



APRA

APRA'S SUPERVISION PHILOSOPHY

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Introduction

APRA is an independent statutory authority that supervises institutions across banking, insurance and superannuation, and promotes financial system stability across Australia. This document outlines the Supervision Philosophy that underpins the supervisory approach used by APRA to execute on its mandate. It forms part of a series of publications explaining how APRA undertakes its responsibilities as a prudential regulator.

APRA's mandate is to protect the Australian community by establishing and enforcing prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by entities it supervises are met within a stable, efficient and competitive financial system. APRA also acts as a data collection agency for the Australian financial sector, plays a role in preserving the integrity of Australia's retirement incomes policy and administers the Financial Claims Scheme.

Supervision involves the conduct of a range of activities directed at protecting the Australian community by identifying and responding to significant prudential risks to regulated entities, industries and the financial system in a timely and effective manner. Prudential risks include financial, operational and behavioural risks that could have an adverse impact on the outcomes for depositors, policyholders or superannuation fund members, or for the financial system more broadly.

APRA's Supervision Philosophy is designed to ensure that APRA's supervisory approach and activities align with its mandate and vision for financial resilience and supervisory excellence. It supports supervisors in exercising their professional judgement and sets the direction for the ongoing development of the supervision methodology – the frameworks, processes, systems and tools used to supervise the financial sector. The Supervision Philosophy comprises:

- three key attributes that anchor APRA's supervisory approach; and
- five foundational elements that describe the key areas of emphasis within APRA's supervisory approach and provide the direction and guidance for supervisors.

The successful application of the Supervision Philosophy supports APRA to deliver on its mandate by enabling:

- Proactive and accurate risk **identification** across a broad risk spectrum, including risks that change or emerge over time.
- Dynamic **assessment** of identified risks and their impact on an entity's financial health.
- Prompt **response** to address and **resolve** issues, ramping-up supervision intensity where entities fail to address them effectively.

APRA's supervision philosophy

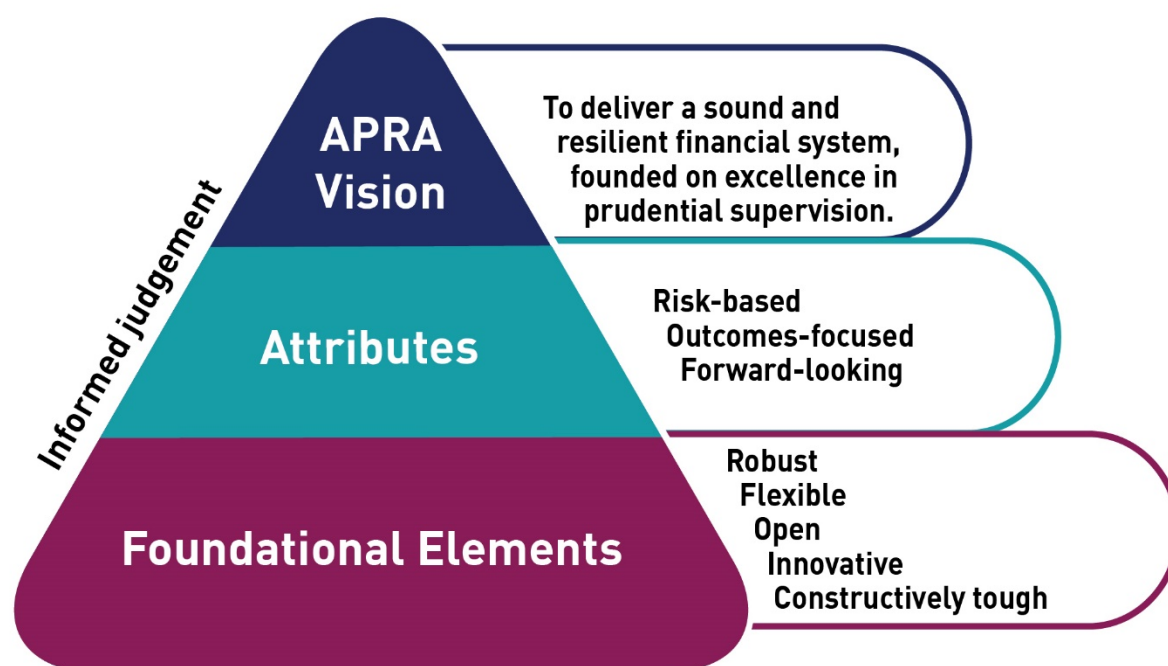


Figure 1. The APRA supervision philosophy

Vision

APRA's vision is to deliver a sound and resilient financial system, founded on excellence in prudential supervision.

