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THE ROAD TO RECOVERY OR AN EXIT STRATEGY?

APRA SAYS YOU MUST PLAN FOR BOTH

APRA is finally addressing one of the biggest lessons learned from the GFC: the failure of firms to plan for the worst while still expecting public support to ride out a crisis.

To fix this situation, APRA has introduced new recovery and exit planning requirements to ensure that regulated businesses make plans to rebuild their financial resilience or exit before they become non-viable. These requirements are contained in two new standards: CPS190 Recovery and Exit Planning (CPS190); and CPS 900 Resolution Planning, and are accompanied by relevant Prudential Practice Guides.

In this article, we provide a summary of CPS190 and also learn from the experience of those who have been through these kinds of situations before.

WHAT ARE THE NEW REQUIREMENTS OF CPS190?

CPS 190 will come into effect from 1 January 2024 for banks and insurers, and from 1 January 2025 for RSE licensees.

Recovery and Exit Plans must include:

- A standalone, concise summary of the Plan
- A trigger framework for early identification and monitoring of stress
- A governance framework for monitoring triggers and timely activation of the Plan
- Credible recovery actions to stabilise and restore financial resilience
- Credible exit actions to effect an orderly and solvent exit
- A communications strategy

As part of APRA's revised approach to prudential architecture, entities are split into two categories: significant financial institution (SFI) or a non-significant financial institution (non-SFI).

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WHAT REQUIREMENTS APPLY TO YOU?

Significant financial institution (SFI) means:

- ADI's: An ADI or authorised NOHC that is not a foreign ADI and has total assets in excess of AUD $20 billion;
- General insurance: A general insurer, authorised NOHC or a parent entity of a Level 2 insurance group that is not a Category C insurer and has total assets in excess of AUD $10 billion;
- Life insurance: a life company or registered NOHC that is not an Eligible Foreign Life Insurance Company and has total assets in excess of AUD $10 billion;
- Superannuation: RSE licensee that has total assets in excess of AUD $30 billion in the case of a single RSE operated by an RSE licensee, or if the RSE licensee operates more than one RSE, where the combined total assets of all RSEs exceed this amount; or
- is determined as such by APRA, having regard to matters such as complexity in its operations or its membership of a group.

A SFI's Plan must also include scenario analysis and an assessment of recovery capacity. SFIs must also include for each recovery and exit action in the Plan:

- a timeline for the implementation of the action;
- analysis of any barriers to implementation, execution risks and key dependencies;
- a summary of the preparatory measures needed to support the timely and effective execution of the action; and
- where relevant, an estimate of the impact of the action on the capital and liquidity position of the APRA-regulated entity, based on credible assumptions.

All entities, regardless of whether they are SFIs or non-SFIs must also:

- Maintain the capability to execute its Plan
- Take reasonable preparatory steps to support implementation of the Plan
- Maintain sufficient financial resources to implement the Plan
- Regularly monitor indicators of stress

Recovery and Exit Plans must be integrated into an entities' RMF, the ICAAP (for banks and insurers) and the business plan and performance review (for RSE licensees).

For SFIs, it's Plan must be reviewed annually, while for non-SFIs, its every three years.

A copy of the Plan must be provided to APRA following each review, within three months of the recovery and exit plan being approved by the Board. Entities must also notify APRA if it has activated its recovery and exit plan.

If there is one paragraph in CPS190 which encapsulates APRA's overall message to regulated entities it's this: "An APRA-regulated entity must not assume extraordinary public sector support in its recovery and exit planning."

If a crisis hits don't expect a government bailout and plan accordingly.

AUSTRALIA, A LATE FOLLOWER

Australia is a behind foreign jurisdictions such as the UK, which introduced recovery plan requirements as part of the prudential rulebook several years ago. This is not entirely surprising and reflects the different experience Australia had during the GFC compared to other countries.

However, APRA has by no means been unaware of what's happened internationally, nor the need to implement this kind of regulation. Its new powers are the result of work done several years ago, having first been considered in the aftermath of the GFC in 2012 when the Government issued a consultation paper 'Strengthening APRA's Crisis Management Powers'. That work was paused pending the outcome of the 2014 Financial System Inquiry and was only picked up again by APRA in 2021 after prioritising other recommendations stemming from that Inquiry as well as other things it deemed to be a higher priority.

CPS190 and CPS900 are, in APRA's view, the implementation of legislation enacted in 2018 (the Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Act).

OUR CASE STUDIES

PRACTICAL LESSONS LEARNT

In his previous life as an Appointed Actuary for a European-based reinsurer, PFS Managing Director, Adrian McGarva, has firsthand experience of pulling a company back from the brink.

