# The APRA Supervision Blueprint

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# Introduction

The APRA Supervision Blueprint provides the strategic direction for APRA's approach to supervising deposit-taking, general insurance, life insurance and superannuation institutions. This supervisory approach is outlined in APRA's Framework for Prudential Supervision.

The Blueprint is designed to ensure that APRA's methodologies, tools and supporting processes are aligned with the objectives of APRA's supervisory approach and that APRA's supervisors are adequately supported and guided in the exercise of their professional judgement.

APRA's supervisory activities are tailored to the specific risks and issues a supervised institution faces. The Framework for Prudential Supervision requires supervisors to identify risks and ensure that appropriate supervisory action is taken to keep the risks to which an institution is exposed at an acceptable level. APRA's Probability and Impact Rating System (PAIRS) and its Supervisory Oversight and Response System (SOARS) provide a structure to guide supervisors in gauging risks and determining an appropriate supervisory response.

APRA's Framework for Prudential Supervision will evolve with changes in the regulatory regime and innovations in the industries APRA supervises. APRA will continue to enhance its supervisory tools as required, consistent with this vision. APRA is committed to the ongoing review of its supervisory processes and systems against its peers to ensure these are in line with international best practice.

# Section 1: Principles and approach

## APRA's mission and supervisory approach

### Mission

APRA's mission is to 'establish and enforce prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by the institutions APRA supervises are met within a stable, efficient and competitive financial system'.

### Supervisory approach

APRA's supervisory approach is forward-looking, primarily risk-based, consultative, consistent and in line with international best practice. This approach recognises that the board and management of regulated entities are primarily responsible for financial soundness and prudent risk management.

Our approach to supervision involves identifying the key risks taken by supervised institutions, ensuring these risks are adequately measured, managed and monitored and assessing the adequacy of these institutions to access financial resources to withstand potential losses. APRA undertakes its mission through appropriate risk analysis and supervisory actions/ responses.

APRA needs to be conscious of the impact of its supervisory interventions. These interventions may include imposing requirements (with or without legal force) on a supervised institution, making recommendations or suggestions and enforcement action. It is critical that APRA's interventions are proportionate to the prudential outcome desired.

Under our regulatory regime, supervised institutions are also required to seek APRA's approval for specific transactions, documents and arrangements. APRA seeks to promote sound prudential practice by assisting institutions to interpret and understand our prudential requirements and guidelines. In its principles-based approach to regulation, APRA strives to respond to these requests for approval and interpretation in a consistent manner and on a timely basis. Our supervisory approach also recognises an institution's particular circumstances (e.g. the approach to risk and risk management) and incorporates these in assessments.

## Objective of APRA's Framework for Prudential Supervision

### Objective of the Framework

APRA's Framework for Prudential Supervision balances the need to take a structured and methodical approach to implementation of APRA's prudential requirements against the need to maintain sufficient flexibility to respond to new and emerging risks. The Framework provides guidance to prudential supervisors on how to implement the key elements of our supervisory methodology while, at the same time, allowing sufficient flexibility for supervisors to use professional judgement. It encourages staff to think beyond minimum guidance material.

APRA's Framework for Prudential Supervision provides for a 'baseline' level of supervisory activity. This baseline level of activity seeks to give APRA sufficient information to adequately identify and assess the key risks affecting each of the regulated industries and institutions. It provides an objective basis from which to determine our 'risk-based' priorities. These risk-based activities attract the bulk of our attention.

