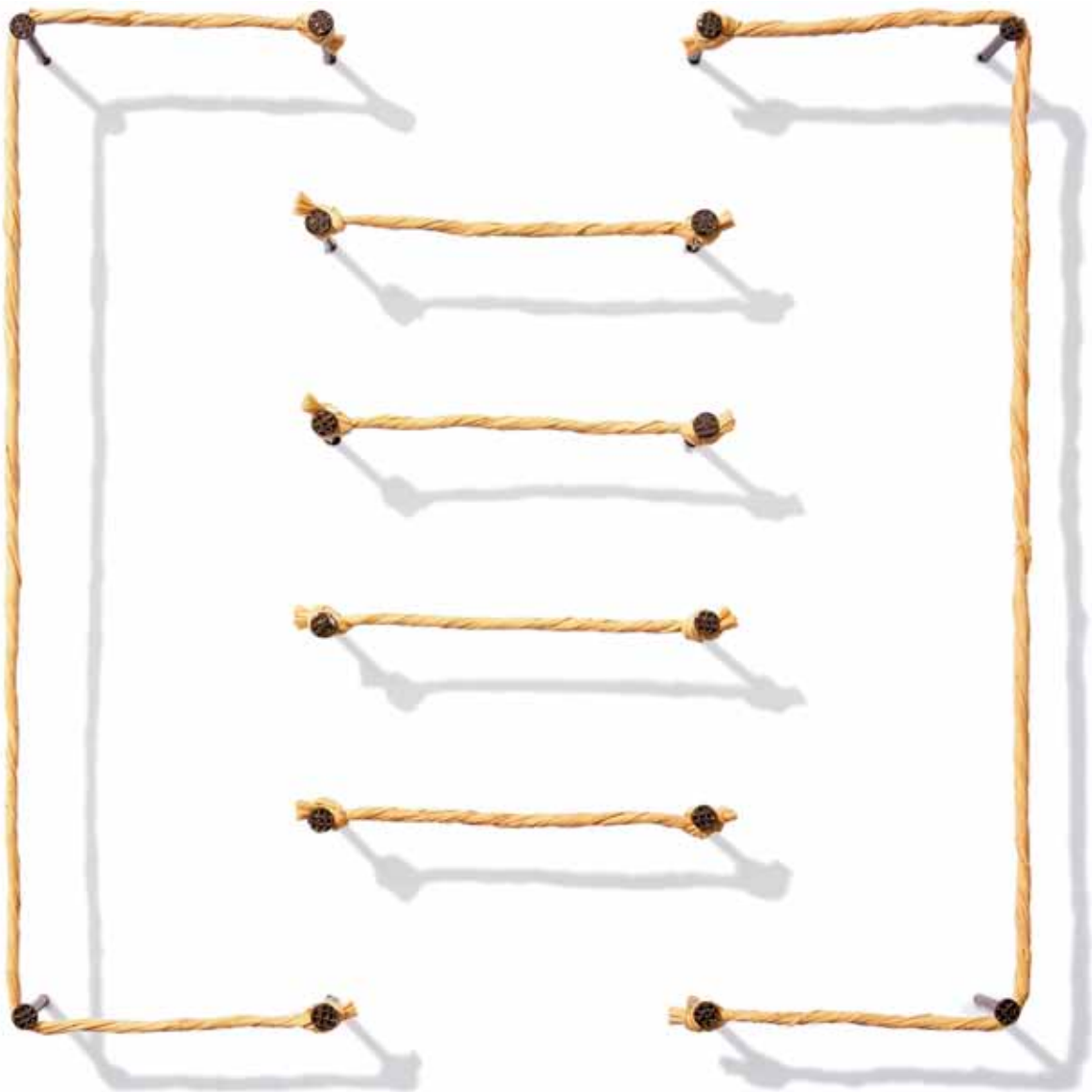




# Supervisory Oversight and Response System

November 2010



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# Chapter 1 – Introduction

In October 2002, APRA introduced new risk assessment and supervisory response tools known as the Probability and Impact Rating System (PAIRS) and the Supervisory Oversight and Response System (SOARS).

These supervisory tools are the centrepiece of APRA's risk-based approach to supervision and assist APRA in:

- making better risk judgements;
- quickly and consistently taking supervisory action where necessary;
- strengthening the ability of supervisors to take effective action; and
- improving oversight and reporting on problem entities.

SOARS is used to determine how supervisory concerns based on PAIRS risk assessments should be acted upon. It is intended to ensure that supervisory interventions are targeted and timely. All APRA-regulated entities that are subject to PAIRS assessment are assigned a SOARS stance.

