



PRUDENTIAL PRACTICE GUIDE

Draft CPG 190 Financial Contingency Planning

September 2022

Disclaimer and Copyright

This prudential practice guide is not legal advice and users are encouraged to obtain professional advice about the application of any legislation or prudential standard relevant to their particular circumstances and to exercise their own skill and care in relation to any material contained in this guide.

APRA disclaims any liability for any loss or damage arising out of any use of this prudential practice guide.

© Australian Prudential Regulation Authority (APRA)

This work is licensed under the Creative Commons Attribution 3.0 Australia Licence (CCBY 3.0). This licence allows you to copy, distribute and adapt this work, provided you attribute the work and do not suggest that APRA endorses you or your work. To view a full copy of the terms of this licence, visit <https://creativecommons.org/licenses/by/3.0/au/>

Contents

About this guide	4
Glossary	5
Chapter 1 - Contingency planning	6
Chapter 2 - Role of the Board	8
Chapter 3 - Developing the plan	9
Chapter 4 - Maintaining the plan	15

About this guide

Prudential practice guides (PPGs) provide guidance on APRA's view of sound practice in particular areas. PPGs frequently discuss legal requirements from legislation, regulations or APRA's prudential standards, but do not themselves create enforceable requirements.

This PPG sets out guidance for all APRA-regulated entities to assist in the implementation of *Prudential Standard CPS 190 Financial Contingency Planning* (CPS 190). Under CPS 190, all APRA-regulated entities are required to undertake financial contingency planning so that they are ready to respond to severe financial stress that may threaten their viability.

This PPG, *Prudential Practice Guide CPG 190 Financial Contingency Planning* (CPG 190), provides guidance to support the implementation of CPS 190. It sets out the key areas of focus that APRA supervisors will have when assessing an entity's financial contingency planning.

CPS 190 sets requirements for all APRA-regulated entities, proportionate to their size and complexity. Not all of the practices outlined in this PPG will be relevant for every entity; for example, certain guidance relates to requirements that apply only to significant financial institutions (SFIs). Subject to meeting their requirements under CPS 190, APRA-regulated entities have the flexibility to manage their financial contingency planning practices in a manner that is best suited to achieving their objectives.

Glossary

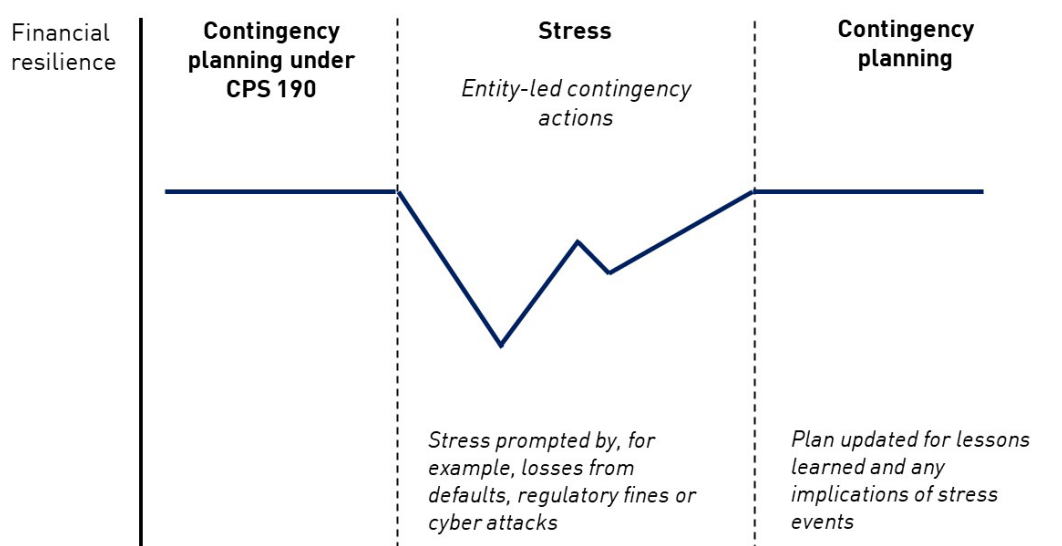
ADI	Authorised deposit-taking institution
APRA	Australian Prudential Regulation Authority
CPS 190	<i>Prudential Standard CPS 190 Financial Contingency Planning</i>
CPS 900	<i>Prudential Standard CPS 900 Resolution Planning</i>
ICAAP	Internal Capital Adequacy Assessment Process
Non-SFI	Non-significant financial institution
PPG	Prudential practice guide
RSE	Registrable superannuation entity
RSE licensee	Registrable superannuation entity licensee as defined in s10(1) of the <i>Superannuation Industry (Supervision) Act 1993</i>
SFI	Significant financial institution

