurance Act provides that the institution of proceedings against a company for an offence against this Act or the FSCODA does not prevent the institution of proceedings for the judicial management or the winding-up of the company on a ground that relates to the matter that constitutes the offence. There are no equivalent provisions in the Banking and Insurance Acts.

9.42 The Bill amends the Banking and Insurance Acts to replicate the position in the Life Insurance Act with appropriate modifications. *[Schedule 1, item 113, Schedule 2, item 119, section 69BA of the Banking Act, section 129AA of the Insurance Act]*

9.43 For clarity, these amendments are not intended to imply that administrative proceedings not mentioned in those respective sections are prevented by the institution of proceedings for an offence based on the same matter.

## **Imposing, varying and revoking conditions of authorisation**

9.44 Currently, there are provisions in the Industry Acts that allow APRA to impose, vary and revoke conditions of authorisation, or registration (in the case of the Life Insurance Act).

9.45 However, the provisions in the Banking and Life Insurance Acts are not as clearly set out or comprehensive as those in the Insurance Act. For example, it is not an offence if a condition of registration is breached under the Life Insurance Act.

9.46 Sections 13 and 14 of the Insurance Act provide a comprehensive model for imposing, varying and revoking conditions of authorisation. These provisions allow APRA, at any time and by written notice, to impose conditions, or additional conditions, on an insurer's authorisation. They also enable APRA to vary or revoke conditions imposed on a general insurer's authorisation. Section 14 further provides that an insurer commits an offence, with a maximum penalty of 300 penalty units, if it does, or fails to do, an act that results in a contravention of a condition of the insurer's authorisation. If an individual commits an offence under Part 2.4 of the *Criminal Code Act 1995* (which relates to extension of criminal responsibility, including complicity), the maximum penalty is 60 penalty units.

9.47 The Bill therefore replicates the provisions of sections 13 and 14 of the Insurance Act into the Banking and Life Insurance Acts with appropriate modifications to harmonise the position across the Industry Acts. [*Schedule 1, items 12 and 13, Schedule 3, item 5, subsections 9(7)-9(9), sections 9AA and 9AB of the Banking Act, and sections 22 and 22A of the Life Insurance Act*]

## **Revoking an authorisation**

9.48 Currently, sections 9A of the Banking Act and 15 of the Insurance Act allow APRA to revoke an authorisation for various reasons, including where the regulated entity has failed to comply with the requirements of the respective Acts.

9.49 There are no equivalent grounds in the Life Insurance Act, so that APRA has the power to revoke a life company's registration only if:

- it has ceased to carry on a life insurance business in Australia under section 26 of that Act; or
- it has requested that its registration be cancelled and certain conditions are met.

9.50 The absence of a wider range of grounds in the Life Insurance Act is inconsistent with the other two Industry Acts and potentially ineffective for dealing with the resolution of a life insurer.

9.51 The Bill therefore addresses this anomaly by replicating the provisions of sections 15 and 17 of the Insurance Act in the Life Insurance Act with appropriate modifications.

9.52 New section 26 of the Life Insurance Act will therefore give power to APRA to revoke a life company's registration if APRA is satisfied that: (1) the company has no liabilities in respect of life insurance business carried on by it in Australia; *and* (2) one of certain other listed conditions is met such as failure to comply with a regulatory requirement, failure to comply with a Commonwealth law specified in the regulations, insolvency or, in the case of a foreign life insurer, revocation of its authorisation in a foreign country.

9.53 As provided for in the Insurance Act in the same context, new section 27A will provide that, if APRA considers that it would, under section 26, revoke a life company's registration if it had no liabilities, APRA may direct the life company to arrange an assignment of those liabilities to one or more other life companies registered under the Act. *[Schedule 3, items 6 and 9, sections 26 and 27A of the Life Insurance Act]*

9.54 The Bill also makes consequential amendments to the Life Insurance Act to accommodate the new revocation grounds by adding the following decisions as reviewable decisions under section 236:

- a decision to revoke registration under subsection 26(1);
- a refusal to revoke the registration of a company under section 27;
- a decision to give a direction to assign liabilities under subsection 27A(1);
- a refusal to approve a proposed assignment under subsection 27A(4); and
- a decision to impose conditions on an approval under subsection 27A(4). *[Schedule 3, item 90, subsection 236(1) of the Life Insurance Act]*

9.55 Separately, the Bill inserts an additional ground into the Industry Acts to allow APRA to revoke the authorisation of a foreign-regulated entity if the entity's authorisation is revoked by a foreign regulator, including its home regulator (see 7.41).

