A core element of APRA’s Framework for Prudential Supervision is that APRA establishes a supervisory action plan resulting from its assessment of the key information available to it. In turn, this supervisory action plan impacts on future activities and information available for supervisory assessments. APRA’s supervision activities are tailored to the specific risks and issues a regulated entity faces. The Framework requires supervisors to identify and measure risks and take appropriate actions to ensure that the risks to which a regulated entity 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 regulated entity’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 a regulated entity and its ongoing ability to meet its financial promises to beneficiaries. This assessment provides an overview of the key risk areas of a regulated entity and where our understanding of the regulated entity needs to be strengthened together with more granular ratings and judgements in key risk areas. The supervisory action plan has its basis in the judgements we make as part of our risk assessment and focuses on these areas. APRA is committed to undertaking a level of ‘baseline’, or minimum, supervision involving both on-site and off-site activities so that regulated entities’ risk assessments and supervisory action plans remain current and appropriate. Baseline supervision requirements also establish the need for APRA supervisors to liaise with the home regulator regarding the off-shore parent for foreign branches and/or subsidiaries operating in Australia. Above and beyond these requirements, supervisors are expected to undertake activities that address key risks and issues with a focus on the capacity of regulated entities to continue to meet the financial promises they make. ‘Baseline’ requirements form a key component of APRA’s Framework for Prudential Supervision and allow us to pursue our objective of risk-based supervision.

Entity risk assessment

The purpose of a dynamic, integrated risk assessment of a regulated entity is to ensure that supervisory judgements made about an entity are accurate, timely and robust, and the supervisory attention afforded to each entity is appropriate. These assessments are founded on high quality risk analysis. Risk assessments are central to APRA’s allocation of supervisory resources and the implementation of risk- based supervision. The main objectives of a risk assessment of a regulated entity are to: • determine the probability that an entity 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 risks identified. Entity risk assessments are completed using APRA’s Probability and Impact Rating System (PAIRS). A PAIRS assessment articulates APRA’s overall assessment of a regulated entity. It details our dynamic assessment of the key risks, management and controls and capital support for the regulated entity. The supervisory action plan gives consideration to the importance of the key risks and issues and the systemic importance of the regulated entity as well as heightened industry risks. APRA’s supervisory actions are driven by its Supervisory Oversight and Response System (SOARS). At a high level, SOARS assists in the risk based allocation of supervisory resources. 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 regulated entity. This involves a consideration of the issue or activity and the potential risks to which a regulated entity may be exposed. The level of detail in the assessment takes into account the nature of the information and regulated entity 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 regulated entity’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 regulated entity’s processes and procedures and may involve both onsite 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 regulated entity’s ability to meet its financial promises to its beneficiaries.

Prudential consultations

In addition to prudential reviews that focus on specific risks or issues, ‘baseline’ supervision requires supervisors to hold prudential consultations – discussions with a regulated entity’s Board or senior executives that focus on obtaining an update on key strategic and risk issues, and explaining APRA’s supervisory assessment of the regulated entity and any prudential concerns. Entity financial analysis

APRA analyses financial data based on the financial returns regularly provided by regulated entities. This financial data provides detail on areas such as financial strength, performance and operations. Supplementary financial information may also be available from other sources including a regulated entity’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 regulated entity’s financial position and emerging trends or potential issues that should be monitored or followed up with the entity. 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 regulated entity, its size, complexity and risk profile. Appropriate supervisory actions are taken where a deterioration in financial performance or stability becomes evident.

Other off-site analysis

Off-site analysis covers a broad range of activities, including analysing specific information requested from a regulated entity, information provided under prudential standards and information that is requested from regulated entities to support industry analysis or specific research.

Ongoing interaction

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

Conglomerates and related regulated entities

A conglomerate group, for the purposes of APRA’s Framework for Prudential Supervision, is one where there is more than one related regulated entity and potentially across more than one industry. Groups are defined as either Level 2 or Level 3 in accordance with the prudential framework. A conglomerate group is usually headed by a regulated entity (either a non-operating holding company, ADI, general insurer, life insurer or RSE licensee). The assessment of the 'lead' regulated entity in the group considers the implications of, and relationships with, the other regulated entities in the group.

Industry analysis

Industry analysis involves research and assessments of the state of an industry with a view to enhancing our supervisory outcomes. APRA regularly reviews each industry it supervises and the general state of the macroeconomic environment for emerging issues and threats. These reviews may lead to actions relating to a specific regulated entity and/or a selection of entities and/or lead to a revision of our prudential requirements. In addition to regular industry reviews, APRA completes regular peer group financial analysis and both proactive and responsive ad hoc reviews. APRA's Industry Analysis team provides supervisors with up-to-date information on industry developments and emerging issues or trends that may adversely impact regulated entities’ risk profiles. Supervisors are responsible for determining whether any risks or issues identified necessitate a change to their supervisory action plan for a regulated entity. Supervisory actions will vary by regulated entity and reflect APRA’s riskbased approach. Ad hoc reviews In addition to regular analysis of key industry risks and issues, other ad hoc reviews may also be conducted by various areas of APRA on particular topics or themes.

Requests for approvals and interpretations Regulated entities often approach APRA for approval of various requirements and for interpretations of legislation and prudential standards. Judgements are made against the prudential principles underlying the requirements, consistent with APRA’s principlesbased 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 of a regulated entity. In most cases, the application requirements are set out in legislation or prudential standards and are supplemented by internal guidelines. In considering requests, APRA considers whether the regulated entity 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: Structural approvals These involve changes to an existing regulated entity structure and may arise through acquisitions or changes in ownership. Structural change may affect the future business of regulated entities and has the potential to impact on the current and future security of financial promises. Prudential approvals There are some areas/activities within the prudential framework where specific APRA approval is required. Particular issues or potential areas of concern may be identified as part of the policy development process and need to be subject to an appropriate degree of review by APRA to ensure activities are conducted in a manner which protects the financial interests of beneficiaries. Interpretations Part of APRA’s role is to promote sound prudential practice by assisting regulated entities to 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 to give 'the APRA line’ when responding to requests for policy interpretation.

Licensing

APRA licenses regulated entities 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 entity 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. 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 assist in finalising recommendations to the delegated decision-maker.

Enforcement

Enforcement refers to a special category of supervisory activity, in which specific intervention and remedial actions are pursued, usually because APRA does not believe that a regulated entity has the ability or willingness to rectify serious identified weaknesses that threaten financial viability or safety. Enforcement action is also taken, as relevant, in respect of individuals who have been involved in the activities of one or more regulated entities. Enforcement activities are an important component of APRA’s Framework for Prudential Supervision. APRA maintains a separate Forensic Analysis & Enforcement (FA&E) team, supported by Legal Services, to undertake enforcement activities and such activities are governed by the Enforcement Steering Group.

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, outcomesfocussed and principles-based approach to supervision). The main support components of the Framework include its applications, procedures, guidance and reference material.

Quality assurance within APRA’s Framework for Prudential Supervision

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 principlesbased, 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; • Internal Audit; and • independent review.