# INFORMATION PAPER

## APRA's Supervision Priorities

1 February 2021

# Contents

# Executive summary

APRA is a supervision-led agency, seeking to maintain a sound and resilient financial system founded on excellence in prudential supervision. Following publication of its supervision priorities early in 2020, APRA's focus necessarily shifted from planned activities to ensuring the financial system remained resilient in the face of the COVID-19 pandemic and its broader economic and financial impacts.

APRA's supervision played an important role in supporting financial system stability in Australia during 2020. In collaboration with the Council of Financial Regulators (CFR) and peer agencies, APRA's actions supported the financial system's ability to act as a shock absorber of the pandemic's economic fallout. Led by both intense supervisory liaison and targeted regulatory interventions, APRA's actions included:

- providing guidance to banks and insurers on capital management;
- providing capital relief on deferred loans;
- facilitating the implementation of Government's early release of super program; and
- scrutinising and challenging entities' approaches to managing business disruption.

APRA's supervisory response continues to evolve in light of the changing impacts of COVID-19. APRA's planned activities balance the need for it to respond to the impact of the pandemic on regulated entities while ensuring that the regulatory burden is minimised, where possible.

This Information Paper outlines APRA's planned supervisory priorities for each industry over the next 12-18 months. The agenda includes significant cross-industry elements. Importantly, APRA's priorities are aligned to the four key community outcomes in APRA's 2020-2024 Corporate Plan:[1]

- maintaining financial system resilience;
- improving outcomes for superannuation members;
- transforming governance, risk culture, remuneration and accountability (GCRA) across all regulated financial entities; and
- improving cyber-resilience across the financial system.

COVID-19 has meant that while work has continued on all four outcomes, APRA has prioritised maintaining financial system resilience in the short term. APRA's supervisory priorities may vary as the risk outlook evolves, not least in response to the ongoing impacts

[1] APRA, *Corporate Plan 2020-2024* (August 2020)

of COVID-19. In protecting the stability and soundness of regulated entities, APRA will work to maintain public confidence in the financial system and aid the economic recovery.

APRA's supervisory program is risk-based, forward-looking and outcomes-focused. This approach is reflected in APRA's recently updated supervision methodology, facilitated through the introduction of the Supervision Risk and Intensity (SRI) Model.

Complementing the SRI Model, the upcoming introduction of a new data collection solution, APRA Connect, will see APRA enhance its use of technology and data to support supervisory assessments and guide decision-making at an industry and entity level.

While the Australian financial system is, on the whole, in a sound financial position, APRA will strive to ensure that the balance sheet strength and very low incidence of disorderly failure among APRA-regulated entities is maintained. This is supported by APRA's heightened focus on recovery and resolution planning and stress testing.

In superannuation, improving outcomes for members remains a core supervisory priority. In December 2020 APRA published the first full refresh of the MySuper Heatmap, followed soon after by the issue of notices requesting further information from trustees of MySuper products where underperformance persists. This enhanced transparency of investment performance and fees in MySuper products enabled APRA to target its supervisory efforts on particular MySuper products, and in 2021 APRA will further sharpen its supervisory focus on underperformance, including the use of enforcement powers where appropriate.

Improving cyber resilience is an area of major strategic focus for APRA underpinned by the its 2020-2024 Cyber Security Strategy. APRA will be seeking to ensure regulated entities significantly improve their cyber resilience practices. In 2021, APRA will focus on the effective implementation of its information security standard by all regulated entities.

APRA remains committed to delivering on its community outcome of transforming GCRA. In addition to the implementation of the upcoming remuneration prudential standard, a range of GCRA-related supervisory reviews and 'deep-dives' will be conducted over the next 12-18 months. APRA is also investing in new tools to assess and benchmark GCRA practices across entities, such an industry-wide risk culture survey. APRA's insights will increasingly be shared with industry and the public to reinforce prudential expectations and drive accountability.

This paper should be read in conjunction with APRA's Policy Priorities Information Paper which outlines forthcoming changes to APRA's prudential framework that support these priorities and the supervision effort.[2]

[2] APRA, *APRA's Policy Priorities* (Information Paper – January 2021)

# Chapter 1 - Introduction

## 1.1 APRA's mandate and role of supervision

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 the entities APRA supervises are met within a stable, efficient and competitive financial system.

APRA's supervision activities are fundamental to APRA's ability to meet its mandate. Supervision plays a critical role in identifying significant risks to entities and the financial system and ensuring these are appropriately addressed in a timely and effective manner.

A key strategic initiative within APRA's corporate plan is to improve and broaden risk-based supervision. As part of this initiative, APRA is now implementing its new SRI Model that is responsive to a rapidly changing environment, as outlined below.[3]

In addition, in 2021, APRA will be introducing a new data collection solution, APRA Connect, which will enable APRA to collect more granular data, strengthening our data-driven decision-making and enabling enhanced data submission capabilities.