9.56 Further, the Bill inserts a supplementary ground into the Banking Act to allow APRA to revoke the authorisation if a body corporate, that is as a foreign corporation within the meaning of paragraph 51(xx) of the Constitution, is unlikely to be able to meet its liabilities in Australia and is unlikely to be able to do so within a reasonable period of time. *[Schedule 1, item 15, subparagraph 9A(2)(h)(i) of the Banking Act]*

9.57 Finally, the Bill inserts an additional ground into the Industry Acts to allow APRA to revoke the authorisation of a regulated entity if the entity fails to comply with a requirement of a provision of Commonwealth law that is prescribed in regulations. *[Schedule 1, item 15, Schedule 2, item 12, Schedule 3, item 6, subparagraph 9A(2)(iia) of the Banking Act, subparagraph 15(1)(a)(ia) of the Insurance Act, and subparagraph 26(1)(a)(ia) of the Life Insurance Act]*

## **Consequential amendments**

9.58 The Bill makes consequential amendments to the Banking and Insurance Acts to remove certain existing references to ‘a provisional liquidator’ in light of the new definition of ‘liquidator’. *[Schedule 1, item 97, 101 and 102, Schedule 2, item 82, 88 and 89, paragraph 16AK(1)(c), subsections 16AL(5) and 16AL(7) of the Banking Act, paragraphs 6ZZO(b) and 6ZZP(1)(b), and subsections 6ZZQ(5) and 6ZZQ(7) of the Insurance Act]*

9.59 The Bill makes consequential amendments to the Banking Act to update references to the new section 16AAA. *[Schedule 1, items 92 and 93, subsections 16AD(1) and 16AD(2) of the Banking Act]*

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## **Chapter 10**

### **Resolution planning**

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#### **Outline of chapter**

10.1 Schedules 1 to 3 to this Bill amends the Industry Acts to clarify and strengthen APRA's powers in relation to resolution planning.

#### **Context of amendments**

10.2 It is important that APRA has the powers it needs, not only to implement an orderly resolution of a failed regulated entity, but to set appropriate prudential requirements for resolution planning and addressing potential barriers to resolution, in advance of any crisis occurring.

10.3 An important lesson from the global financial crisis was that effective resolution requires an advanced level of preparedness through contingency planning, before a failure or crisis event materialises. This has been reflected in the increased international focus on recovery and resolution planning, including in the Key Attributes which provide that authorities should have, at their disposal, a broad range of resolution powers, and put in place an ongoing process for recovery and resolution planning. Both the BCBS and IAIS have also taken steps to incorporate requirements for recovery and resolution planning into their core principles for supervision.

10.4 APRA's supervision of regulated entities includes working with them to ensure that viable contingency plans are in place for managing a crisis affecting the entity, and to address potential impediments to such plans where necessary. In line with the amendments in the Bill, APRA has indicated its intention to further develop its framework for resolution planning, including formally reflecting this in its prudential framework through standards and guidance, following appropriate consultation.

10.5 The amendments in the Bill clarify the legislative framework for resolution planning, in particular to ensure APRA has clear powers to make and enforce prudential standards on resolution.

10.6 Under the Industry Acts, the term 'prudential matters' is important in determining the scope of the prudential standard-making powers of APRA and the matters for which regulations may be made. However, this term is currently defined differently between the Banking and Insurance Acts, and the Life Insurance Act does not contain a

definition (meaning it is not completely clear which matters APRA may make prudential standards on). None of the Industry Acts currently contain any specific reference to resolution, which may lead to uncertainty regarding APRA's ability to make prudential standards on resolution. In addition, although depositor and policyholder protection is a fundamental objective for the prudential supervision of ADIs and insurers, the definition of 'prudential matters' in the Industry Acts does not explicitly reflect this.

10.7 The Bill therefore makes amendments to harmonise the definition of 'prudential matters' across the Industry Acts as applicable, including incorporating a specific reference to resolution and explicitly referring to protecting the interests of depositors or policyholders (as applicable) in each Industry Act.

