

APRA DRAFT PRUDENTIAL PRACTICE GUIDE – SPG 235

ASFA Submission

June 2009

Association of Superannuation Funds of Australia

ASFA Secretariat
Level 6
66 Clarence Street
Sydney NSW 2000

PO Box 1485
Sydney NSW 1005
Ph: +61 2 9264 9300
Fax: +61 2 9264 8824

Outside Sydney
1800 812 798

Website: www.superannuation.asn.au

The Association of Superannuation Funds of Australia Limited ABN 29 002 786 290 ACN 002 786 290

Please Note:

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5 June 2009

Mr. David Rush
General Manager
Policy Development
Australian Prudential Regulation Authority
GPO Box 9836
Sydney NSW 2001
reserves@apra.gov.au

Dear Mr. Rush,

DRAFT PRUDENTIAL PRACTICE GUIDE – SPG 235: Use of Reserves in Superannuation Funds

The Association of Superannuation Funds of Australia Ltd (ASFA) is pleased to provide comments the above draft prudential practice guide (PPG).

In preparing this submission the ASFA has consulted with its members.

The comments below are directed specifically to the PPG and not to the accompanying documents.

Introduction to PPG

ASFA considers that a trustee's reserving policy should be intrinsically linked to the fund's risk management processes, as, in our view, reserving is fundamentally a risk management process. Should APRA agree with this view the point should be drawn out strongly in the introductory comments.

ASFA considers it appropriate that all trustees should, as part of their risk management processes:

- identify the risks;
- evaluate the possibility of the risk occurring;
- determine how these risks will be minimised, and managed should they eventuate
- quantify the potential financial impact of the risk eventuating;
- determine, with reference to contractual arrangements (e. outsourcing contracts, trustee contracts), who should ultimately bear the cost;
- if another party is bearing the cost, determine whether a further contingency may be that the other party is unable to meet the cost.

From this process the trustee's reserving policy should evolve.

As such it would assist if the preceding concepts were reflected in the introductory section of the PPG.

The introductory paragraphs (particularly paragraph 4) seem to indicate a preference by the regulator for funds running reserves so as to spread the costs of any eventuality across generations of members.

ASFA would like APRA to clearly state whether it considers that reserving is the only appropriate approach or whether it is also appropriate for a trustee following an appropriate risk management process to conclude that any recovery of costs be from the current generation of members.

ASFA is aware of trustees that use this latter approach.

During our member consultation process it became clear that there is some confusion surrounding the purpose of the reserves outlined in the draft PPG, and whether the PPG applies to Defined Benefit funds. AFSA suggests that the introduction makes it clear, if it is APRA's intention, that:

- the PPG is referring to reserving for accumulation style funds, does not apply to a pure defined benefit fund, but does apply to the accumulation component of a hybrid fund; and
- the PPG is not referring to solvency reserving, and is not designed to address liquidity issues, but is limited to the three types of reserves mentioned. Should APRA wish to address solvency reserving for accumulation funds this should be covered by a separate heading in the PPG.

Our defined benefit members would like it made clear that there is no expectation that they should be holding an operational risk reserve in addition to their existing solvency reserves.

Some common types of reserves

In Paragraph 8 in the first bullet point, it is stated that APRA considers it prudent practice for trustees to hold operational risk or contingency reserves. However in Paragraph 13 it is made clear that this should be the case where the fund does not have access to shareholder capital, for example in a not for profit fund. It would be helpful if this distinction, if such a distinction is warranted, was made clear in Paragraph 8.

General comments on management of reserves

We have no specific comments on this section.

Management of specific types of reserves

Operational risk or contingency reserve

In the discussion on operational risk and contingency reserves, perhaps the equity issue could be made clearer by exploring the concept that running an operational risk reserve could be viewed as like insurance cover. That is, the fund is effectively requiring each generation of members to contribute a small amount to reduce the risk of being required to pay a substantial amount should a catastrophic event occur. For this reason, a trustee may consider it equitable that all generations of members contribute to the reserve rather than having the cost carried by those in the fund at the time of an event (a point made by APRA in Paragraph 3).

Again, ASFA would like APRA to clearly state whether the above approach is the only approach or whether the regulator consider that it may also be appropriate for a trustee to only recover the cost of an event from the current generation of members.

In Paragraph 13 the management of operational issues in for-profit funds is linked to the charging of trustee fees, with the implication being that the level of such fees is set at an amount designed to cover any operational contingency issues. Our for-profit members have informed us that such funds pay for

any operational issues (unit pricing, backdating transactions etc.) from their shareholder capital. We suggest that it be made clear in Paragraph 13 that the amount a trustee would pay in such circumstances is not limited to the amount of the trustee fee they charge. The two concepts should be de-coupled as this Paragraph is confusing.

Whilst many for-profit funds meet the cost of operational risks from shareholder capital, some of our for-profit members hold explicit operational risk reserves for various reasons. The PPG should not leave the impression that it is inappropriate for a for-profit trustee to hold an operational risk reserve. Where the trustee, as part of the risk management process, decides they would like to hold such a reserve this should be allowed.

Fundamentally, the reserving policy should be a reflection of the RMS and RMP considerations which would include consideration of contractual arrangements and protections they do (or don't) provide members should various identified risks eventuate.

Self-insurance reserve

We have no specific comments on this section.

Investment fluctuation reserve (IFR)

There is debate in the superannuation industry about the appropriateness of an IFR. Ultimately the argument appears to turn on whether in these days of choice of fund and increased portability rights funds should be using crediting rates or whether unitisation is a more appropriate method for determining the value of members' benefits.

It is suggested that, rather than noting in Paragraph 26 that industry developments have caused trustees to reconsider the appropriateness of IFRs, a more positive statement should be included recommending that trustees with an IFR reconsider the appropriateness of the reserve for their fund and their membership given industry developments.

In Paragraph 8 in the third bullet point, it is stated that the remaining investment fluctuation reserves are generally associated with hybrid DB arrangements. For completeness, it would be helpful if this information was also included at Paragraph 26, after the statement that many funds have dispensed with IFRs.

Should you require further information, please contact our Principal Policy Adviser, Robert Hodge on (02) 8079 0806.

Yours sincerely

Melinda Howes
Director Policy and Industry Practice