APRA applies a **risk-based** approach by directing supervision resources towards areas that pose the greatest risk or impact; focuses on being **forward-looking** through anticipating the impact of current and emerging risks; and holds entities and individuals to account for delivering desired, clear and timely **outcomes**. This relies on supervisory judgement and expertise, informed by evidence and analysis.[4]

## 1.2 Transition to the SRI Model

A fundamental element of APRA's supervisory approach is the use of a structured framework to identify and assess risks, so that APRA can effectively direct its resources towards the areas and entities of greatest risk. From 2012, APRA used the Probability and Impact Rating System (PAIRS) and the Supervisory Oversight and Response System (SOARS) to identify and assess risk and to determine the appropriate supervisory response. By 30 June 2021, APRA will have completed migration to a new system to assess risk and determine supervisory intensity: the SRI Model. During this time, regulated entities can expect to be engaged by APRA in regard to their SRI tier and stage; details of which will remain confidential to the entity, consistent with that of PAIRS and SOARS ratings. The SRI tier and stage will provide a foundation for the intensity of APRA's supervisory engagement with entities ensuring clarity of expectations.

---

[3] APRA, *Supervision Risk and Intensity (SRI) Model* (November 2020)

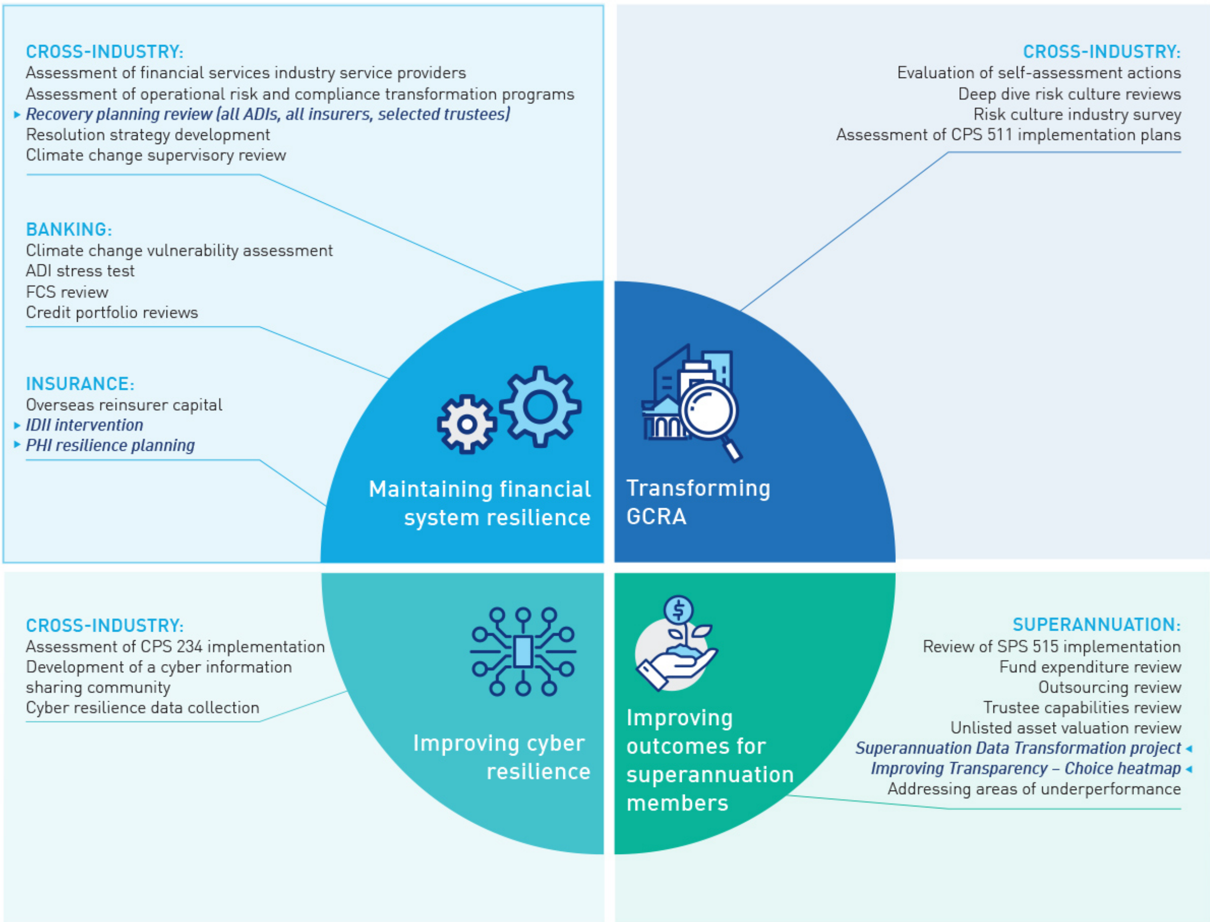
[4] APRA, *APRA's Supervision Philosophy* (October 2020)