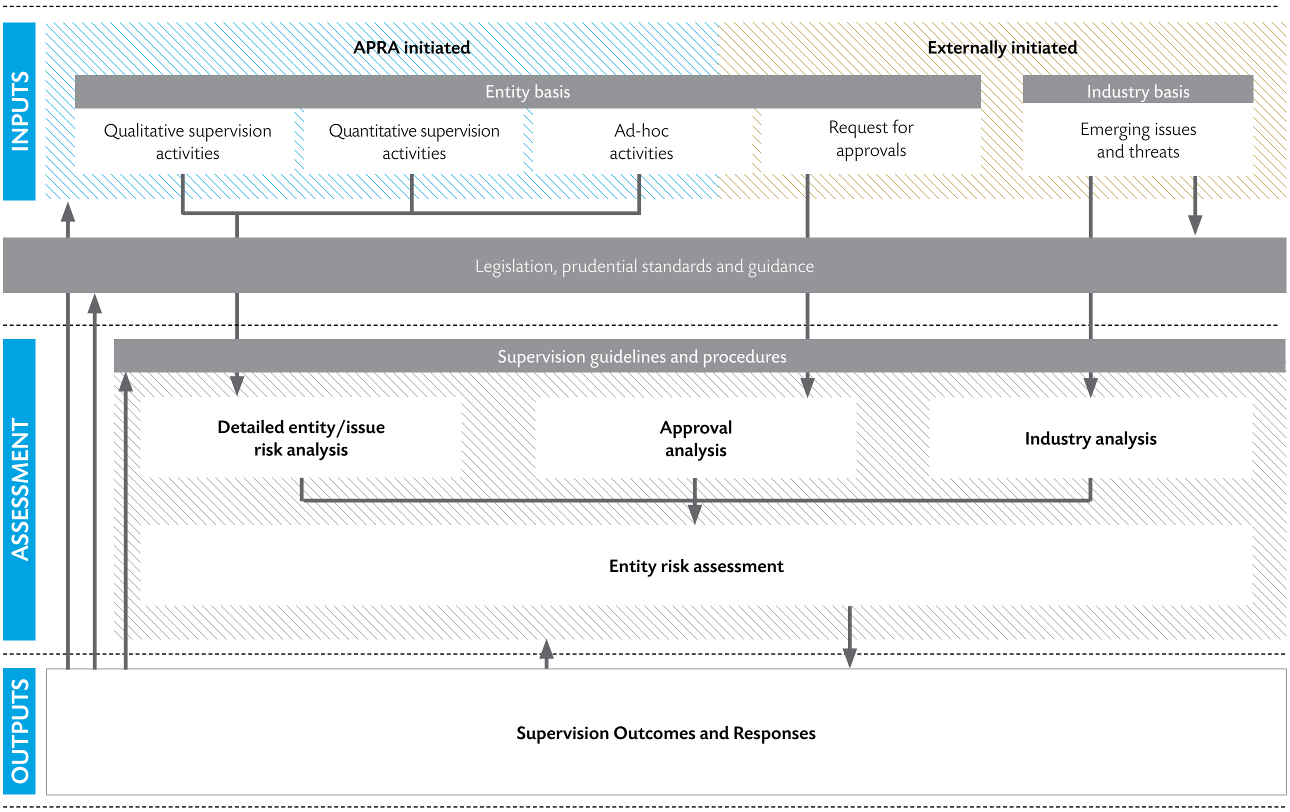
The Framework provides a basis for determining the most effective and efficient allocation of prudential activities so as to best achieve all our objectives. This includes the process of review and maintenance of the Framework itself.

### Scope of the Framework

APRA's Framework for Prudential Supervision encompasses all activities, supporting procedures, processes, systems and guidelines that are used in forming risk assessments and supervision strategies to ensure that entities are best able to meet their financial promises to beneficiaries.

Central to our supervision is the development of entity risk assessments and appropriate supervisory outcomes. To form these views, we complete activities in three primary assessment streams:

1. APRA-initiated supervisory activities related to individual supervised institutions and supervisory action plans.




2. Institution-initiated requests for determinations against, or interpretations of, legal/prudential requirements. This is impacted by, and has an impact on, an individual institution's risk assessment.
3. Overall assessments of regulated industries and the financial sector. This also impacts on individual institution assessments and supervisory action plans.

## Vision for APRA's Framework for Prudential Supervision

APRA's vision is to be a world-class integrated prudential supervisor recognised for its leadership, professionalism and innovation. The Framework supports this vision by adopting an approach that is risk-based, outcomes-focussed, principles-based and consistent with APRA's values. In so doing, it provides an efficient and effective basis for supervising institutions. The processes that comprise the Framework are supported by user-friendly applications.