An explanation of SOARS is the subject of this document.

# Chapter 2 – SOARS stances

Consistency is a vital element in supervisory professionalism. APRA needs to treat like entities similarly and, in particular, to match supervisory intensity consistently to the probability and impact of failure signals coming out of PAIRS. SOARS is APRA's main tool to achieve consistent application of supervisory intervention.

The supervision stance of a regulated entity is derived from the combination of the PAIRS *probability rating* and *impact rating*, as illustrated in Figure 1 below.

The risk profile and typical supervision activities for regulated entities in each supervision stance are described below.

SOARS comprises four supervision stances:

- Normal
- Oversight
- Mandated Improvement
- Restructure

Figure 1: Supervision stance

		Probability rating				
		Low	Lower Medium	Upper Medium	High	Extreme
Impact rating	Extreme					
	High					
	Medium					
	Low					
	Normal					
	Oversight					
	Mandated Improvement					
	Restructure					

# Chapter 3 – Normal

## 3.1 Risk profile

Entities categorised as Normal are not expected to fail in any reasonably foreseeable circumstance. Such entities are assessed by APRA as having robust governance and control frameworks, responsible persons of sound calibre (individually and collectively) and a strong capital position.

Normal entities generally have the ability to absorb unexpected losses within existing resources, without any significant pressure on their financial health.

Some entities may be categorised as Normal because the potential adverse consequences of their failure, or their beneficiaries and the industry more broadly, may be very limited.

## 3.2 Typical supervision activities

Typical supervision activities for entities categorised as Normal include:

- prudential reviews;
- analysis of data received on a monthly, quarterly and/or annual basis; and
- other supervision activities as required or at the discretion of the responsible supervision team.

# Chapter 4 – Oversight

## 4.1 Risk profile

Entities categorised as Oversight are not expected to fail, but there are aspects of their risk position that may create vulnerabilities in extremely adverse circumstances and that require more extensive examination by APRA.

Broadly speaking, there are two sorts of Oversight entities: those that reside naturally in this stance, and those that should be in Normal but that have some identifiable but non-fatal weakness or weaknesses in their risk position.

APRA tolerates entities remaining permanently in Oversight if their business plan or risk appetite makes this appropriate. Entities with naturally high levels of inherent risk – for example, aggressive business plans, or narrow product or geographic scope – are often in Oversight on a permanent basis. APRA's broad strategy with this group is close monitoring and communication; APRA wants to ensure that the responsible persons in such entities understand that they have limited scope to assume more risk.

For the second sort of Oversight entities – those with weaknesses in management and control – there is likely to be a particular aspect(s) of the business that needs to be remedied. APRA usually adopts a suasion approach to ensure there is improvement in these areas. However, responsible persons in such entities should have no doubt as to APRA's concerns and the consequences of ignoring them. Entities in Oversight usually take ownership of issues and agree on an action plan with APRA. APRA's goal is to see these entities return to Normal status.

## 4.2 Typical supervision activities

For entities in Oversight, APRA lifts its supervisory intensity and closely monitors key risk areas. Typical supervision activities could include:

- more frequent and/or more targeted prudential reviews by the supervision and risk/technical specialist teams;
- more frequent and more detailed collection and analysis of data and reports;
- communication with auditors and actuaries;
- special investigations by external experts eg auditors, actuaries, etc;
- requests for revised business plans;
- assessing the rectification plans put in place by the entity;
- expressing concerns to the responsible persons of the entity; and
- expressing views/concerns to relevant overseas regulators where applicable.

# Chapter 5 – Mandated improvement

## 5.1 Risk profile

For entities in Mandated Improvement, APRA's assessment is that operations are being conducted in a way that, or the circumstances of the entity, potentially puts beneficiaries at risk, so improvements to the operations or the circumstances of the entity are needed. Mandated Improvement entities remain unlikely to fail in the short term, but this expectation is in part due to APRA's view that supervisory intervention will be necessary to help avert any failure.

APRA does not expect entities to be permanently classified as Mandated Improvement. A Mandated Improvement entity will either shift to Oversight, move to Restructure or exit the industry via merger, wind-up or some other means.

Once an entity moves into Mandated Improvement, APRA supervisors must clearly and urgently communicate this fact to the entity, and require the entity to commence short-term remediation to stabilise and then improve any deficiencies.

## 5.2 Typical supervision activities

APRA intervenes actively for entities in Mandated Improvement. Typical supervision activities include:

- requiring rectification plans and monitoring milestones;
- requiring revised business plans;
- increasing capital requirements;
- issuing directions;
- accepting enforceable undertakings, often undertakings to exit the business by finding a new and sounder owner;
- engaging external resources (specialist investigator, actuary etc) to report to APRA;
- consideration of fitness and propriety issues; and
- placing prohibitions on acquisitions.