The SRI Model applies a more contemporary categorisation of risks, elevating non-financial risks whilst preserving the importance of financial resilience. It better caters for the different industries and changing risk assessments. The model is also aligned with APRA's enforcement approach ensuring a timely and appropriate supervisory response.[5]

## 1.3 APRA's supervision priorities

Consistent with the strategic priorities outlined in APRA's Corporate Plan for 2020-2024, APRA's supervision priorities aim to deliver four key community outcomes: maintaining financial system resilience, transforming GCRA, improving cyber-resilience and improving outcomes for superannuation members.

APRA's supervisory priorities are summarised below and detailed in the chapters that follow.




KEY: ▸ *Denotes those supervision activities which are relevant for all APRA-regulated entities within the industry/industries*

[5] APRA, *APRA's Enforcement Approach* (September 2019)

# Chapter 2 - Cross-industry

This chapter outlines APRA's planned supervisory activities for cross-industry risks. These activities cover three of APRA's four key community outcomes: maintaining financial system resilience; improving cyber resilience; and transforming GCRA.

## 2.1 Maintaining financial system resilience

### 2.1.1 Protecting the financial safety and soundness of APRA-regulated entities

During 2020, many countries, including Australia, experienced their largest economic contractions since the Great Depression as a result of COVID-19. Volatility in asset and funding markets early in the downturn was also elevated. Historically, economic and financial market disruptions of this size have often caused stress and failures in the financial system.

Significant monetary and fiscal support played a key role in limiting the impact of the downturn on households, businesses, and ultimately the financial system. This allowed financial systems to play a role in supporting economies. Their ability to do this was facilitated by resilience built up in the post-GFC period, supported by regulatory actions.

On the whole, Australian financial entities have sufficient resilience to continue to support economic recovery. APRA remains alert to changes in economic, financial and health conditions as the system continues to recover from the effects of the pandemic. Over the next 12-18 months, APRA will focus on ensuring that the resilience of regulated entities is maintained through regular stress testing and other activities.

### 2.1.2 Fostering the operational resilience of APRA-regulated entities

Weaknesses in operational resilience can have both financial and non-financial impacts on entities, and can undermine their ongoing viability. Ongoing access to financial services, such as banking, insurance and superannuation, is essential to supporting economic activity. For these reasons, operational resilience was one of APRA's key areas of focus as the threat posed by COVID-19 became apparent.

APRA is incorporating the lessons learned from COVID-19 into its supervisory practices to further strengthen the operational resilience of the Australian financial system. APRA expects entities to significantly strengthen their operational resilience practices.

APRA is updating its operational resilience standards and guidance as outlined in its Policy Priorities paper. To complement the policy updates, APRA's supervision activities over the next 12-18 months will focus on:

- The impact of changes made to their operations by entities in response to the pandemic and the effectiveness of existing contingency arrangements to protect against any risks that may have arisen;
- The extent to which regulated entities' risk profiles reflect changes to business practices and strategy as a result of COVID-19, and any operational risk losses; and
- Assessment of the range and concentration of service providers used by APRA-regulated entities.

APRA has work underway focusing on ADIs' management of operational and compliance risks. Several ADIs have transformation programs underway to address issues identified in self-assessments of their management of operational risk. APRA has also conducted reviews in this respect and will continue to assess the state of entities' operational and compliance risk management transformation programs and practices. In addition, APRA intends to release a compliance risk management information paper in 2021 to help drive further improvements in entities' compliance management.

### 2.1.3 Enhancing contingency planning for adverse events, informed by regular stress testing

Stress testing is a core component of APRA's toolkit used to enhance financial resilience. It provides a risk-based, forward-looking assessment of the ability to withstand stress at an industry, cohort and individual entity level.

APRA regularly conducts stress tests across the banking and insurance sectors to assess their resilience to severe but plausible adverse scenarios. These tests help to improve both APRA's and industry's understanding of the impact of future potential risks, allowing appropriate safeguards to be put in place.

In response to the onset of COVID-19, APRA increased its use of stress testing across all regulated industries, enabling timely assurance and insight. In 2021, APRA's stress testing program will include regulator-led common scenario stress tests across nominated industries for select scenarios, as well as engaging with entities on the stress test activities they undertake as part of their Internal Capital Adequacy Assessment Process.