10.8 The Bill also harmonises the Banking Act and the Life Insurance Act with the Insurance Act by clarifying that entities must comply with prudential standards applicable to them.

10.9 As noted above, resolution planning includes identifying and addressing barriers to resolution which may arise during the planning process. While addressing such issues would be expected to be part of the normal supervisory process between APRA and a regulated entity, it is important that APRA has the power to enforce its prudential standards or otherwise require actions to facilitate resolution, through directions where necessary (see 3.31 to 3.36 for further details).

10.10 A specific example of a potential barrier to resolution in a group context would be where certain critical parts of a group are found to be outside the scope of APRA's resolution powers. While the various powers available to APRA to implement a resolution (as amended by this Bill) apply to a regulated entity, an authorised NOHC and subsidiaries of the regulated entity or authorised NOHC, they do not generally apply to an unauthorised holding company or its subsidiaries (which are not themselves regulated entities or subsidiaries of a regulated entity or authorised NOHC).

10.11 The Bill ensures that APRA is able to address this situation directly by providing it with the power to require a holding company to ensure that a regulated entity has an authorised NOHC where appropriate. In certain circumstances, this may help minimise prudential risks and make it more credible for APRA to use its powers to ensure an orderly resolution of the regulated entity.

## **Summary of new law**

10.12 Schedules 1 to 3 to this Bill amend the Industry Acts 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);
- specify which entities must comply with prudential standards; and
- enable APRA to require a holding company to ensure a regulated entity has an authorised NOHC, where appropriate.

### Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<i>Refinement and harmonisation of prudential standards</i>	
The definition of ‘prudential matters’ is harmonised across the Industry Acts, and includes specific reference to facilitating the resolution of a regulated entity and its group in the definition.	‘Prudential matters’ is defined differently between the Banking and Insurance Acts, and contains no explicit reference to resolution. The Life Insurance Act does not contain a definition of ‘Prudential matters’.
APRA may determine prudential standards in relation to the subsidiaries of ADIs and subsidiaries of authorised NOHCs of ADIs (and particular classes of these subsidiaries).	Unlike the Insurance and Life Insurance Acts, the Banking Act does not explicitly empower APRA to determine prudential standards in relation to the subsidiaries of ADIs and subsidiaries of authorised NOHCs of ADIs (and particular classes of these subsidiaries).
The definition of ‘prudential matters’ in the Industry Acts explicitly refers to protecting the interests of depositors or policyholders.	The definition of ‘prudential matters’ in the Banking and Insurance Acts implicitly includes, but does not explicitly refer to, protecting the interests of depositors or policyholders.
<i>Harmonise provisions creating obligation for entities to comply with prudential standards</i>	
Each of the Industry Acts states that regulated entities, authorised NOHCs, and subsidiaries of regulated entities or authorised NOHCs are obliged to comply with prudential standards made in relation to them.	Unlike the Insurance Act, the Banking and Life Insurance Acts do not state clearly that regulated entities, authorised NOHCs, and subsidiaries of regulated entities or authorised NOHCs are obliged to comply with prudential standards made in relation to them.
<i>Enabling APRA to require a holding company of a regulated entity to ensure</i>	

<i>the regulated entity has an authorised NOHC</i>	
<p>APRA can require a holding company of a regulated entity to either become an authorised NOHC or to ensure that one of its subsidiaries becomes an authorised NOHC of the regulated entity in accordance with the conditions set by APRA.</p> <p>(APRA will still be able to require, as a condition of initial authorisation or registration of an ADI or insurer, that it be a subsidiary of an authorised NOHC, and be able to impose a condition on an ADI's or insurer's authority/registration to this effect.)</p>	<p>APRA can authorise or register a holding company as an authorised NOHC upon their application, but APRA cannot require a holding company that is not authorised, to be authorised. APRA can also require, as a condition of initial authorisation or registration of an ADI or insurer, that it be a subsidiary of an authorised NOHC, and can impose a condition on an ADI or insurer's authority/registration to this effect.</p>