## Risk tolerance

In meeting the Government's *Statement of Expectations for APRA*, APRA has endorsed the objective that the prudential regime maintains a low incidence of failure of supervised institutions while not impeding continued improvement in efficiency or hindering competition. Consistent with this objective, APRA has established a 'baseline' level of supervisory activity that is necessary to confirm entity risk assessments and ensure that supervisory action plans remain current and relevant. Supervisors are expected to pursue appropriate risk-based supervisory activities in addition to meeting baseline requirements. This level of activity reflects APRA's appetite for risk within a non-zero failure regime. It explicitly recognises the balance that must be struck between achieving a desired level of comfort regarding a supervised institution's prudential soundness and the ability to pursue risk-based supervision.

APRA's risk tolerance and baseline supervisory requirements are reviewed periodically by its Supervision Steering Group to ensure they remain appropriate and adequately reflect the current environment.

## Risk-based supervision

To be *risk-based* is to direct supervisory resources and activities to areas of greatest risk or impact.

Risk–based supervision targets attention and supervisory resources on those supervised institutions that face greater risks. Timely and proportionate intervention is essential to APRA's effectiveness.

## Outcomes-focussed

To be *outcomes-focussed* is to focus on substance over form; to look to the achievement of a supervisory outcome rather than merely follow a process.

A key part of APRA's supervisory assessments are supervisory action plans for supervised institutions. While these focus on addressing the key risk areas for an institution, in some cases broader industry or process issues may be identified which also require action.

## Principles-based regulation

To be *principles-based* is to give emphasis to the achievement of sound prudential outcomes in setting regulatory requirements and expectations, without necessarily seeking to specify or prescribe the exact manner in which those outcomes must be achieved.

Principles-based regulation recognises the complexity and diversity that exists among supervised institutions and seeks to avoid a 'one-size-fits-all' approach. Adopting a principles-based approach allows supervised institutions to use a variety of approaches to comply with high-level principles, rather than APRA seeking to control an institution through detailed prescription. Although there are areas where some degree of prescription is required, our prudential assessments focus on the underlying principles for the requirement. This approach allows our prudential requirements to accommodate an ever-evolving financial sector.

## Incorporating our values

APRA's Framework for Prudential Supervision also reflects our values: foresight, accountability, collaboration, integrity and professionalism.

- *Foresight* – our assessments are forward-looking and anticipate future events and a supervised institution's preparedness to handle them. These assessments include both institution and industry-level perspectives and incorporate the expected impacts of such events in risk assessments and supervisory actions or responses.
- *Accountability* – APRA's Framework for Prudential Supervision provides processes and practices that will ensure sufficient justification for our assessments and decisions.
- *Collaboration* – successful implementation of APRA's Framework for Prudential Supervision requires extensive collaboration and consultation, both within APRA and with supervised institutions and industries. Collaboration also requires that supervisors have access to relevant expert advice and appropriate resource material when they encounter new, complex or difficult issues.
- *Integrity* – APRA's Framework for Prudential Supervision is conceptually sound and results in balanced and fair supervisory actions. This approach also enables supervisors to reach consistent outcomes.
- *Professionalism* – activities and assessments that are completed as part of our supervision are of a high quality. APRA's Framework for Prudential Supervision also provides supervisors with scope for appropriate levels of professional judgement to be applied.

APRA's Framework for Prudential Supervision evolves with changes to the regulatory regime and innovations in the industries APRA supervises. Further, APRA aims to continue to enhance its supervisory tools as required, consistent with this vision. APRA is committed to the ongoing review of its supervisory activities and tools against international regulatory counterparts to ensure these remain in line with international best practice.

# Section 2: The phases of prudential supervision

There are three key phases of prudential supervision: licensing, ongoing supervision and enforcement.

Supervision commences with the process of licensing an institution. APRA assesses licence applications to ensure that only those companies that meet prudential requirements and have the capacity to operate on an ongoing basis can operate in Australia.