A 'sound and resilient financial system' is one in which regulated entities can withstand shocks so as to avoid failure, now and in the future, and where disruptions to the continuity of financial services are minimised.

The primary responsibility for the financial soundness and prudent risk management of a regulated entity rests with the board of directors and senior management. It is the role of APRA to supervise how well these duties are carried out and to intervene where needed.

Supervisory 'excellence' is, therefore, a key enabler of a sound and resilient financial system. Excellence is achieved through the application of a contemporary supervision methodology that is fit for purpose, both today and into the future. APRA supervisors help deploy the supervision methodology – so they themselves need to be suitably equipped with sufficient skills and capabilities to carry out their duties.

Informed judgement

A fundamental emphasis in the supervision philosophy is **informed judgement**. Using all the tools at their disposal, supervisors ultimately form judgements about the risks facing an entity or industry, assess their relative importance and craft a response to achieve a desired supervisory outcome.

Critical to the application of informed judgement is the collection and analysis of high quality data that is timely, relevant, accurate and well understood. Recognising the importance of data, APRA has established a data strategy and continues to evolve its approach to the collection and analysis of industry and entity data.

Supervisors apply their judgement based on evidence and analysis. Inherent in this approach is the risk that the effort deployed departs from expectations. To minimise such outcomes, APRA is staffed by teams with relevant skills and experience, and major decisions involve the most senior and experienced supervisors.

APRA is committed to the continuous uplift in the capabilities of its people and adopting a strategic approach to supervisory training programs designed to cultivate, build and maintain the high degree of supervisory 'bench-strength' expected of a regulator with such an important remit.

Attributes

At the heart of APRA's supervision philosophy are three key attributes that support APRA's vision for financial resilience and supervisory excellence.



Risk-based – directing supervisory resources and activities to areas of greatest risk or impact.

Risk-based supervision is essential to ensuring that APRA's scarce resources are devoted to rectifying issues of identified heightened importance that pose threats to individual entities or the wider financial system.

APRA's risk-based approach is designed to identify and assess those areas of greatest risk to a regulated entity, industry or to the financial system as a whole. Supervisory resources are then allocated to target these prioritised risks. Risk-based supervision also implies that not all areas of risk can, or will, be addressed. APRA supervision teams must, therefore, use their informed judgement to choose the areas that will have the greatest impact on ensuring the regulated population meet their financial promises.

APRA recognises that, to remain effective, risk-based supervision must be timely. Early identification and escalation of significant risks support APRA's ability to take effective corrective action where warranted.



Forward-looking – anticipating the impact of current and emerging risks.

APRA seeks to be forward-looking, assessing safety and soundness not just against current risks, but against those that could plausibly arise further ahead. An important aspect of supervision involves assessing how entities can manage adversity and stress. These assessments need to include both entity and industry-level perspectives, and incorporate the expected impacts of such events in risk assessments and supervisory responses. Where APRA determines it necessary to intervene to mitigate the risks that a regulated entity is creating, it seeks to do so at an early stage.



Outcomes-focused – ensuring supervision delivers desired, clear and timely results.

To be outcomes-focused places emphasis on the achievement of a desired supervisory outcome, rather than merely following a process. APRA applies a strategic approach to supervision that sets clear expectations for an end-state, designed to strengthen the financial health of the entity. Establishing clarity around desired outcomes, and the steps that must be taken to achieve them, focuses the supervision effort on results.

This approach applies equally to specific cohorts of entities and across the wider APRA-regulated industries; banking, insurance and superannuation. Assessing, testing and communicating more broadly whether outcomes have been achieved forms a key part of APRA's focus on accountability and transparency.