## Detailed explanation of new law

### Refinement and harmonisation of prudential standards

#### *Refined and harmonised definition of 'prudential matters'*

10.13 The Bill harmonises the definition of 'prudential matters' in the Banking Act and Insurance Act (as applicable), and adds an equivalent definition to the Life Insurance Act, subject to appropriate industry-specific amendments. [*Schedule 1, item 8, Schedule 2, item 7, Schedule 3, item 97, subsection 5(1) of the Banking Act, subsection 3(1) of the Insurance Act, Schedule Dictionary of the Life Insurance Act*]

10.14 The Bill also harmonises the Insurance and Life Insurance Acts with the existing position under the Banking Act by explicitly noting APRA's power to make prudential standards applicable to a 'group of bodies corporate' (as well as to the regulated entity, its authorised NOHC and subsidiaries). Given that prudential matters may relate to groups as a whole, as well as to the regulated entity, its authorised NOHC and subsidiaries, it is important that the definition of 'prudential matters' refers to 'relevant group(s) of bodies corporate' under all the Industry Acts.

10.15 The Bill further amends the definition of 'prudential matters' to clarify that it refers to not just the 'conduct' of a regulated entity and its group, but to the 'structure or organisation' of a regulated entity and its group. This would include how a regulated entity, its group or members of the group are structured in a legal ownership sense or organised from a business or operational perspective.

10.16 The Bill further amends the definition of ‘prudential matters’ to clarify that it includes matters that facilitate the resolution of the regulated entity and its group. This amendment clarifies that APRA can make prudential standards that relate to planning for resolution, and addressing barriers to resolution whether during normal times or in a time of emerging stress. For this purpose, the Bill inserts a new definition of ‘resolution’ into the Industry Acts. This definition refers to the process by which APRA and other relevant persons – which includes, for example the agencies in the CFR, other State/Territory or Commonwealth agencies, and foreign regulators – may manage or respond to the failure or potential failure of an entity, including through the exercise of functions under the relevant State/Territory or Commonwealth law or the law in a foreign jurisdiction. In APRA’s case, this would include the use of any of its powers and its role in administering the FCS. *[Schedule 1, item 10, Schedule 2, item 9, Schedule 3, item 100, subsection 5(1) of the Banking Act, subsection 3(1) of the Insurance Act, Schedule Dictionary of the Life Insurance Act]*

10.17 The term ‘failure’ in the definition of resolution is intended to refer broadly to situations in which the on-going viability of an entity is in jeopardy, which may be prior to point at which the entity is insolvent as normally defined. This reflects that to achieve an orderly resolution of a distressed entity, it may be necessary for APRA and other relevant persons to intervene as early as possible, and before insolvency. *[Schedule 1, item 10, Schedule 2, item 9, Schedule 3, item 100, subsection 5(1) of the Banking Act, subsection 3(1) of the Insurance Act, Schedule Dictionary of the Life Insurance Act]*

***Harmonise provisions creating obligation for entities to comply with prudential standards***

10.18 The Bill amends the Banking Act to enable APRA to determine prudential standards in relation to prudential matters to be complied with by the subsidiaries of ADIs, and subsidiaries of authorised NOHCs (and particular classes of ADIs, authorised NOHCs, or subsidiaries of ADIs or authorised NOHCs). *[Schedule 1, item 18, subsection 11AF(1) of the Banking Act]*

10.19 The Bill also amends the Insurance Act and Life Insurance Act to clarify explicitly that APRA can require a subsidiary of an insurer or of an authorised NOHC (and particular classes of the subsidiaries) (Subsidiary A) to ensure that its subsidiaries, or Subsidiary A and its subsidiaries, satisfy the particular requirements in relation to prudential matters. Corresponding amendments are also made to the Banking Act. These amendments harmonise the Industry Acts. *[Schedule 1, item 20, Schedule 2, items 17 and 18, Schedule 3, item 59, subsection 11AF(1) of the Banking Act, subsection 32(3) of the Insurance Act, and 230A(3A) of the Life Insurance Act]*

10.20 The Bill inserts provisions corresponding to section 35 of the Insurance Act (obligation to comply with prudential standards) in the Banking Act and Life Insurance Act. This clarifies that an ADI, life company, authorised NOHC, or subsidiaries of the ADI/life company or authorised NOHC must comply with the prudential standards applying to them. *[Schedule 1, item 26, Schedule 3, item 60, section 11AAA of the Banking Act, and section 230AAA of the Life Insurance Act.]*

