



INFORMATION PAPER

APRA's Supervision Priorities

1 February 2022

Disclaimer Text

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Executive summary

APRA's supervision function supports APRA's mandate for ensuring a safe and stable financial system. It does this by undertaking regular reviews and assessments of regulated financial institutions, with the goal of identifying significant risks to those institutions, and the financial system more broadly, in a timely and effective manner, and acting to ensure those risks are well managed and mitigated. To maximise the effectiveness of these supervision activities, and reflecting APRA's focus on preventative action before risks crystallise into problems, APRA's supervisory program seeks to be risk-based and forward-looking.

This information paper outlines APRA's supervision priorities for the next year, aiming to ensure the Australian financial system is 'protected today and prepared for tomorrow'.¹ This information is intended to provide transparency on where APRA will be spending much of its time, and assist entities regulated by APRA, and other stakeholders, to proactively engage on key priority areas and better prepare for engagement with APRA.

APRA's supervision priorities are aligned to the key objectives articulated in its 2021-2025 Corporate Plan, being:

1. ensuring resilient and prudently managed financial institutions;
2. promoting the stability of the Australian financial system; and
3. contributing to the community's ability to achieve good financial outcomes.

APRA's priorities over the previous two years have centred on financial system resilience in the face of COVID-19. This remains a focus. However, with the continued evolution of the financial sector, APRA's supervision priorities also address new and emerging products and practices, as well as evolving expectations of entities and the role they play in the financial system.

In addition to activities dedicated to system resilience, particular supervision priorities for APRA over the coming year include:

- cyber risk preparedness and responsiveness, across all industries that APRA regulates;
- a continuing focus on risk culture, including rolling out a risk culture survey to benchmark perceived risk behaviours and the effectiveness of risk structures within entities;
- upgrading contingency and continuity frameworks in the banking sector;

¹ For more information on the strategic themes of 'protected today and prepared for tomorrow', refer to [APRA's Corporate Plan 2021 - 2025](#) (August 2021) and [APRA's Policy Priorities](#) (February 2022).

- ensuring sound insurance principles are applied in the insurance industries, with a focus on availability, affordability and sustainability of insurance; and
- rectifying sub-standard industry practices in superannuation and eradicating unacceptable product performance.

The full suite of priority supervision areas is set out in this paper. Combined, these priorities are intended to ensure the fundamentals for a sound financial system are being delivered, while also preparing the system for the future.

Complementary to this Information Paper is APRA's Policy Priorities Information Paper, published concurrently.

Chapter 1 - Cross-Industry

This chapter outlines supervisory activities that APRA will undertake over the coming year to address cross-industry risks. APRA's priorities include strengthening the resilience of regulated entities in the domains of cyber risk, risk culture and governance, remuneration and accountability, as well as enhancing recovery planning and the management of growing risks, such as climate risk.

1.1 Preserving the resilience of regulated entities

1.1.1 *Improving cyber resilience*

With escalating cyber risks, and in line with the Australian Government's Cyber Security Strategy², cyber resilience is a key cross-industry supervision priority. Regulated entities need to continuously improve their cyber resilience practices to be able to withstand new and more sophisticated cyber-attacks. Over the coming year, APRA will:

- continue its CPS 234 *Information Security* independent compliance assessments of regulated entities (in tranches), following a successful pilot in 2021;
- collect cyber resilience data, to improve APRA's ability to target supervisory activities and profile the industry for cross-industry insights;
- share insights with industry from CPS 234 independent assessments, and data collected, in order to strengthen cyber practices; and
- work with industry and government agencies to expand the cyber information sharing community and collaboration opportunities, thereby improving situational awareness.

1.1.2 *Operational resilience*

While the financial services industry withstood the impact of COVID-19, APRA expects entities to continue to strengthen their operational resilience. This is particularly important in the face of the continued pandemic, as well as the ever-changing nature and complexity of the financial system, including its service providers, and the impact of mergers and acquisitions.