Chapter 1 - Contingency planning

This section provides guidance on contingency planning, as set out in paragraphs 13-16 of CPS 190 for SFIs, and paragraphs 33-36 for non-SFIs.

1. Historical experience has shown that entities who are not adequately prepared for severe stress will often experience difficulties restoring their financial strength or exiting the industry in an orderly manner. A financial contingency plan sets out the steps an APRA-regulated entity could credibly take to avoid its failure and protect depositors, insurance policyholders and superannuation fund members. When used effectively, these plans should enable regulated entities to restore their businesses to a stable and viable position in a timely manner during stress (see Figure 1).

Figure 1. Indicative contingency planning lifecycle



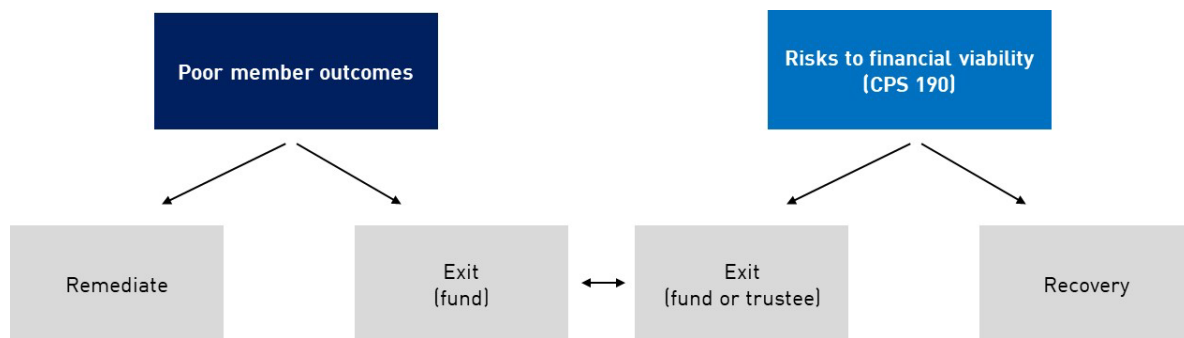
2. The main components of a financial contingency plan, as required under CPS 190, are summarised below (see Figure 2).

Figure 2. Key components of the contingency plan



3. The financial contingency plan is an important part of an entity’s risk management framework and must be integrated appropriately. For ADIs and insurers, there are important linkages to the Internal Capital Adequacy Assessment Process (ICAAP), contingency funding plans and risk appetite. For example, triggers used in financial contingency planning would support an entity in meeting its overall risk appetite. They would also support an entity in transitioning capital planning from business-as-usual (ICAAP) to a contingency response.
4. For RSE licensees, CPS 190 is focused on managing risks to the trustee’s financial viability (for example, insolvency). This is intended to supplement, but not replace, the actions that an RSE licensee would take to address poor member outcomes. Figure 3 below provides a stylised comparison of the actions that an RSE licensee could take in these scenarios. Under all circumstances, an RSE licensee must be able to demonstrate how its contingency actions would be consistent with the RSE licensee’s legal obligations, including the duty to act in the best financial interests of beneficiaries.