Significant focus will continue to be given to stress testing the ADI industry, given the importance of the ADI sector to financial system stability. In early 2021, APRA will conclude its analysis from the final cycle of the 2020 ADI 'streamlined' stress tests, providing feedback to relevant entities. A more comprehensive stress test of the largest ADIs is planned for 2021.

For the insurance industry, targeted stress test activities will continue, subject to the economic and macro environment and emerging risks. For the superannuation industry, APRA plans to sharpen its supervision by advancing the role of stress testing in providing assurance and insight at both industry and entity level.

## 2.2 Improving cyber resilience

APRA seeks to reduce the impact of cyber incidents on the financial system and Australian community. In the face of escalating risks, APRA expects regulated entities to significantly improve their cyber resilience practices and be able to withstand cyber-attacks.

Cyber resilience is an area of major strategic focus for APRA, underpinned by its 2020-2024 Cyber Security Strategy.[6] The updated strategy seeks to influence the practices of regulated entities and involves acting in concert with peer regulators and other government agencies, while supporting the Australian Government's 2020 Cyber Security Strategy.

As part of its Cyber Security Strategy over the next 12-18 months, APRA will:

- initially as a pilot with a small group of select APRA-regulated entities, instruct entities to engage independent auditors to assess compliance with *Prudential Standard CPS 234 Information security* to identify and address weaknesses in cyber practices;
- continue to collect cyber resilience data which will be used to generate cross-industry insights on better practice examples. These insights will be shared with regulated entities to strengthen cyber practices;
- launch a pilot for a cyber information sharing community across APRA regulated entities to improve industry situational awareness and the sharing of technical information; and
- in concert with the CFR, test cyber resilience of Australia's financial services industry via a pilot Cyber Operational Resilience Intelligence-led Exercise.[7]

## 2.3 Transforming governance, risk culture, remuneration and accountability

APRA is continuing its work to transform GCRA across APRA-regulated entities' management of financial and non-financial risk. Over the next 12-18 months, APRA will:

- following the finalisation of *Prudential Standard CPS 511 Remuneration*, conduct an implementation review across a sample of regulated entities and share these insights in due course with all regulated entities;
- drive improvement in the governance and risk culture practices by continuing risk culture deep dives at a small number of large Australian financial entities, follow up and evaluation of entities' actions in response to risk governance self-assessments and regular prudential engagements. This will include working to close issues currently resulting in capital overlays or enforceable undertakings; and

[6] APRA, Speech by Geoff Summerhayes '*Strengthening the chain*' (November 2020)

[7] CFR, *CORIE framework launched to test cyber resilience of Australia's financial services industry* (December 2020)

- implementing a tool to benchmark and assess trends in risk culture across regulated entities, after undertaking a risk culture survey for a pilot group of regulated entities.

APRA will also be working with Government to extend the accountability regime to all APRA-regulated entities.

## 2.4 Improving recovery and resolution capability

COVID-19 emphasised the importance of APRA's strategic priority to enhance its recovery and resolution capability and that of the industry via effective contingency planning and regular testing of those plans. In 2020 APRA was focused on contingency planning for near-term risks to the financial system. Stabilisation in the external environment will enable APRA to refocus on its planned supervisory priorities over the next 12-18 months. APRA is proposing to release for consultation a draft cross-industry prudential standard on recovery and resolution planning as outlined in its Policy Priorities Paper. This will be reinforced by the following supervisory priorities:

- strengthening the credibility of recovery plans across all APRA-regulated industries to ensure that supervised entities have and maintain a credible recovery capability, with APRA's assessment of an entity's recoverability as a key input into the SRI Model assessment;

- ensuring that simple, credible resolution strategies are in place for more vulnerable entities across each industry. These are critical for situations where an entity is facing financial stress and private sector recovery is not possible; it means that the entity and APRA are prepared to implement an orderly exit or resolution that maintains financial stability and minimises any impact on public funds and beneficiaries (depositors, policy-holders and members); and

- driving improvements in small ADIs' compliance with *Prudential Standard APS 910 Financial Claims Scheme* to ensure that entities are adequately prepared should the Financial Claims Scheme safety net be required.

Expanding recovery and resolution planning in the superannuation industry is also an important priority over the coming period and will help underpin the Government's implementation of the *Your Future Your Super* reforms.[8]

## 2.5 Climate-related financial risks

Climate change is a driver of financial risks, as well as business opportunities, for all APRA-regulated entities. While the financial nature of these risks is increasingly understood, there remains a need for regulated entities' to enhance their capacity to manage and respond to climate risks. APRA continues to increase its scrutiny of the manner in which ADIs, insurers and superannuation trustees are managing the impact of risks arising from climate change.