Particular areas of focus will be strengthening operational resilience in the oversight of third-party service provision, operational risk and compliance, among others. Accordingly, from a supervision perspective, APRA will:

- monitor regulated entities' improvements in contingency planning, business continuity arrangements, and management and oversight of third-party providers; and

² [Australian Government's 2020 Cyber Security Strategy](#)

- develop a non-financial risk data collection in 2022 to provide data-driven insights and drive supervisory resource allocation.

APRA will also devote attention to changes in entities' operational risk and compliance profiles that are a result of:

- entity-driven transformation and improvement programs;
- merger and acquisition activities across all industry groups; and
- regulatory reforms such as the ADI (Authorised Deposit-Taking Institution) transition from Advanced Measurement Approach (AMA) for Operational Risk Regulatory Capital to the Standardised Measurement Approach (SMA).

1.1.3 Climate-related financial risks

The changing climate presents risks to all sectors of the economy. With CPG229 *Climate Change Financial Risks*³ now in place, APRA will be seeking to develop additional tools to evaluate climate-related financial risks, and increasing its scrutiny of entities' progress in addressing the impact of climate risk.

APRA's near-term activities will be to:

- complete the Climate Vulnerability Assessment currently underway, with the aim of exploring the potential financial exposure and macroeconomic risks to large ADIs, the financial system and economy from both physical and transition climate risks; and
- undertake a cross-industry, entity-level self-assessment survey. The results will help APRA to understand the alignment between entities' management of climate-related financial risks, the guidance set out in CPG 229, and the recommendations of the *Task Force on Climate-related Financial Disclosures*.⁴

1.2 Transforming governance, culture, remuneration and accountability (GCRA)

Following foundations laid in recent years, APRA is continuing to work to lift GCRA practices across APRA-regulated entities.

Over the next year, APRA will:

³ [Final Prudential Practice Guide CPG 229 Climate Change Financial Risks \(apra.gov.au\)](https://www.apra.gov.au/consult/2021/0010)

⁴ [Recommendations | Task Force on Climate-Related Financial Disclosures \(fsb-tcfd.org\)](https://www.fsb-tcfd.org/)

- undertake a pre-implementation review of implementation of CPS 511 *Remuneration* across a select number of entities, including benchmarking against peers and sharing insights with industry;
- release for consultation new reporting and disclosure requirements to support CPS 511;
- extend APRA’s risk culture survey to approximately 40 additional regulated entities⁵ across insurance and superannuation. This follows APRA’s successful pilot with 10 general insurance entities in early 2021 and the subsequent roll-out to 18 of the largest ADIs in November 2021. APRA will engage with entities to discuss how issues that are identified through the survey will be addressed, as well as publish insights on the broader themes that emerge from the survey results;
- conduct risk culture ‘deep dives’ at a small number of large entities. APRA will also continue to assess entities’ actions in response to risk governance self-assessments and regular prudential engagements. This will include assessing whether issues that are currently resulting in capital overlays or enforceable undertakings have been resolved; and
- work with the Government and ASIC to establish and plan implementation of the Financial Accountability Regime (FAR) for all APRA-regulated entities.

1.3 Recovery planning

Following release of the draft Prudential Standards for Financial Contingency and Resolution Planning (CPS 190 and CPS 900 respectively), APRA will continue to build resolution capability across regulated industries. Supervisory activity will focus on enhancing the maturity of financial contingency (recovery and exit) planning, and reducing the risk of disorderly failure. This will include ensuring recovery plans are in place for all entities that APRA supervises, along with increasing the quality of plans to improve their credibility. In addition, preparatory work on expectations for resolution planning under CPS 900 will also be a priority during 2022, drawing on pilot exercises to date.

⁵ This list will be confirmed by early 2022.

Chapter 2 - Banking

In addition to the cross-industry areas of priority over the coming year, there will be a strong focus on upgrading contingency and continuity frameworks in the banking industry, in addition to an ongoing focus on the areas of credit, capital and liquidity. APRA will also be devoting attention to the implications of banking-like service innovation (e.g. cryptocurrencies, Banking as a Service (BaaS), and non-bank payment providers).