Figure 3. Superannuation: poor member outcomes and financial viability



5. For foreign banks and insurers that have branch or locally-incorporated operations in Australia, it is important that the local financial contingency plan is appropriately integrated with head office or group arrangements. This is particularly important where there may be a material dependency on contingency actions at this level. It is better practice for local operations to consider other credible options available to them, beyond these sources. The financial contingency plan would be appropriate for local risks, with scenarios and triggers relevant to stresses that may be experienced in Australia.
6. Where APRA has determined a resolution plan for an entity under *Prudential Standard CPS 900 Resolution Planning* (CPS 900), a prudent entity would update its financial contingency plan to align with any implications of the resolution plan. For example, executing certain contingency actions could undermine the effectiveness of resolution pre-positioning measures, such as divestments; conversely, certain pre-positioning measures, such as changes in structure, could impact an entity’s contingency planning.

Chapter 2 - Role of the Board

This section provides guidance on the key requirements of Boards, as set out in paragraphs 17, 18 and 21 of CPS 190 for SFIs, and paragraphs 37-38 for non-SFIs.

7. An effective financial contingency plan would support the Board of an APRA-regulated entity in responding to stress that could threaten its financial viability. It is important that Boards have confidence in the assumptions relied upon and the credibility of actions contained within financial contingency plans.
8. Under CPS 190, Boards are required to approve the financial contingency plan. As a key user of the plan, it is important that the Board can quickly navigate and easily understand it. A prudent Board would use simulation exercises to test the effectiveness of the plan in meeting their needs.
9. Under CPS 190, the Board must also oversee regular reviews of the financial contingency plan and ensure that findings are addressed by management. Changes in market conditions, business models or growth plans can impact the assumptions used in financial contingency planning, and it is important that the plan continually evolves over time. APRA expects that the Board would hold management to account for keeping the plan current and effective.
10. Under CPS 190, the Board must also oversee the execution of contingency actions in stress. Ineffective execution of financial contingency actions can have serious consequences on an entity's prudential standing and reputation. Failed transfers, for example, can undermine stakeholder confidence, amplify the impacts of stress and increase the likelihood of failure.
11. For SFIs, CPS 190 requires Boards to form a view on the sufficiency of an entity's recovery capacity. This is an important indicator of the aggregate effectiveness of recovery actions; it demonstrates the total amount of losses that could be offset from implementing plausible recovery actions in stress (see Chapter 3).
12. Where the Board of an SFI forms a view that recovery capacity is not sufficient to restore financial resilience in stress, it must consider other actions to improve recovery capacity. This could include adding additional actions to the contingency plan or taking additional preparatory steps to increase the effectiveness of existing actions. Entities could also strengthen their existing financial resilience, such as holding higher regulatory capital, if there is limited scope to improve recovery capacity.

Chapter 3 - Developing the plan

This section provides guidance on the key components to be included in financial contingency plans, as set out in paragraphs 19-21 of CPS 190 for SFIs and paragraph 39 for non-SFIs.

Trigger framework

13. CPS 190 requires the financial contingency plan to include a trigger framework. The purpose of this framework is to support the entity in identifying, at an early stage, stress that could threaten its financial viability. APRA would not expect the trigger framework to operate in a mechanical manner: a prudent entity would not wait for triggers to be breached, should there be a need for timely action; conversely, breaching a trigger would not result in an automatic predetermined course of action. A well-designed trigger framework would be integrated with other monitoring or early warning indicators in the risk management framework and support an entity in meeting its risk appetite.
14. Triggers that are set at an early stage would allow the entity to begin preparing for the potential implementation of contingency actions as stress unfolds. Better practice would be to use cascading triggers, to support a graduated dialling up of an entity's crisis response. For example, initial trigger points could serve as a prompt for enacting governance arrangements under the contingency plan, while subsequent trigger points could prompt a closer examination of certain contingency actions.
15. The earlier the entity begins preparing for the execution of potential contingency actions, the greater the likelihood that these will be successful. The types of triggers to be included in the framework are therefore an important consideration. Under CPS 190, the trigger framework must be relevant to an entity's operating environment and its risk profile.
16. A prudent trigger framework would include a variety of indicators of stress, based on both actual and forecast outcomes. These indicators could include measures of economic stress, balance sheet or profitability vulnerabilities, or sustainability concerns.
17. A prudent trigger framework would also be appropriately calibrated to the types of actions in the contingency plan. For example, an entity that is reliant on contingency actions with long implementation timeframes would typically set triggers at an early stage to ensure that the estimated benefits from contingency actions can be fully realised. This includes actions that depend on external investors completing due diligence. Due diligence for asset sales or transfers could take several months, particularly if limited pre-positioning has taken place.

