

# SUBMISSION

Submission to APRA:  
Discussion Paper –  
Strengthening Financial  
Resilience in  
Superannuation

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25 March 2022

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25 March 2022

## **Discussion Paper – Strengthening Financial Resilience in Superannuation**

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to the consultation on the Discussion Paper: *Strengthening Financial Resilience in Superannuation* (Discussion Paper).

### **About ASFA**

ASFA is a non-profit, non-partisan national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its \$3.4 trillion in retirement savings. Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing over 90 per cent of the 17 million Australians with superannuation.

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If you have any queries or comments in relation to the content of our submission, please contact me on (03) 9225 4021 or by email [fgalbraith@superannuation.asn.au](mailto:fgalbraith@superannuation.asn.au).

Yours sincerely

Fiona Galbraith  
Director, Policy

## General comment

Funds understand the need for financial resilience to cover financial requirements and operational risk.

However, funds have expressed concerns with two matters - the process to make a submission and aspects of the Operational Risk Financial Requirement.

## Specific comments

### 1. Making of submissions through APRA Connect

The webpage with respect to the consultation states as follows

*Written submissions from RSE licensees are requested to be submitted as an ad hoc return through APRA Connect, the data collection solution for reporting entities to lodge information and data with APRA. Comprehensive instructions for submitting an ad hoc return are contained in the APRA Connect Guide under section 6.11.*

Members have queried the use of APRA Connect to make written submissions.

Importantly, funds have advised that, instead of facilitating an ad hoc return, APRA Connect had been set up as if this were a mandatory data reporting form.

As a consequence of this, funds have reported that they received a notice via Connect advising that they had breached the data reporting provisions on the official due date.

In a number of funds this triggered an incident report in fund's governance, risk management and compliance function and caused a risk investigation. As a perceived breach of a mandatory regulatory reporting requirement, often this matter was escalated up through the organisation, including in some instances to the board.

#### **Recommendation 1**

Given the above, we would recommend that submissions to consultations by RSE licensees not be made through APRA Connect.

#### **Recommendation 2**

If submissions from RSE licensees continue to be made through APRA Connect, we would urge that this is facilitated through the ad hoc return process, as stated on the consultation webpage, and not in the form of a mandatory data reporting form.

## 2. Operational Risk Financial Requirement (ORFR)

### 2.1. ORFR target amount set at 25 basis points

*Superannuation Prudential Guidance SPG 114, Operational Risk Financial Requirement*, at paragraph 9, states that

*APRA expects a soundly run RSE licensee that has implemented an effective risk management framework to have an ORFR target amount that is equivalent to at least 0.25 per cent of funds under management (FUM).*

Members have raised a number of issues and observations with respect to this:

- the 25 basis points target amount does not have basis in law
- APRA's guidance, and its requiring in practice, that all funds must maintain an ORFR target amount of at least 25 basis points, does not acknowledge that the law requires the trustee to undertake an assessment of risk, having regard to the circumstances of the fund, and determine the appropriate ORFR target amount
- the Executive Summary to the Discussion Paper, on Page 4, acknowledges that:  
*'Every RSE licensee must form a view of their required level and structure of financial resources and manage these to suit their particular circumstances'*
- the circumstances and risk profiles of funds and trustees vary significantly
- there is no legal basis for saying that a provision for operational risks needs to track against FUM, as the costs to be covered may be a mix of fixed and variable costs, and variable costs may not be a function of FUM but of other factors, such as the number of members / accounts affected by the realisation of a risk
- monitoring and tracking ORFRs target amounts against FUM is time-consuming and creates additional, unnecessary cost for funds, which is not in the best financial interests of members
- this can be contrasted with the matter of trustee capital more broadly where there is no requirement as to quantum imposed
- this results in a significant amount of money within super funds effectively being quarantined in a reserve to meet the ORFR, which in most instances is invested conservatively and is likely to be addition to other reserves held within the fund such as administration or insurance reserves.

As a result of the above there is a question as to whether the ORFR target amount, set at 25 basis points of FUM, is in the best financial interests of members. Funds have noted that the amount of money set aside to meet the ORFR target amount will continue to grow to such an extent that in future it may be difficult to justify the quantum involved.