---

[8] Australian Government Treasury, *Your Future, Your Super package* (November 2020)

In a letter to industry in 2020, APRA outlined areas of focus for its climate risk activities.[9] Though some supervision initiatives were deferred due to COVID-19, APRA remains committed to ensuring that regulated entities take a strategic and risk-based approach to the management of climate-related financial risks. APRA intends to develop climate risk guidance in 2021 to assist with this, as highlighted in the Policy Priorities paper.

APRA is currently completing a supervisory review of the regulated entities that participated in APRA's 2018 climate risk survey. The outcomes of these reviews are being used to inform the development of APRA's climate risk guidance and ongoing supervision activities.

As part of APRA's actions to both uplift the scenario analysis capability and strengthen the understanding and management of climate-related risks within the financial sector, APRA is leading work on a climate vulnerability assessment (CVA) together with the CFR. Beginning with large ADIs in 2021, the CVA will:

- explore the potential financial exposure and macroeconomic risks to large ADIs, the financial system and economy from both physical and transition climate risks; and
- assist APRA in understanding how the large ADIs might adjust their business models in response to different climate change scenarios.

APRA is currently designing the CVA and expects to engage with the ADIs participating in the assessment in 2021. The design of the CVA will reflect APRA's cooperation with international peer regulators. APRA also recognises that there have been significant investments by large ADIs in recent years to improve their climate risk assessment and response capabilities, and where possible the CVA will leverage this capability. The CVA also presents an opportunity for enhanced consistency across ADIs in their approach to assessing climate-related risks, improving the value of the climate risk analysis for both individual ADIs and the wider market.

[9] APRA, *Understanding and Managing the Financial Risks of Climate Change* (Letter, 24 February 2020)

# Chapter 3 - Banking

The banking industry entered COVID-19 well-capitalised and with sound liquidity and funding. COVID-19 presented unprecedented risks and the potential for significant adverse outcomes for customers and banks. Government, central bank and prudential support programs have been provided to mitigate this. These programs will be gradually unwound in the period ahead.

APRA is focused on maintaining the banking industry's resilience and enhancing its crisis readiness, supporting prudent outcomes through the pandemic and in the transition to the post-pandemic recovery. In response to COVID-19, APRA made a necessary shift from baseline supervision to a sharpened focus on financial resilience. In 2021, in addition to the cross-industry initiatives outlined in Chapter 2, APRA will focus on the three key areas outlined below. In doing so, APRA recognises that its supervisory approach must be tailored and proportionate to the various cohorts of the industry, recognising differing business models and challenges.

## 3.1 Credit Risk

While Government support measures, including APRA's temporary capital relief for loan repayment deferrals, have played an important role in assisting borrowers, credit risk increased significantly for banks as a result of COVID-19. Banks are expected to experience an increase in credit losses as government support is withdrawn and they will need to work through elevated volumes of problem loans.

Credit quality, problem loan management and provisioning will therefore be areas of focus in the period ahead. APRA will maintain a heightened level of supervisory engagement as it monitors credit risk, with a particular emphasis on the identification of problem loans and higher risk portfolios, including undertaking 'deep dives' to obtain assurance about effective portfolio management. Progress on reducing and ultimately clearing loan repayment deferral portfolios will continue to be monitored. To facilitate this, banks may be asked for portfolio specific data and other credit information.

The pending finalisation of *Reporting Standard ARF 220 Credit Exposures and Provisions*, which is the enhanced data collection for credit risk, will allow APRA to undertake improved analysis and monitoring. For banks accredited to use the internal ratings-based approach to credit risk, APRA will be assessing portfolio re-rating and model performance. Reflecting the importance of credit to the operation of the broader economy, APRA will also be monitoring the availability of credit to different types of borrowers.

## 3.2 Capital Management

APRA expects that at all times banks maintain capital adequacy, and during COVID-19 there has been a need to ensure that banks use buffers to absorb losses and continue to provide credit to support the economy if needed.

APRA has provided capital guidance to banks, including on dividend payouts and will continue to monitor ADIs to ensure ongoing prudent capital management. APRA will continue to assess banks' capital management, including their stress testing capabilities, the scenarios they consider and how recovery planning options have been integrated, in order to identify gaps and ensure that they deliver on their capital management plans.

## 3.3 Liquidity

Bank funding and liquidity positions have benefited from extraordinary central bank support provided during COVID-19. APRA will continue to focus on the stability of bank liquidity and funding in the face of uncertainty and will be examining how, when appropriate, ADIs will be able to transition away from the extraordinary support that has been provided in an orderly manner.

APRA has a program of supervisory work aimed at ensuring reliability and stability in funding and liquidity, including:

- addressing risk management deficiencies identified at peak times of COVID-19;
- facilitating a smooth reduction in Committed Liquidity Facility limits given the increasing availability of Commonwealth and State government securities to provide High Quality Liquid Assets; and
- supporting the transition of the banking industry to funding self-reliance as external support measures are phased out.