Governance

18. Under CPS 190, the financial contingency plan must include governance arrangements for the monitoring of triggers, the timely activation of the plan and implementation of specific actions within it.
19. It is important that there are clear responsibilities for the regular monitoring of triggers and decision making regarding the use of the plan. Prudent entities would integrate the monitoring of financial contingency plan triggers into existing risk management processes and decision-making forums, where appropriate.
20. A prudent financial contingency plan would clearly set out accountabilities for activating the plan and, where appropriate, the implementation of specific contingency actions within it. Successful execution of contingency actions would require strong coordination from a range of stakeholders including, for example, communications, finance and risk teams.

Recovery and exit actions

21. Under CPS 190, the financial contingency plan must demonstrate how credible recovery actions could be taken to stabilise and restore the entity's financial resilience in a stress event that may threaten its viability. The financial contingency plan must also include credible exit actions that demonstrate how it could enable an orderly and solvent exit from regulated activity where recovery actions are not effective.
22. A prudent contingency plan would identify a menu of credible contingency actions to provide flexibility in responding to stress. Listing the actions that were considered, but not included in the financial contingency plan, can also be important in demonstrating why they would not be credible options in stress. Table 1 below sets out examples of common contingency actions that have been used domestically and internationally in responding to stress.

Table 1. Illustrative examples of contingency actions

Recovery actions	Exit actions
Earnings retention	Solvent wind-down
Cost savings	Return of deposits
Capital raising or injection	Voluntary transfer to another regulated entity
Asset sales	Successor fund transfer
Risk reduction	Change of trustee
Changes to business and investment strategies	
Liability management	
Run-off of lines of business	

23. The type of contingency actions that would be considered credible will differ according to the industry an entity operates in, its ownership structure, its business model and its risk profile. For example, capital raisings may not be a credible option for certain

entities, based on their ownership structure. Larger and more complex entities would be more likely to have access to a wide range of credible recovery actions.

24. Relying on a limited number of actions would provide less flexibility in responding to stress. In these circumstances, a prudent entity would place a very strong focus on preparatory measures to reduce the risk that the execution of that action may not go according to plan. This could include developing 'playbooks', which set out detailed instructions for executing contingency actions under various scenarios. It could also include prior engagement with potential transfer partners, to understand the information that would be necessary for due diligence, the conditions under which a transfer may not be feasible and the time needed for implementation. Table 2 below provides further examples of preparatory measures.
25. Where entities have material overseas subsidiaries, it would be prudent to identify contingency actions that could be undertaken by the local subsidiary in those jurisdictions, rather than relying solely on parental support.
26. Under CPS 190, an APRA-regulated entity must take reasonable preparatory steps to support the timely and effective implementation of the contingency plan, in advance of recovery or exit actions being required. This would be informed by a thorough assessment of each contingency action. For SFIs, there are four minimum assessment criteria required under CPS 190, as set out in Table 2 below.