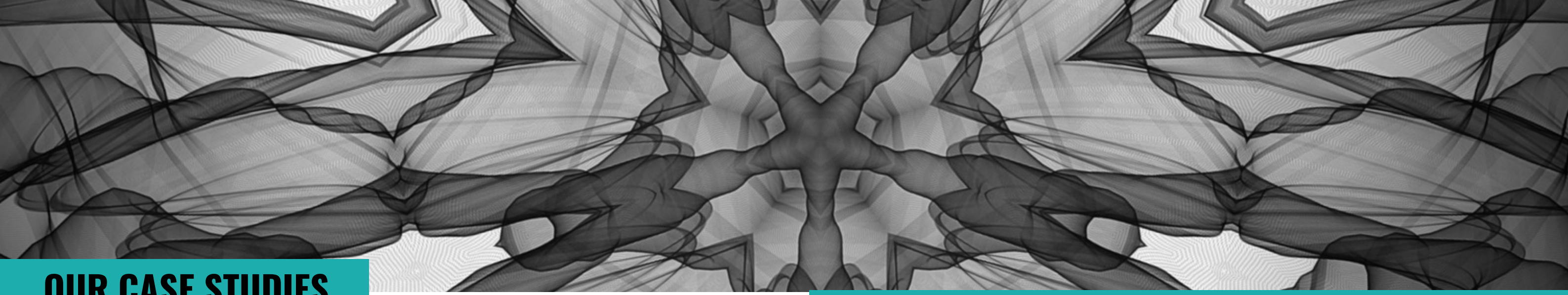
The reinsurer had experienced strong and sustainable growth for several years when the GFC hit. Whereas many others were badly affected "in some ways we just could have continued on as we were" says Adrian.

But it was one of their investors, a Dallas-based hedge fund, which needed to return capital to its investors and balance its own portfolio which ended up creating problems.

"Board composition became an issue, the strategic direction became an issue, and ultimately that led to us packaging up and selling off parts of the business."

In the end, they managed to negotiate their way through, and the company still exists today - albeit in a different form.

Reflecting on the lessons learnt from his experience Adrian says "Putting thought into how a crisis can be managed is never time wasted because things can come out of nowhere. You need to have a plan and execute quickly. It might feel a bit negative having to plan for a crisis when things are going well, but I think it would have enabled us to execute on our ultimate approach much more coherently and under less pressure."



OUR CASE STUDIES

COMMUNICATION IS KEY

CPS190 requires regulated entities to develop a multi-faceted communications strategy. This makes sense when you consider that recovery and exit situations can quickly escalate into being public affairs plus employee wellbeing and motivation needs to be maintained. When it comes to staff "you need to be as completely honest and transparent however you need to accept you can't share everything and that you don't know always have the answers. Saying nothing is worse than saying you don't know" says Sean Williamson, Principal at PFS.

In recent years, Sean has been involved in two major recovery events at two different firms, one of which as CEO. Having been through the experience multiple times, Sean believes that engaging the right people who can identify and resolve problems is key. Having a plan, tackling the problem early on, correctly identifying the root causes and making important decisions without delay is what makes the difference. "Significant issues require significant actions and time is generally of the essence in recovery situations. The larger the problem, the sooner it needs to be addressed with commensurate actions.

WHEN IT ALL GOES ACCORDING TO PLAN

While recovery and exit planning requirements will be phased in from next year, planning for tough times isn't exactly a new idea. There are plenty of examples of entities thoroughly assessing their risks, developing robust plans, and executing these effectively.

Jane Byrne, PFS Director and GRC Practice Leader, had the privilege of being involved in such a situation a few years ago. "It was a well organised exit from the market" says Jane. "The company covered all aspect from communications, operations, insurance, legal, tax, investments and more."

Always with an eye to governance, Jane explains that the company set up a Board subcommittee which did the day-to-day monitoring of how the plan was being executed and engaged an external consultant to act as the project manager due to resourcing constraints. These arrangements helped deliver the successful outcome.

Jane's experience leads her to give the following advice: "A well thought through plan developed during the quiet times is really invaluable. And when it comes to execution, make sure you have strong governance arrangements in place. Everything won't always go according to plan but with the right oversight and accountability in place, you can still deliver a good outcome – whether that's a return to normal or an orderly exit."

HOW PFS CAN HELP

PFS can help with developing and refining your recovery and exit plans, whether you need something built from the ground up or a review of what you have already done. We have experience across all elements of recovery and exit planning, from financial and operational, through governance and communications.

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