# Chapter 4 - Insurance

Overall, the insurance industries that APRA regulates remain well-capitalised, and have flexed and adapted to the operational issues arising from COVID-19. Each industry is experiencing its own challenges, either as a result of underlying sustainability issues or due to the COVID-19 driven economic disruption.

## 4.1 General insurance

In 2020 general insurance industry profitability declined due to the catastrophic bushfire and storm events and the early impacts of COVID-19 on investment returns. Despite this, the industry's capital coverage has remained stable.

The pandemic has raised questions around the role of insurers in protecting the community against pandemic risks. These risks are extremely difficult to insure as they frequently manifest globally and are therefore highly correlated, meaning coverage is unlikely to be affordable. The most prominent example of this has been in business interruption (BI) insurance.

Recovery and resolution planning for insurers remains a priority in line with APRA's broader cross-industry work on crisis readiness and work has also continued on managing the risks associated with insurers' high reliance on overseas reinsurance.

### 4.1.1 Business interruption insurance

The economic and social disruption from COVID-19 has put the spotlight on insurers and the role of business interruption (BI) cover in assisting the business community with the recovery from COVID-19 impacts. APRA has been closely monitoring the industry's exposure to business interruption policies, given the uncertainty that has arisen over the effect of policy wordings. Some of these matters are currently being tested in the Courts, and early indicators are that insurers may be liable for exposures beyond their original intent because of insufficient attention to the precision of policy terms and conditions.

The ongoing uncertainty has caused challenges for insurers and policyholders and resolving that uncertainty as quickly as possible is critical, to allow all parties to move forward. APRA is working with peer regulators, industry and other stakeholders towards this objective.

APRA expects that insurers will reserve prudently for potential claims, and pay all legitimate claims in a timely fashion. APRA has undertaken intense monitoring of the potential impact BI could have on insurers and this will continue into 2021. Entities can expect APRA to maintain a close watch over the BI legal proceedings and seek regular updates on insurers' exposures, provisioning levels, stress testing and the extent of support from reinsurers, in an effort to assess the potential impact on capital levels. APRA is also assessing the readiness of insurers to deploy recovery options in the event of a severe adverse outcome and will be monitoring steps being taken by insurers to facilitate the availability and affordability of appropriate cover into the future.

More broadly, BI provides a case study in the efficacy of insurers' governance and risk management practices in relation to how products are developed, reviewed and updated. This will be a focus area for supervisors in the short to medium term including the robustness of pricing processes and the link between policy wordings and reinsurance to assess any potential misalignment in coverage.

### 4.1.2 Overseas reinsurance

The global reinsurance market is critical to the functioning of the Australian insurance industry and supports the availability of insurance to the Australian community. While reliance on reinsurance is a necessary feature of the insurance industry, it presents certain risks should that reinsurance not be available. To manage this risk, APRA will continue with supervisory activities aimed at understanding the parent group's capital management approach and capital support available to Australian reinsurers, both in times of business-as-usual and stress situations. During COVID-19, APRA increased its engagement with home regulators and parent groups of offshore reinsurers in order to identify and respond to broader institutional and systemic impacts of the pandemic, and this will continue in 2021.

## 4.2 Life insurance and friendly societies

While capital coverage in the life insurance industry has remained relatively stable, the industry continues to face significant product sustainability and profitability challenges. COVID-19 is expected to exacerbate these challenges. As a result, maintaining financial resilience and sustainability is an area of heightened supervisory focus.

Due to COVID-19, certain areas of focus prior to the pandemic, such as product sustainability and data quality, have been reinforced. Activities such as regular stress testing exercises using COVID-19 related scenarios, new data collections, and recovery planning are either underway or planned in the near future.

In response to the industry's challenges, APRA has increased its engagement at the industry level, reinforcing its message that accountability for improving the ongoing sustainability of the industry sits with a broad set of stakeholders in the life insurance and friendly society ecosystem. If the sustainability challenges are not appropriately addressed by the industry, then there is a risk that some types of life insurance may not be available to the Australian community in the future.

### 4.2.1 Sustainable products

The life insurance industry faces long-standing challenges, substantially in relation to legacy products with unsustainable features. Instances of poor product design and unsustainable product offerings are threatening affordability of retail products. Pricing and design of insurance offerings available through superannuation are also facing sustainability challenges.

APRA will maintain its heightened supervisory focus and willingness to intervene, reflecting concerns about the sustainability of certain products. Individual disability income insurance

(IDII) is a particular area of focus. APRA has already intervened in relation to IDII with a number of measures, including higher capital requirements, to incentivise the industry to change market practice.[10]

The higher capital requirements will remain in place until individual insurers can demonstrate they have taken adequate steps to address APRA's concerns. In instances where individual insurers fail to meet expectations, APRA may impose further capital requirements, or if appropriate, take more forceful action, such as issuing directions or imposing licence conditions.