2.1 Upgrading contingency and continuity frameworks

The resilience of banking services is essential to the community and the ability of individuals and businesses to meet their banking needs. Since the height of the COVID-19 crisis, APRA's focus on continuity of banking services and contingency planning for banks has evolved significantly and APRA plans to do more work in these areas, in line with APRA's broader cross-industry priorities. The resilience of critical banking services in the face of COVID-19 saw the need for all businesses, including banks, to adjust their operating models, act strategically in relation to key suppliers and focus on their IT resilience (including cyber risk). APRA, together with peer regulators, has been working with large ADIs to develop enhanced crisis response plans for cyber risk to the payments system. This crisis response work will continue in 2022, along with a focus on concentration of third-party providers to the banking sector.

Banks can and do fail. The larger the bank involved, and the more systemically important its functions, the greater the need for advanced planning to manage its resolution in the event of failure. Along with consulting on a new Resolution Planning Prudential Standard, APRA will continue working with ADIs on their recovery plans. In particular, APRA will extend coverage of this work to other ADIs, with plans to be submitted by entities later in the year.

2.2 Credit quality, capital stress testing and liquidity sufficiency

In response to COVID-19, APRA's supervision of the banking industry centred on the fundamental areas of credit quality, capital stress testing and liquidity sufficiency, as well as the cross-industry focus areas of business continuity and contingency planning. While the banking sector remained strong in the face of the pandemic, its ongoing impacts requires APRA's supervisory attention on these fundamental areas to continue.

In 2022, there will be a particular emphasis on the quality of residential mortgage origination. With the implementation of prudential standards APS 220 *Credit Quality* and APS 222 *Associations with Related Entities* from the start of 2022, APRA will also shift its focus to reviewing credit risk models ahead of the 2023 implementation of the updated APS 113 *Internal Rating-based Approach to Credit Risk*.

Capital resilience will be examined through an industry stress test which will incorporate the revised capital standards. In addition, a review of Prudential Capital Requirements (PCR) for a range of individual entities will be undertaken over the coming year.

Liquidity and funding supervision activities will centre on resilience of funding profiles, especially in light of the removal of the Committed Liquidity Facility by end-2022, and plans for the repayment the RBA's Term Funding Facility by the middle of 2024. APRA also expects the industry to continue to undertake preparatory contingency measures to ensure readiness for zero or negative rates, should they arise.

2.3 Responding to banking-like service innovation

The financial services industry is rapidly evolving with new banking-like services, delivery mechanisms, products and participants (both regulated and unregulated) emerging as a result of digital innovation. Examples include crypto-currencies, Banking as a Service (BaaS), and non-bank payment providers. This evolution of banking services impacts the business models and the strategic priorities of incumbent banks, potentially creating new or additional prudential risks. Similarly, new participants may challenge established regulatory boundaries and frameworks, including mechanisms for consumer protection.

APRA will continue to actively monitor developments, and seek to position itself to appropriately respond so that depositors, the financial system and the community are appropriately protected as new innovations occur. This will inevitably require close collaboration and cooperation with peer agencies and the Commonwealth Government, including as part of the work associated with the Government's announcements on [Transforming Australia's Payment System](#).

Chapter 3 - Insurance

APRA regulates three insurance industries: general insurance, life insurance and private health insurance. In addition to the cross-industry areas of focus, the three sectors face both unique and shared challenges and APRA's supervisory response is designed to target these areas.

3.1 Addressing availability, affordability and sustainability

Access to affordable and adequate insurance is important for the community and a vital element of a safe and stable financial system. Across the three insurance industries which it regulates, APRA has a strategic focus on not only safeguarding current policyholders, but also assisting to address challenges in affordability and availability of insurance for the Australian community. It is clear that in a number of areas, individuals and businesses are finding it increasingly difficult to acquire adequate and sustainable insurance coverage at an affordable price.