After an institution is licensed, it moves to a phase of ongoing supervision. This accounts for the majority of APRA's supervisory activities. Supervisors take sufficient actions to ensure that supervised institutions will continue to meet financial promises to beneficiaries. Through ongoing supervision, activities and assessments are undertaken commensurate with a supervised institution's risk profile and desired supervisory outcomes. This includes increasing supervisory intensity in line with SOARS stances. Where issues or concerns are identified, prompt corrective actions are pursued.

In some instances, APRA may have serious prudential concerns that must be rectified through specific intervention and remedial enforcement action. Distress and enforcement situations represent a serious threat to the financial security of beneficiaries and will result in two possible outcomes: either a supervised institution will take sufficient action and return to a phase of heightened ongoing supervision or it will be actively managed by APRA to exit the industry.

APRA maintains a Financial Crisis Management Plan that guides its response to situations where a supervised institution is in financial distress. This refers to an event that has the potential to threaten the solvency of an institution such as to render it unable to meet its obligations to its beneficiaries and/or disrupt the stability of the financial system.

# Section 3: APRA's Framework for Prudential Supervision

The Blueprint for APRA's Framework for Prudential Supervision considers:

- supervision outcomes and responses;
- entity risk assessment;
- APRA's supervisory activities;
- supporting material and infrastructure; and
- quality assurance within the Framework.

APRA aims to reduce the likelihood and impact of financial sector losses but does not guarantee zero failure. As supervisors, we increase the intensity of supervisory intervention in line with a supervised institution's risk profile to ensure that any issues are addressed before they pose a threat to the institution or its beneficiaries. The supervisory actions and responses we take are designed to ensure that the safety and stability of the institution is maintained and that intervention and enforcement occurs as necessary (and on a timely basis) to ensure this is the case.

## Supervision outcomes and responses

A critical factor in implementing an outcomes-focussed regime is setting appropriate supervisory action plans that take into account the key risks facing a supervised institution/industry and determining supervision outcomes and responses that clearly address those key risks. The structure of the Framework is designed to focus on the importance of our supervisory actions and responses.

Actions comprise ongoing supervision of a supervised institution and responses to particular issues. Supervision outcomes and responses can range from a normal cycle of review to a heightened supervisory stance that requires extra supervisory oversight, mandating improvements or restructuring an institution. This may include enforcement action against a supervised institution or persons related to a supervised institution.

APRA supervisors draw up a supervisory action plan for each supervised institution based on their assessment of the risk indicators available to them. In turn, this supervisory action plan impacts on future activities and information available for supervisory assessments. These plans are updated dynamically as and when new information is received and after each new entity risk assessment.

APRA's supervision activities are tailored to the specific risks and issues a supervised institution faces. The Framework requires supervisors to identify and measure risks and take appropriate actions to ensure that the risks to which a supervised institution is exposed are at an acceptable level. Supervisors must be able to demonstrate that the activities that form part of a supervisory action plan are adequate and appropriate to the institution's risk profile and desired supervisory outcomes.

In completing an entity risk assessment, supervisors form an opinion as to the financial soundness and viability of the institution and its ongoing ability to meet its financial promises to beneficiaries. This assessment provides an overview of the key risk areas of an institution and where our understanding of the institution needs to be strengthened. The supervisory action plan has its basis in the judgements we make as part of our risk assessment and focuses on these areas.

## Entity risk assessment

The purpose of a dynamic, integrated entity risk assessment is to ensure that supervisory judgements made about a supervised institution are accurate, timely and robust, and the supervisory attention afforded to each institution is appropriate. These assessments are founded on the risk analysis completed on a supervised institution- and issue-specific basis. These risk assessments are central to APRA's allocation of supervisory resources and the implementation of risk-based supervision.

The main objectives of entity risk assessment are to:

- determine the probability that a supervised institution will not meet its financial promises;
- measure the impact of the potential consequences of not meeting those promises; and
- determine an appropriate supervisory action plan incorporating actions to address key issues identified.