APRA has observed worsening claims experience and a decline in profitability of insurance offered through superannuation funds, as well as instances of premium volatility and material changes in product design. In December 2020 APRA highlighted these warning signs at a roundtable of senior participants in both the life insurance and superannuation industries. APRA will shortly be communicating with industry on observed threats to the sustainability of insurance in superannuation and APRA's expectations of respective industry participants to act decisively to address them. APRA will actively monitor the industry's response and will intensify its actions if needed.

### 4.2.2 Friendly societies

APRA has established a three-year supervision roadmap, tailored to enhance the financial resilience of friendly societies. The roadmap was communicated to the industry in December 2020. In 2021, APRA will be reviewing the impact of the prolonged low interest rate environment on business model sustainability; board composition; and recovery planning. Planning work for other components of the roadmap (risk management, minimum capital requirement, and stress testing) will begin in the second half of 2021.

## 4.3 Private health insurance

While PHIs are generally financially sound, the effect of COVID-19 on investment returns, deferred claims liabilities, and the industry's response through the provision of financial hardship assistance and deferred premium increases underpinned a continued decline in profitability over the past 12 months. While investment incomes have stabilised, insurance margins remain under pressure as health (and hence claim) costs continue to rise faster than premiums.

The industry continues to face sustainability challenges due to rising premiums that are causing affordability issues and resulting in declining membership, particularly among the younger population. APRA expects that the economic impacts from COVID-19 will exacerbate sustainability challenges, as unemployment has increased amongst the younger population and wage growth remains subdued. In June 2019, APRA outlined its expectations that PHIs would develop robust, actionable strategies to address sustainability risks, as well as

---

[10] APRA, *Sustainability measures for individual disability income* (Letter, December 2019)

recovery plans that outline how they will respond if their strategy is not successful or other material risks threaten their solvency.

Continuing the work commenced in 2020, in 2021 APRA will remain focused on building industry resilience and preparedness through recovery planning. APRA supervisors will also be assessing PHIs' progress in addressing affordability and sustainability risks. PHIs that take a passive approach to these risks can expect more intense supervision. More broadly, APRA will continue to drive an uplift in the practices of PHIs to ensure that they are well positioned to address new challenges in a rapidly changing operating environment. This will include working towards improving the industry's governance and controls around IT and outsourcing services, recognising that PHIs are using a growing range of material service providers.

# Chapter 5 - Superannuation

The superannuation industry withstood significant and unexpected headwinds in 2020, including a weakened economic environment, shrinking superannuation inflows (driven by increasing unemployment) and an entrenched low interest rate environment. The temporary expansion of the Early Release Scheme (ERS) for COVID-19 led to a sharp increase in member outflows. Operational resilience was also tested on a number of fronts.

Despite the challenges 2020 posed, the industry performed reasonably well, ending the year in a sound position. However, there remains a need for the industry to maintain its focus on enhancing member outcomes and tackling areas of underperformance. This was a continued area of focus for APRA throughout 2020. As APRA's first full refresh of its MySuper Product Heatmap showed in December, a number of funds continue to display entrenched underperformance, and will face heightened scrutiny and possible enforcement action as APRA further steps up its efforts to lift member outcomes in 2021.

## 5.1 Sharpening APRA's supervisory approach

Improving outcomes for superannuation members continues to be one of APRA's key community outcomes. APRA is focused on embedding a superannuation trustee culture that is continuously improving the quality of outcomes delivered to members and ensuring areas of underperformance are addressed. APRA's overall strategy for improving outcomes for superannuation members is centred around four key areas:

- strengthening the prudential framework;
- sharpening APRA's supervisory approach;
- enhancing superannuation data and insights; and
- improving industry transparency.

APRA's initiatives for strengthening the prudential framework are outlined in APRA's policy priorities paper.

In addition to supervision of individual entity risks, APRA will conduct a number of thematic supervisory activities in the next 12 – 18 months as follows:

- Complete its review into unlisted asset valuation practices that commenced in 2020 after observing some trustee valuation practices during COVID-19. APRA will engage with poorer performing entities to ensure their practices are enhanced.
- Review trustees' implementation of requirements under *Prudential Standard SPS 515 Strategic Planning and Member Outcomes* (SPS 515) by examining:
  - the Business Performance Reviews for a range of trustees. One of APRA's focus areas will be on how trustees demonstrate they are responding to the impact of COVID-19 on their business operations; and

- expenditure management of certain advertising, promotion, sponsorship and payments to parent organisations by a select group of trustees.

- Continue heightened supervision of MySuper products identified as underperforming on APRA's MySuper heatmap, and extending to underperforming choice products based on the expansion of APRA's heatmap to choice products in 2021. APRA will take enforcement action where appropriate to require trustees to improve performance or transfer members to another product.