Insurance affordability and availability is a complex issue for which collective action is needed from insurers, regulators, federal, state and local governments and consumers. In contributing to solving this complex issue, APRA is focused on ensuring that an appropriate balance is maintained between the sustainability of insurance and access to affordable and well-designed insurance products for consumers.

Over the next 12 months, APRA will continue to assess how insurers themselves are addressing these issues. APRA will also provide insights and advice to inform government and other stakeholder action, particularly on the nature and extent of accessibility and affordability issues and the risks that exacerbate these challenges.

3.1.1 *Reinsurance Pool*

In May 2021, the Federal Government announced the establishment of a reinsurance pool in response to ongoing affordability issues in cyclone-prone Northern Australia. APRA has provided specialist advice on the design and prudential implications of this pool, which will ease premium pressure on households, strata-owners and small businesses in areas more vulnerable to cyclone and related flood damage. The reinsurance pool is a tangible example of the collaborative effort needed to address some of the more concerning access and affordability issues in the Australian community.

3.2 General Insurance

The general insurance industry was particularly impacted in 2021 as a result of uncertainty created by the wording and design of business interruption insurance (BI). BI policies were not generally designed or priced to respond to pandemics, but the uncertainty of coverage resulted in two test cases needing to be heard in the courts to clarify the extent of policyholder coverage.

APRA commenced work in 2021 to examine the root causes of why these issues occurred with BI, with the intention of minimising the risk of similar issues manifesting in other product lines. This will be an ongoing area of activity in 2022.

3.2.1 *Strengthening insurance risk management*

Given the issues that occurred in relation to BI, APRA has required a selection of insurers significantly exposed to BI to undertake a self-assessment of their insurance risk management framework to identify any weaknesses or gaps in their control frameworks. The insurers have also been required to review this in the context of unintended exposure to cyber risk in policies that have been written for other purposes and to outline a plan to address any weaknesses identified. APRA has received the industry self-assessments and will analyse and benchmark the results over the first half of 2022. APRA will work with individual insurers to ensure areas identified by the assessments are addressed, and will also share learnings and best practice publicly to ensure that the entire industry benefits from this exercise.

3.2.2 *Enhancing the financial resilience of the GI industry*

In line with APRA's cross-industry priority on mature recovery plans across all regulated entities, APRA's work on recovery planning for general insurers, initially targeting large entities, has been extended to ensure all general insurers have credible and robust recovery plans in place by the end of 2022.

3.3 Life insurance and friendly societies

The key focus of APRA's supervision of the life insurance industry is product sustainability, which is critical for good long-term consumer outcomes, including on-going availability of suitable products and policyholder affordability. APRA will also continue to pay close attention to the areas of risk governance and data quality in life insurance.

3.3.1 *Sustainable products*

Following many years of losses and continued issues with individual disability income insurance (IDII), during 2021 APRA reviewed the progress life insurers had made in meeting APRA's expectations for sustainable practices in this product line. The review found that, while good progress had been made, there was still more to do. The sustainability of IDII products therefore remains a key supervision priority for life insurance in 2022.

In 2022, APRA will look closely at the new generation of IDII products released in late 2021. These products were developed in line with sustainability measures set out by APRA, and in consideration of the requirements of ASIC's new Design and Distribution Obligations. As experience evolves, APRA will monitor developments closely to ensure that life insurers do not revert to previous unsustainable market practices.

While APRA will continue to work with life insurance companies and other industry stakeholders towards long-term product sustainability, both for IDII and other product lines, APRA has emphasised that decisive action should be industry-led. Where industry-led responses are inadequate, APRA will not hesitate to maintain, or even increase, supervisory adjustments to the capital requirements of life insurance companies, where appropriate.

3.3.2 *Friendly societies*

Given the niche nature of the industry, and building on APRA's work over recent years to enhance risk governance in friendly societies, over the first half of 2022 APRA will finalise its work on an APRA-led industry-wide stress test of friendly societies. In addition to completing the stress test, a review of risk management and governance practices will be undertaken.