Entity risk assessments are completed using APRA's Probability and Impact Rating System (PAIRS) assessment and tools. A PAIRS assessment articulates APRA's overall assessment of a supervised institution. It details our dynamic assessment of the key risks, management and controls and capital support for the institution and its supervisory action plan. The supervisory action plan gives consideration to the importance of the key risks and issues and the systemic importance of the regulated entity.

APRA's supervisory actions are driven by its Supervisory Oversight and Response System (SOARS). At a high level, SOARS assists in the allocation of resources toward key risk areas. APRA's four supervision stances are:

- Normal;
- Oversight;
- Mandated Improvement; and
- Restructure.

## APRA's supervisory activities

The majority of the inputs into APRA's Framework for Prudential Supervision require detailed assessment of the implications of different types of information for a supervised institution. This involves a consideration of the issue or activity and the potential risks to which an institution may be exposed. The level of detail in the assessment takes into account the nature of the information and institution involved, consistent with APRA's risk-based approach.

### Prudential reviews

A prudential review is a key supervisory activity that allows supervisors to form detailed assessments of a supervised institution's (or group's) key inherent risks and the adequacy of its management and controls to address those risks. Prudential reviews challenge and test the effectiveness of the institution's processes and procedures and may involve both on-site and off-site components. The aim is to identify key risks and confirm that these are well-managed, or to identify areas for improvement and take supervisory action where those areas of risk may bring into question the institution's ability to meet its financial promises to its beneficiaries.

### Prudential consultations

In addition to prudential reviews that focus on specific risks or issues, supervisors hold prudential consultations – discussions with a supervised institution that focus on obtaining an update on key strategic and risk issues with the institution's senior executives. This forum is used to focus on key risk issues, including APRA's supervisory assessment of the institution. These discussions can also be used to obtain updates on key aspects of an institution's business strategy and operations and to convey any prudential concerns held by APRA about the institution's strategy or risk management practices.

### Entity financial analysis

APRA receives financial returns from its supervised institutions on a regular basis that provide details on areas such as financial strength, performance and operations. Additional financial information may also be available from other sources including the institution's website or company announcements by listed entities. Supervisors analyse this information to ensure that any trends in business, earnings and/or capital are detected and assessed and appropriate supervisory actions are taken.

Financial analysis results in an assessment of a supervised institution's financial position and emerging trends or potential issues that should be monitored on an ongoing basis. These are critical inputs into a PAIRS assessment and supervisory action plan. The depth of financial analysis and areas to be reviewed depend on the nature and operations of the institution, its size, complexity and risk profile.

Appropriate supervisory actions are taken where a deterioration in financial performance becomes evident.

### Other off-site analysis

Off-site analysis covers a broad range of activities, including requests for specific information from a supervised institution, information provided under prudential standards and information that is requested from supervised institutions to support industry analysis or specific research.

### Ongoing interaction

There are many ways in which supervisors interact with supervised institutions on an ongoing basis. These may include meetings, providing advice to a supervised institution (formally or informally), discussions about business changes within the institution, dealing with regulatory issues such as breaches and complaints, routine correspondence and market information.

### Industry analysis

Industry analysis involves research and assessments of the state of a supervised industry with a view to identifying particular issues to enhance our supervisory outcomes. These reviews may lead to actions relating to a specific supervised institution and/or lead to a revision of our prudential requirements. APRA regularly reviews each industry it supervises and the general state of the macroeconomic environment for emerging issues and threats.

In addition to regular industry reviews, APRA completes regular peer group financial analysis and both proactive and responsive *ad hoc* reviews.

Industry analysis provides supervisors with up-to-date information on industry developments and emerging issues or trends that may adversely impact on the risk profiles of supervised institutions. Supervisors are responsible for developing an appropriate supervisory action plan to mitigate any risks or issues identified.

Industry risk assessments will consider:

- emerging or existing issues that have the potential to alter the risk profile of a category of supervised institutions;
- implications of the issue for supervised institutions; and
- key areas and triggers where specific supervisory action may be required.

The main risks and issues identified must be considered in setting supervisory action plans for all supervised institutions. Supervisors assess the impact of identified issues on the institutions within their portfolio and incorporate actions, as necessary, to address the risks supervisory action plans.