10.21 Failure to comply with a prudential standard may result in certain consequences under the respective Industry Acts, including the following (existing) consequences:

- *Banking Act:* APRA giving a direction under section 11CA, or the Federal Court granting an injunction under section 65A. In the case of an ADI, such a failure may result in APRA revoking its section 9 authority under subsection 9A(2). In the case of an authorised NOHC, such a failure may result in APRA revoking its NOHC authority under subsection 11AB(2).
- *Insurance Act:* APRA giving a direction under section 104, or the Federal Court making an order for judicial management under Part VB or granting an injunction under section 129D. In the case of a general insurer, such a failure may result in APRA revoking the section 12 authorisation under subsection 15(1). In the case of an authorised NOHC, such a failure may result in APRA revoking its NOHC authorisation under subsection 21(1).
- *Life Insurance Act:* APRA giving a direction under section 230B, or the Federal Court making an order for judicial management under Part 8 or granting an injunction under section 235. In the case of a life company, such a failure may result in APRA revoking its registration under subsection section 26. In the case of an authorised NOHC, such a failure may result in APRA revoking its NOHC registration under subsection 28C(2).

### **Enabling APRA to require a holding company of a regulated entity to ensure the regulated entity has an authorised NOHC**

10.22 The Bill amends the Industry Acts to enable APRA to give a notice to a body corporate that is a holding company of a regulated entity, to require it to ensure, in accordance with the conditions (if any) specified by APRA in the notice, either of the following occurs:

- the body corporate becomes an authorised NOHC of the regulated entity, or

- one of its subsidiaries becomes an authorised NOHC of the regulated entity. [*Schedule 1, item 16, Schedule 2, item 16, Schedule 3, item 11, section 11AE of the Banking Act, section 23A of the Insurance Act, section 28AA of the Life Insurance Act*]

10.23 The decision by APRA to give such a notice is reviewable internally and upon application to the Administrative Appeals Tribunal if the person disagrees with the internal review outcome. [*Schedule 3, item 91, subsection 236(1)(ge) of the Life Insurance Act*]

10.24 The amendments in the Industry Acts provide that, in accordance with any conditions set out by APRA, the body corporate has power to comply with APRA's notice despite anything in its constitution or any contract or arrangement to which it is a party. The existing Part 4A of the Transfer Act already provides for a mechanism that may be used to comply with such a notice given by APRA. [*Schedule 1, item 16, Schedule 2, item 16, Schedule 3, item 11, subsection 11AE(4) of the Banking Act, subsection 23A(4) of the Insurance Act, subsection 28AA(4) of the Life Insurance Act*]

10.25 Part 4A of the Transfer Act was enacted in 2007 to address certain identified impediments to the adoption of a NOHC structure by financial groups. The enactment of Part 4A removes these impediments arising under particular requirements of the Corporations Act. When Part 4A was enacted in 2007, related amendments were also made to the *Income Tax Assessment Act 1997*.

10.26 Failing to comply with APRA's notice would attract the application of the existing sections 11CG of the Banking Act, 108 of the Insurance Act and 230F of the Life Insurance Act, which set out the consequences of non-compliance with a direction (an offence with a maximum penalty of 50 penalty units). However, these non-compliance sections do not apply if the contravention of a requirement in an APRA notice happens merely because APRA refuses to grant the body corporate (or its subsidiary) an authority to become an authorised NOHC, and APRA's reasons for that refusal do not include the reason that one or more conditions specified in the notice are not satisfied.

### **Consequential amendments**

10.27 The Bill amends the Banking Act to enable APRA to determine prudential standards in relation to prudential matters to be complied with by the subsidiaries of ADIs, and subsidiaries of authorised NOHCs (and particular classes of ADIs, authorised NOHCs, or subsidiaries of ADIs or authorised NOHCs). As a result, the Bill amends the Banking Act to explicitly state that prudential standards may impose different requirements to be complied with by different classes of ADIs, authorised NOHCs or subsidiaries of ADIs or authorised NOHCs, in different

situations or in respect of different activities. This harmonises the Banking Act with the Insurance Act and Life Insurance Act. *[Schedule 1, items 18 and 19, subsection 11AF(1) and (1A) of the Banking Act]*