3.4 Private Health Insurance

The private health insurance (PHI) industry remains challenged by affordability issues and increasing claims costs, the underlying drivers of which are expected to persist notwithstanding the distortive impacts of COVID-19. Building on the work undertaken since 2019, APRA will continue to engage with industry to assess insurer strategies to respond to these challenges, as well as providing insights and advice to Government to assist with development and implementation of longer-term solutions.

3.4.1 *Prudent management of the unwinding of the Deferred Claims Liability*

APRA will continue to focus on the unwinding of the Deferred Claims Liability (DCL). In June 2020, APRA issued private health insurers with guidance on how to treat the liability arising for claims deferred due to COVID-19 (known as the DCL). As at January 2022 there continues to be significant uncertainty in the ultimate amount of the DCL. This uncertainty has been magnified by the current Public Health Orders in place across Australia requiring the suspension of non-urgent elective surgeries due to the surge in the number of COVID-19 cases.

APRA will also continue to engage with industry and other government agencies to police insurers' commitment not to profit from COVID-19.

3.4.2 *Operational and cyber resilience*

The PHI industry relies extensively on service providers to fulfil policyholder obligations and the collection of both financial and health data elevates the importance of matters such as information security. APRA is developing data collections covering these areas, to inform thematic reviews across a selection of insurers over the course of 2022. APRA will also continue to review the strength of relationships with systemic service providers to the PHI industry. These actions will be undertaken in conjunction with the cross-industry supervision priorities described in Chapter 2.

Chapter 4 - Superannuation

APRA has two key objectives for its supervision of superannuation: rectifying sub-standard industry practices; and eradicating unacceptable product performance. To achieve these, APRA will continue to exercise its powers to ensure RSE licensees are delivering good outcomes for superannuation members.

Over the coming year, APRA will also examine the extent to which RSE licensees have incorporated heightened obligations arising from the Government's 2021 *Your Future, Your Super* (YFYS) reforms into decision-making frameworks and business operations. Preparing for the Government's proposed introduction of a retirement income covenant and entities' readiness for associated changes will also be an area of heightened interest for APRA.

4.1 Rectifying sub-standard industry practices

With continued under-performance in some areas of the industry, over 2022 APRA's supervisors will target RSE licensees (trustees) identified through thematic reviews conducted in 2021⁴ as having sub-standard practices, to ensure improvements are implemented in a timely and prudent manner. For RSE licensees that were not specifically captured by these thematic reviews, APRA will undertake a gap analysis against thematic concerns identified, and require actions to improve practices where needed.

With particular regard to *Prudential Standard SPS 515 Strategic Planning and Member Outcomes* (SPS 515), APRA will follow up on its 2021 review of business planning and business performance review (BPR) processes to ensure that improvements have been made. Where uplift is not observed, APRA will interrogate further.

APRA will continue to engage with individual RSE licensees to assess how they are complying with their duty to act in the best financial interests of members in relation to expenditure. APRA is considering whether further action, including in some cases enforcement action, is required in relation to certain specific examples of expenditure.

Where RSE licensees face challenges in delivering sustainable, competitive outcomes for members owing to factors such as lack of adequate asset and revenue growth and/or declining memberships, APRA will seek and, where necessary, drive action by RSE licensees to ensure their members' interests are not compromised.

4.2 Eradicating unacceptable product performance

APRA's increased supervisory intensity on product performance has resulted in RSE licensees acting to improve outcomes for members through fee reductions and improved investment performance. It has also resulted in an increase in merger activity where trustees conclude that their members may be better served in another fund. This heightened

⁴ [Findings from APRA's superannuation thematic reviews](#)

supervisory approach will continue, and be extended to non-MySuper (choice) products and options, following the publication of the inaugural Choice Heatmap in December 2021.