### Requests for approvals and interpretations

Supervised institutions are required to obtain prior approval from APRA for certain types of activity. They also often approach APRA seeking interpretations of legislation and prudential standards and guidance on their implementation. Judgements are made against the prudential principles underlying the requirements, consistent with APRA's principles-based approach.

Although consistency in responses to industry is essential, APRA's Framework for Prudential Supervision maintains sufficient flexibility to vary responses depending on the individual circumstances and risk profile of a supervised institution. In most cases, the application requirements are set out in legislation and are supplemented by internal guidelines. In considering these requests, APRA seeks to ensure that the institution will operate in a sound and prudent manner and, on an ongoing basis, is able to meet its financial promises to beneficiaries.

The main types of approvals/interpretations are:

(a) Structural approvals – these involve changes to an existing supervised institution structure and may arise through approvals, acquisitions or changes in ownership. Structural change may affect the future business of supervised institutions and has the potential to impact on the current and future security of financial promises.

(b) Prudential approvals – there are some areas/activities within the regulatory regime where specific APRA approval is required. Particular issues or potential areas of concern may be identified as part of the policy development process and, where these are raised by institutions, they are subject to an appropriate degree of review by APRA to ensure activities are conducted in a manner which protects the financial interests of beneficiaries.

(c) Interpretations – part of APRA's role is to promote sound prudential practice by ensuring that supervised institutions understand and implement our prudential requirements appropriately. Communicating the rationale for our requirements and clarifying their intent is an important APRA function. APRA seeks to interpret its requirements consistently and the Framework supports staff in ensuring they are giving 'the APRA line' when responding to requests for policy interpretation.

### Licensing

APRA licenses supervised institutions to ensure that only those that can meet prudential requirements and have the capacity to meet their financial promises on an ongoing basis can operate in Australia.

Licensing applications are assessed by frontline supervisory teams and involve consultation with risk or technical specialists as required. Assessments of licence applications ensure that if an institution is successfully licensed, it can move directly to ongoing supervision. A procedure is in place that outlines key steps in the process for assessing a licence application. This is typically a rigorous and lengthy process.

APRA has established a cross-divisional Licensing Committee to ensure consistency in approach to the assessment of licensing applications, to assist staff making assessments with suggestions and commentary, to provide constructive challenge to their assessment of the application and to make recommendations to the delegated decision-maker.

### Enforcement

Enforcement refers to a special category of supervisory activity. In Enforcement, specific intervention and remedial actions are pursued, usually because APRA does not believe that an institution has the ability or willingness to rectify serious identified weaknesses that threaten financial viability or safety. Enforcement activities are critical to ensuring financial promises to beneficiaries continue to be met and form an important component of APRA's Framework for Prudential Supervision.

APRA maintains a separate Enforcement team to undertake enforcement activities and these are governed by an Enforcement Committee.

## Supporting material and infrastructure

The key principles for the material and infrastructure supporting APRA's Framework for Prudential Supervision are that it is:

- flexible;
- efficient (minimises duplication); and
- effective (supports APRA's risk-based, outcomes-focussed and principles-based approach to supervision).

The main support components of the Framework include its applications, procedures, guidance and reference material.

There are several key areas where systems support APRA's Framework for Prudential Supervision: data and information capture, data analysis, capture of assessments, supervisory planning and resource management.

Supervisory systems aim to minimise inefficiencies in data and information capture and administrative burden whilst retaining flexibility for supervisors.

## Quality assurance within the Framework

Adopting an outcomes-focussed approach to supervision is central to increasing the quality of our prudential assessments. By embedding a mindset which is risk-based, outcomes-focussed and principles-based, and ensuring all elements of APRA's Framework for Prudential Supervision support this, we improve the quality of our prudential assessments and actions.

Improving the quality and consistency of the use of the Framework occurs at four main levels:

- APRA management;
- the Supervision Framework Team, which is responsible for the maintenance and development of APRA's supervisory methodologies, practices and tools;
- Internal Audit; and
- independent review.

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