The approach to determining the appropriate amount of ORFR should be flexible and risk based, akin to the approach adopted with respect to ADIs and the broader financial services.

### **Recommendation 3**

ASFA recommends that SPG 114 be amended to remove the reference to RSE licensees having an ORFR target amount equivalent to at least 0.25 per cent of funds under management.

Instead, trustees should determine the appropriate ORFR target amount having regard to the circumstances of the fund.

## **2.2. Impact of another APRA financial requirement on the ORFR target amount**

Paragraphs 17 and 18 of SPG 114 are to the effect that, where the assets of an RSE licensee's business operations are invested in the assets of another related APRA-regulated entity (e.g. a PST or a life insurance policy) that is also covered by an ORFR target amount, the RSE licensee may determine that its investment in another entity reduces the RSE licensee's ORFR target amount.

We query, however, the statement that an RSE licensee typically would only be able to demonstrate it has

- undertaken appropriate analysis of the coverage and availability of the other entity's ORFR
- a thorough understanding of the other entity's risk management framework; and
- determined the other entity adequately manages its operational risks

when the other entity is within its business operations, or is closely related to the RSE licensee.

In ASFA's view, this ORFR target amount offset provision should be available in respect of investments held with any APRA-regulated PST/life company, not just those that are within the RSE licensee's business operations or are related entities.

## **2.3. Permitted use of the ORFR**

Some funds have expressed the view that the permitted use of the ORFR, to remediate losses from members' accounts, is too restrictive and that the use of the ORFR should extend to other remediation costs, such as the cost of professional/expert support which is usually required to investigate, report, advise on and resolve issues.

We note that the Discussion Paper, at Page 14, acknowledges that

*'Whilst these financial resources were intended to be used by RSE licensees to make good any losses to members caused by operational risk events, it is evident that RSE licensees are reluctant to call on these financial resources, even where they would be entitled to do so under the provisions of the standard. Instead, RSE licensees are calling on other financial resources (in the form of other reserves or external sources of capital) following an operational risk event'.*

Given this, APRA may like to consider providing further guidance around assessing operational risk events and the circumstances in which trustees can access the ORFR.

**Recommendation 4**

The permitted use of the ORFR should, at a minimum, extend to other remediation costs, such as the cost of professional/expert support which is usually required to investigate, report, advise on and resolve issues.

**2.4. ORFR operational processes - ORFR utilisation and replenishment**

Member organisations have indicated that, historically at least, there was an expectation that every operational risk loss be charged to the ORFR reserve, irrespective of the origin/cause of the loss or the materiality.

Any reimbursement of the loss by third parties can only be made to replenish the ORFR reserve, which necessitates the establishment of a costly and complex record keeping infrastructure around the ORFR. A trustee can only make good an operational risk loss once the administrator has calculated the loss for each member.

Paragraph 15 of SPG 114 acknowledges that RSE licensees may have in place agreements that provide compensation to address the cost of an operational risk event.

Paragraph 16 of SPG 114 suggests that the ORFR should first be used to compensate members, with funding from alternative compensation arrangements used to replenish the financial resources held to meet the ORFR target amount.

Historically an administrator would directly compensate a member for a loss, as required under an administration agreement. The suggested requirement that all such payments effectively need to be put through an ORFR reserve, regardless of materiality, necessitates the establishment of expensive accounting and record keeping systems.

We recommend that, rather compelling an elaborate 'use and replenishment' approach, trustees should be able to rely on agreed compensation arrangement whereby a third party, such as an administrator, directly 'makes good' an operational risk loss to members, with the exception of when the trustee is able to make good the loss at earlier time than would occur under compensation arrangement. The ORFR should not need to be used where operational losses will be met on a timely basis by a third party in the normal course of remedying an event.

Failing this, at a minimum, the trustee should be able to determine and apply a materiality threshold for use of the ORFR.

**Recommendation 5**

Trustees should be able to rely on agreed compensation arrangement whereby a third party directly 'makes good' an operational risk loss to members and not need to utilise the ORFR.

**Recommendation 6**

Trustees should be able to determine and apply a materiality threshold for use of the ORFR.