As part of the YFYS reforms, the Government introduced an annual performance test, to be conducted by APRA. APRA undertook the first annual performance test in August 2021, focused on MySuper products. Over 2022, the annual performance test will be extended to trustee-directed products, including a much broader set of products and investment options.

Thirteen MySuper products were determined by APRA to have failed the 2021 annual performance test. APRA will ensure that these RSE licensees either remediate unacceptable product performance with urgency, or take timely steps to transfer their members to a product where member interests are better served. APRA is assessing the remediation plans of RSE licensees operating the products that failed the annual performance test to ensure timely action. APRA will pay particular attention to the steps RSE licensees are taking to adequately address the risk of failing the annual performance test for a second time. In certain circumstances, APRA has required relevant RSE licensees to prepare, and will hold RSE licensees accountable to give effect to, contingency plans that include pre-positioning for an orderly transfer of members to another fund if required.

Finally, APRA will be increasing the emphasis given to the accuracy of data relating to products and options that is submitted to APRA, and will consider taking enforcement action where data is not provided in an accurate and timely manner.

4.3 Modernising the regulatory approach to retirement prosperity

The Government's proposed retirement income covenant provides an opportunity for RSE licensees to better serve the needs of their members as they reach retirement and to innovate in support of improving retirement outcomes for individuals.

Under the Government's proposals, all RSE licensees will be required to formulate and give effect to a retirement income strategy, which will necessitate a focus on their members' characteristics and needs. APRA will work with all participants in the wealth management sector to encourage innovation in the development of high quality retirement products that deliver good outcomes to members, while avoiding creating legacy issues that have hindered the industry and its customers in the past.

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	Climate risk self-assessment Survey	Approximately 90 entities	2022 H1
Banking	Mortgages thematic review	ADIs	2022 H1
	Credit risk model review	IRB ADIs	2022 H1
	Basel 3B implementation	ADIs	2022
	Annual industry stress test	Selected ADIs	2022
	Climate vulnerability assessment	Selected ADIs	Underway
General Insurance	Insurance Risk Management self-assessments (BI and cyber risk)	10 APRA-regulated entities	Underway
	Contingency Planning	All general insurers	Underway
Private Health Insurance	Outsourcing Risk review	Selected PHIs	2022 H1
	Affordability and sustainability review	All PHIs	2022 H1
Life Insurance	IDII intervention	All LIs	Underway
Friendly Societies	Stress testing	Friendly Societies	2022 H1
Superannuation	Review of SPS515 practices against findings and expectations	All trustees	Underway

Strategic focus	Supervisory activity	Entities included	Expected commencement
	communicated to industry		
	Targeted action on fund expenditure where not demonstrably in members' best financial interest	Selection of trustees	Underway
	Assess and address, as appropriate, sustainability of funds	Selection of trustees	Underway
	Assess how trustees respond to underperformance identified through Heatmaps	Selection of trustees	Underway for MySuper and 2022 H1 for Choice Products
	Performance test – MySuper and Trustee directed products	All trustees	2022 H2
	Assess implementation of proposed retirement income covenant	All trustees	2022 H2
Transforming governance, risk culture, remuneration and accountability			
Cross-industry	Assessment of CPS 511 implementation plans	15 entities (5 entities per industry, superannuation, banking, insurance)	Underway
Banking	Concluding risk culture survey analysis	18 entities (already participating)	Underway
Insurance	Risk culture industry survey	Approximately 20 entities	2022 H1
Superannuation	Risk culture industry survey	Approximately 20 entities	2022 H1

Strategic focus	Supervisory activity	Entities included	Expected commencement
Improving cyber resilience			
Cross-industry	CPS 234 Independent Assessments	All entities (in tranches)	Underway
	Data-driven insights to target supervisory activities and playback themes to the industry	ADIs, GIs, LIs, PHIs and Trustees	2022 H1
	Deep dive thematic reviews informed by the CPS 234 independent assessments, data driven insights and other supervisory activities	Selected ADIs, GIs, LIs, PHIs and Trustees	Underway



APRA