Table 2. Assessment of contingency actions

Criteria	Key considerations
1. Timeline for the implementation of the action	<ul style="list-style-type: none"> • A prudent entity would assess both the time needed to execute an action and the time needed to realise its full benefits. Execution times can be influenced by a range of factors, including governance processes, regulatory approvals and the need for external due diligence.
2. Analysis of the barriers to implementation, execution risks and key dependencies	<ul style="list-style-type: none"> • A comprehensive assessment of barriers to implementation is a key indicator of credibility. Impediments could arise from a range of sources, including interconnectedness, legal, regulatory or operational barriers. • Some actions could be subject to high execution risks, given the number of stakeholders, complexity of the action or reliance on the sentiment of external parties. • A prudent entity would also assess the secondary impacts from executing actions, such as impacts for credit ratings or the cost of funding, where appropriate.
3. A summary of the preparatory measures needed to support the timely and effective execution of the action	<ul style="list-style-type: none"> • Preparatory measures can significantly improve the speed and impact of executing contingency actions. • There are a range of measures entities could take to strengthen the credibility of their actions including, for example, pre-prepared documentation or approvals, the development of playbooks or improvements to data systems.

Criteria	Key considerations
	<ul style="list-style-type: none"> For asset sales or transfers, prior engagement with potential acquirers can materially improve credibility.
4. The estimated impact on capital and liquidity, where appropriate	<ul style="list-style-type: none"> Good practice would be for the estimated impact of each contingency action to be quantified both in nominal terms and prudential ratio terms, where appropriate. In the case of RSE licensees, the impact of a contingency action on the financial resources available to fund their business operations would be a useful part of the assessment. A prudent entity would ensure that the estimated financial impacts are based on robust analysis and that any key assumptions are subject to challenge and scrutiny, informed by both historical and international benchmarks where appropriate. APRA expects that valuation practices would be conservative, based on stressed assumptions. Haircuts, for example, would be applied to asset values to reflect stressed market conditions and transaction costs.

27. Under CPS 190, there are no formal requirements for non-SFIs to assess each contingency action against all of the criteria listed in Table 2 above. However, APRA expects that non-SFIs would be able to clearly demonstrate the credibility of their planned actions. Some of the factors set out in Table 2 may assist non-SFIs in demonstrating credibility.

Scenario analysis

28. For SFIs, CPS 190 also requires that the contingency plan includes scenario analysis which, at a minimum, must include an idiosyncratic and systemic stress scenario.¹ The purpose of scenario analysis is to test the effectiveness of an entity's planned contingency responses and its overall recovery capacity. It is an important complement to stress testing, which provides a forecast of the impact of stress on an entity's balance sheet and cashflows.
29. It is good practice to tailor scenarios to an entity's risk profile. For example, scenarios could consider how an entity's planned actions could be impacted by the actions of its competitors, by different time dimensions ('fast' or 'slow' burn scenarios) or by market sentiment.
30. When undertaken effectively, scenario analysis can provide important insights for assessing the credibility of actions. For example, scenario analysis could indicate that implementation timelines may be longer than anticipated or there are additional

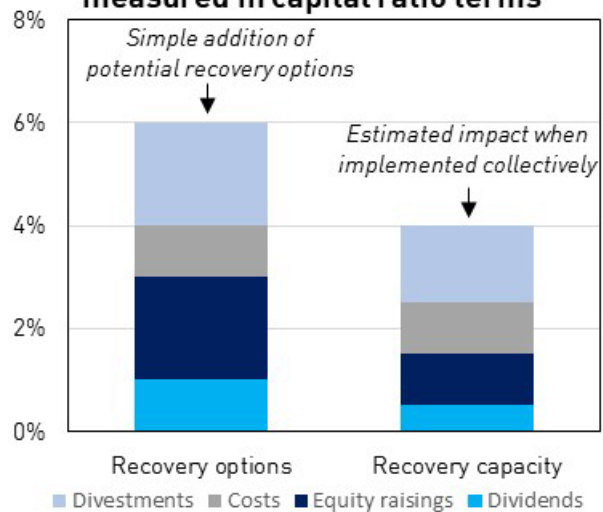
¹ There are no CPS 190 requirements for non-SFIs to undertake scenario analysis. For these entities, scenario analysis would be considered an example of prudent practice.

dependencies which have not been considered. Prudent entities would use lessons learned from scenario analysis to strengthen their contingency plans.