Foundational elements

Five foundational elements set the expectations of APRA's supervision approach and describe the key areas of emphasis when conducting risk-based, forward-looking and outcomes-focused supervision.



Robust – supporting consistent judgement and analysis with evidence and independent challenge.

To promote confidence and engender fairness, supervisory decisions and judgements must be well-founded, supported by evidence, timely and open to challenge. They must also be underpinned by systems, tools and frameworks that provide sufficient structure to ensure a consistent and disciplined application of the supervision methodology.

APRA facilitates consistency and accountability across informed judgements made by APRA supervisors through a range of processes, procedures, delegations, protocols and reporting mechanisms. Supervisory decisions and processes are also subject to quality assurance and

internal audit designed to test and monitor consistency and continuously evolve the supervision methodology towards better practice.



Flexible – adapting and responding to new information and changes in the environment.

The financial system and the environment in which APRA and its regulated entities operate is both diverse and constantly changing. APRA's approach to supervision needs to reflect that diversity, as well as keep pace with new entrants and structural changes as they emerge.

Whilst APRA seeks to apply a structured and disciplined approach to the execution of its mandate, it also needs to embed flexibility in its supervisory methodology to facilitate timely responses to new and emerging risks. This element allows the application of proportionality – adjusting the supervision effort for entities or industries reflecting their relative **size**, **complexity**, the **criticality** of activities conducted, whether these can be easily **substituted** in the market, the degree of **interconnectedness** with others and the ease in which **resolution** activities can be applied.

APRA supervisors must also apply a degree of flexibility in undertaking their work, adapting supervision strategies and the activities performed to achieve desired outcomes, in response to changing market conditions or emerging risks.



Open – optimising communication with external stakeholders to inform, influence and drive accountability.

APRA expects productive and cooperative relationships with regulated entities, built on mutual respect, honesty, candour and professional courtesy. APRA seeks to be open and transparent in its interactions with the board, senior executives and other representatives of regulated entities and expects the same in return.

External communication of APRA's supervisory concerns can enhance accountability and help strengthen supervisory response and outcomes. However, this benefit must always be balanced with financial stability concerns, especially when disclosing entity-specific information.

The strategic use of external communications also allows APRA to influence good industry practice through timely publication of the results of thematic reviews and other activities. Entity-specific disclosure is used tactically having the dual effect of holding the entity concerned to account while sounding a warning to the broader industry.

APRA also uses external communication to achieve transparency on how it undertakes prudential supervision, its assessment and strategy for addressing industry risks and an ex-post view on whether desired outcomes have been achieved.



Innovative – aspiring towards advanced tools and techniques in supervision.

Recognising that APRA's supervisory approach must continue to evolve to account for changes in the regulatory landscape and innovations in the industries APRA supervises, APRA is committed to continuous review and enhancement of its supervision model. This includes comparisons against international peer regulators to ensure its supervisory tools and techniques remain in line with international best practice.

APRA encourages a culture of continuous improvement in its supervisory approach. Whilst a fundamental component of supervision is the application of informed judgement by supervisors, this is enabled through supervisory tools and systems, with an eye to innovation. The use of modern data collection techniques, automated reporting systems, and the latest statistical and programming languages are areas of strategic uplift for APRA and will ultimately enhance the effectiveness and efficiency of the supervision effort.



Constructively tough – the purposeful will to use coercive tools to achieve results at an early stage.

APRA's work is achieved through a variety of supervisory approaches to identify and rectify problems before they threaten the financial health of an entity. In most situations such methods will not involve more coercive or formal enforcement action. However, where it is clear that a particular approach is not delivering a satisfactory outcome, APRA will readily increase its supervisory intensity, making greater use of coercive tools to deliver on its prudential mandate.

In determining when and how to take coercive enforcement action, APRA will actively consider the need to deter a recurrence of serious prudential risks both at the entity level and more widely across the industry. Taking enforcement action to hold entities and individuals to account when they do not meet their prudential obligations can have significant deterrent impacts by demonstrating clear consequences for poor prudential outcomes.



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