- Complete an in-depth review of selected large trustees' management of outsourcing providers, focusing on related party arrangements and managing conflicts of interest.

- Build on APRA's cross-industry GCRA initiatives, and set clear expectations that trustees address actual and perceived barriers that hinder boards from achieving the optimal mix of skills and experience required to fulfil trustee obligations. A broad thematic review and analysis will be undertaken over 2021 which will include review of the adequacy of skills and experience on boards, effectiveness of board appointment and renewal processes, and the quality of board and director performance reviews.

APRA will make industry-level findings from thematic work public, outlining good practice and areas where trustees are expected to strengthen practices.

## 5.2 Enhancing superannuation data and insights

APRA is significantly enhancing its superannuation data collection in order to support supervision and enhance insights in areas such as performance, fund expenditures and insurance. The Superannuation Data Transformation (SDT) program will expand, deepen and refine the data collected from the superannuation industry.[11] APRA has completed consultation on phase one of the SDT program and will release a response package in early 2021. Trustees will be required to report under the new reporting standards in the second half of 2021. APRA intends to continue to work with industry throughout the year via its industry working groups to support trustees during the preparations for the new reporting requirements and the introduction of APRA Connect.

## 5.3 Improving industry transparency

Strengthening transparency will assist stakeholders to hold trustees accountable for the outcomes delivered, particularly where underperformance is identified. The release of MySuper product Heatmaps is a major element in this process, providing credible, clear and comparable information for all MySuper products.

APRA will expand this work by releasing a Choice Heatmap in the second half of 2021 that will cover multi-asset class choice options and will highlight areas of underperformance in those products. APRA will also publish the results from the Government's performance test under the *Your Future Your Super* reforms. The insights from the heatmaps and Government

---

[11] APRA, *Consultation on APRA's Superannuation Data Transformation* (August 2020)

performance test will enable more intense supervisory action against trustees who continue to underperform. As the SDT program progresses, APRA plans to further enhance transparency by publishing additional information on trustee operations and the outcomes they deliver.

# Attachment A: Timelines

Key supervisory activities and timelines are summarised in the table below.

| Strategic focus | Supervisory activity | Entities included | Expected commencement |
|---|---|---|---|
| **Maintaining financial system resilience** | | | |
| **Cross-industry** | Assessment of financial services industry service providers | Selected ADIs and trustees | Underway |
| | Assessment of operational risk and compliance transformation programs | Large ADIs and selected insurers and trustees | Underway |
| | Strengthening recovery planning | All ADIs and insurers, selected trustees | Underway |
| | Resolution strategy development | Selected ADIs, General Insurers and Life Insurers (LIs) | Underway |
| | Climate change supervisory review | 38 large entities | Underway |
| **Banking** | Climate change vulnerability assessment | Large ADIs | 2021 1H |
| | ADI stress test | Large ADIs | 2021 2H |
| | FCS review | Selected small ADIs | 2021 1H |
| | Credit portfolio reviews | Selected ADIs | Underway |
| **Insurance** | Overseas reinsurance – review of group capital management and support | Foreign general insurance reinsurers | Underway |
| | IDII intervention | All LIs | Underway |
| | Resilience planning | All PHIs | Underway |
| **Improving cyber resilience** | | | |
| **Cross-industry** | Assessment of CPS 234 implementation | Initially as a selection of APRA-regulated entities | Underway |
| | Development of a cyber information sharing community | Selection of APRA-regulated entities | Underway |
| | Cyber resilience data collection | Selection of APRA-regulated entities | Underway |

| Strategic focus area | Supervisory activity | Entities included | Expected commencement |
|---|---|---|---|
| **Transforming governance, risk culture, remuneration and accountability** | | | |
| **Cross-industry** | Evaluation of entities' risk governance self-assessment actions | 36 large entities | Underway |
| | Deep dive risk culture reviews | 3 entities per year | Underway |
| | Risk culture industry survey | Large and medium entities | Underway |
| | Assessment of CPS 511 implementation plans | To be determined | 2021 2H |
| **Improving outcomes for superannuation members** | | | |
| **Superannuation** | Review of SPS 515 implementation – Business Performance review | Selection of trustees | 2021 1H |
| | Fund expenditure review | Selection of trustees | Underway |
| | Outsourcing review | Selection of large trustees | Underway |
| | Trustee capabilities review | Selection of trustees | 2021 1H |
| | Unlisted asset valuation review | Selection of trustees | Underway |
| | Superannuation Data Transformation project | All trustees | Underway |
| | Improving Transparency – Choice heatmap | All trustees | 2021 2H |
| | Addressing areas of underperformance | Selection of trustees | Ongoing |