Recovery capacity

31. For SFIs, in addition to quantifying the individual impact of each contingency action, it is important that an assessment is made of the combined impact of all recovery actions in the plan, taking into account dependencies between actions in stress scenarios. At a minimum, recovery capacity must be assessed under both an idiosyncratic and systemic stress scenario.
32. Recovery capacity would not typically be a straight-line summation of the estimated impact of each recovery action. There are important dependencies between contingency actions that could cause some to be mutually exclusive or their effectiveness diminished when executed in parallel. For example, executing an equity raising following a large divestment could have a smaller impact than otherwise assumed, since investors may have much lower expectations for future earnings.
33. In calculating recovery capacity, it is good practice to explain the assumptions made, including the timing and sequence in which actions are executed. For example, some actions might only be effective in the early stages of stress and before losses are incurred, such as earnings retention. Other contingency actions can have material impacts on an entity's business model or investor sentiment, which may undermine the effectiveness of subsequent actions.
34. A stylised example of recovery capacity for a bank, shown in the chart opposite, would be the cumulative ability to rebuild 4 percentage points of common equity tier 1 (CET1) capital over a stressed scenario. This example considers the interdependencies between equity raisings, divestments, cost cutting and dividend reductions.

**Stylised example of recovery capacity:
measured in capital ratio terms**



Communication

35. Under CPS 190, the financial contingency plan must include a communication strategy to support the execution of contingency actions. Maintaining stakeholder confidence is critical to the effective execution of many contingency actions, including equity raisings, transfers or asset sales. Failure to disseminate timely and appropriate information can give rise to significant execution risks.
36. A prudent entity would identify the key stakeholders for particular contingency actions, and tailor communications strategies appropriately. For example, an effective

communication strategy for a return of deposits would likely look very different to an equity raising or a transfer. It is good practice to have pre-prepared communication documentation for each contingency action.

37. A prudent entity would also set out the approach to engaging with regulators and, where appropriate, meeting disclosure requirements. CPS 190 requires an entity to notify APRA if it has activated its contingency plan. While this would ultimately be a matter of judgement, activation could result from an entity enacting any part of the plan, including forming contingency governance arrangements.
38. Maintaining regular and open dialogue with regulators as stress unfolds is an important consideration for entities. Prudent entities would seek to anticipate the information needs of various regulators, across key jurisdictions.

Chapter 4 - Maintaining the plan

This section provides guidance on APRA's requirements of entities in maintaining financial contingency plans, as set out in paragraphs 24-32 of CPS 190 for SFIs and 41-46 for non-SFIs.

Capabilities, monitoring and execution

39. Under CPS 190, entities must maintain the capabilities required to execute the contingency plan. This could include, for example, strategies for accessing financial resources that may be needed to support the implementation of planned actions. Some actions, such as transfers, may involve fees for external parties to support effective implementation. A prudent entity would also assess the operational or liquidity requirements for implementing wind-down or run-off strategies, such as a return of deposits.
40. Certain contingency actions can also have unintended impacts; for example, the sale of assets could boost capital, but weaken liquidity. It is important that contingency plans assess flow on impacts, so that net benefits can be estimated.

Testing and review

41. APRA expects that contingency plans will remain current and effective. While CPS 190 sets minimum review requirements, better practice would be to update plans more regularly if an entity becomes aware of information that could materially impact its effectiveness.
42. Under CPS 190, an SFI must undertake a comprehensive review of the effectiveness of the contingency plan and its capabilities for executing it, at least every three years. This must include operational testing of the plan.
43. Operational testing is a critical way of assessing the plan, through a 'live' simulation with key decision makers and stakeholders. This provides an opportunity to test the way the plan might work in practice using a scenario. It is important that simulations are as realistic as possible; for example, new information would only become apparent as the event unfolds.
44. The three-yearly review would be a deeper dive than the annual process and could include, for example, benchmarking against better practices domestically and internationally. External specialists could be used to facilitate simulations or develop additional capability.



 **APRA**