APRA requires Mandated Improvement entities to present and execute a remediation plan that addresses the area(s) of weakness identified and which restores financial stability within an appropriate timeframe. Both APRA and the regulated entity are clear on what steps need to be taken as part of the remediation plan.

APRA usually allows the responsible persons of entities in Mandated Improvement to retain control, but clearly signals that change must occur. Either the entity will rapidly produce and execute an improvement plan or APRA will commence firm enforcement action. APRA puts pressure on Mandated Improvement entities to ensure that turnaround occurs before they are forced into Restructure.

Effective supervision and remediation of Mandated Improvement entities is where APRA is likely to make the most difference between an entity failing or surviving (or exiting the industry without loss to beneficiaries).



# Chapter 6 – Restructure

## 6.1 Risk profile

Entities in Restructure are those in which APRA has lost confidence that financial promises to beneficiaries will be met in the absence of vigorous intervention. Usually APRA has formed this view because the entities do not have the ability, or the willingness, to rectify the serious weakness(es) identified. Such entities are at material risk of failure, or may even have failed, and APRA will apply its full enforcement powers to protect beneficiary interests.

This category also includes entities which have long ceased to be viable operating businesses, and which are being exited from the industry in an orderly manner.

## 6.2 Typical supervision activities

Generally, entities in Restructure need new capital, management or ownership, or possibly all three.

Typical supervision activities involve the use of APRA's enforcement powers to:

- withdraw licenses;
- replace persons and/or service providers;
- merge entities;
- run-off existing business;
- restrict business activities;
- quarantine assets;
- appoint an inspector, judicial manager or provisional liquidator;
- issue directions or sanctions; or
- place the company into receivership/liquidation.

APRA's paramount concern for entities in Restructure is to minimise the risk of losses to depositors, policyholders and superannuation fund members or, if failure is unavoidable, to minimise the size of such losses.

Restructure entities are managed by APRA's Enforcement Unit.

# Chapter 7 – Supervisory action plan

SOARS involves the development of a supervisory action plan which vary according to an entity's supervision stance.

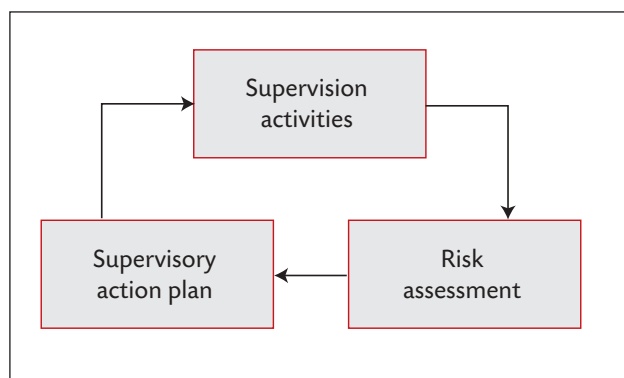
## 7.1 Objective

The objective of a supervisory action plan is to map out the supervision activities to be performed over the forthcoming supervision period, based on the PAIRS risk assessment process and the resulting supervision stance.

## 7.2 Process

Setting a supervisory action plan is an integral component of supervision, as depicted in Figure 2 below.

Figure 2: Supervision process



Supervisors are responsible for preparing supervisory action plans. Supervision activities included in the supervisory action plan are usually coordinated and/or undertaken by the responsible supervision team.

As an entity moves up the SOARS stances, the level of routine supervision activities will likely decrease and the use of APRA's more specialised intervention and enforcement powers will come into effect.

## 7.3 Frequency

Supervisory action plans are revisited after the PAIRS risk assessment has been updated. This is to ensure that the activities and responses included in the supervisory action plan reflect the risks identified as part of the risk assessment process, even if the plan itself does not change.

## 7.4 Disclosure

APRA does not publish a regulated entity's SOARS supervision stance or supervisory action plan. However, APRA does inform each entity of its supervision stance and the broad activities to be performed over the forthcoming period, in the interests of open and direct engagement and for planning purposes.

Using its statutory confidentiality powers, APRA does not allow entities to disclose their PAIRS ratings or SOARS stance. However, entities need to have regard to any continuous disclosure obligations and may need to disclose matters relating to supervisory intervention, particularly more intrusive interventions such as being placed in run-off or having a licence suspended or withdrawn.

# Chapter 8 – Contacts

Any issues or questions in relation to this document can be directed to the Head of the Supervision Framework Team at the Australian Prudential Regulation Authority.

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