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20 July 2012

Neil Grummitt
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Australian Prudential Regulation Authority
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Sydney NSW 2001

Email: superannuation.policy@apra.gov.au

Dear Mr Grummitt,

Draft Prudential Standards for Superannuation

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to the draft Prudential Standards for Superannuation released by the Australian Prudential Regulation Authority (APRA) in April 2012.

About ASFA

ASFA is a non-profit, non-political national organisation whose mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members. We focus on the issues that affect the entire superannuation system. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider membership, represent over 90% of the 12 million Australians with superannuation.

General comments

As an overall comment, ASFA is broadly supportive of the draft prudential standards for superannuation which, in the main, consist of high-level principles that are flexible enough to cater for different arrangements/models. We note that, for the most part, the prudential standards have been drafted in a manner consistent with ASFA's view that they should not be overly prescriptive. ASFA considers that draft standards generally provide sufficient flexibility to enable trustees to develop appropriate policies and procedures to meet the principles outlined in the standards which reflect the size, scale and nature of their organisation. This flexible, risk-based approach is critical to ensuring the industry does not end up with a one-size-fits-all result that is neither efficient nor best practice.

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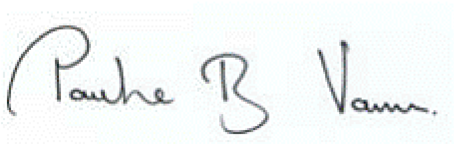
However, as a consequence of this flexible, non-prescriptive approach, we note that there are a number of principles outlined within the draft standards that are open to interpretation by trustees. ASFA's view is that sufficient guidance will need to be provided within the relevant Prudential Practice Guides (PPGs) released by APRA later this year / next year to assist trustees in complying with the requirements in the prudential standards. The absence of the accompanying draft PPGs has made it difficult to determine how APRA intends the standards to apply in practice, which in turn has made the task of providing meaningful comments on the draft prudential standards challenging in a number of areas.

* * * *

I trust that the information contained in this submission is of value. We would be pleased to meet with you to discuss our submission.

If you have any queries or comments regarding the contents of our submission, please contact ASFA's Senior Policy Adviser, Jon Echevarria, on (02) 8079 0859 or by email jechevarria@superannuation.asn.au .

Yours sincerely



Pauline Vamos
Chief Executive Officer

Submission

Draft Prudential Standards for Superannuation

20 July 2012

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Key recommendations

ASFA has made a range of recommendations in this submission in relation to each of the draft Prudential Standards for Superannuation. However, there are five key issues which we believe are the most important and are discussed below.

1 Interpretation of 'insurance'

Paragraph 5 of draft Prudential Standard SPS 250 – Insurance in Superannuation defines 'insurance' for the purpose of the prudential standard as:

> *"insurance acquired by an RSE licensee from a life company registered, or taken to be registered, under section 21 of the Life Insurance Act 1995 (**an insurer**) in respect of any of the following kinds of benefits (**insured benefits**) provided to beneficiaries:*
>
> *(i) death benefits;*
> *(ii) benefits in respect of permanent incapacity;*
> *(iii) benefits in respect of temporary incapacity; and*
> *(iv) benefits in respect of a terminal medical condition…"*

A strict application of this definition implies that SPS 250 does not apply in circumstances where insurance cover is obtained through an insurer that is not a life company (eg. insurance provided through a general insurer). This is because the draft prudential standard, as it is currently written, states that the prudential standard applies only to insurance cover "…acquired by an RSE licensee from a life company".

ASFA notes that the standard does not require RSE licensees to obtain insurance cover (i.e. death, permanent or temporary incapacity etc) from a life company. We also note that a standard additional licence condition issued by APRA under s.29EA of SIS applies to public offer funds, but it only applies if the RSE licensee provides life insurance benefits. That is, if an RSE licensee provides general insurance benefits (eg. income protection cover through a general insurer), the condition has no application. Arguably a similar interpretation should follow in relation to the requirements under SPS 250.

However, we understand that APRA has advised at least one RSE licensee that its intention is for the prudential standard to require all insurance offered through superannuation funds to be offered by a life company (despite this requirement not being expressed in the standard). That is, APRA has advised that draft SPS 250 assumes that the restriction will be extended to all RSE licensees (not just public offer funds). This is despite the fact that this proposed restriction on general insurance arrangements was not specified in the *Discussion Paper: Prudential standards for superannuation* released by APRA in September 2011.

We are aware that a number of RSE licensees currently offer insurance benefits, particularly income protection (IP) insurance, through cover provided by general insurers. Furthermore, these RSE licensees have been able to negotiate favourable terms with their insurance provider over time that are specifically tailored to, and best serve, their membership (including lower premiums, excellent default cover, little or no underwriting, no occupational loadings, very short waiting periods etc).

If APRA's intention regarding the restriction on general insurance is carried through to the implementation of the prudential standard, it will mean that these RSE licensees could not maintain their current arrangements. They would need to withdraw from their current IP contracts and find alternative cover through a life company, which would likely lead to an increase in cost to members. ASFA contends that this outcome is inconsistent with the Stronger Super objectives of establishing low cost superannuation accounts.

In addition, as a result of this proposed restriction (and the fact that it has come up so late in the piece), ASFA considers that RSE licensees will find it difficult, if not impossible, to seek out and transition to an alternative insurer for their IP cover to comply with the standard before they lodge their MySuper application. As a result, this proposed restriction has the potential to lead to RSE licensees not being granted approval to operate a MySuper product because they are not compliant with this draft standard.

It could be argued that RSE licensees have in effect been misled by the fact that this proposed restriction on general insurance was not included in the original APRA discussion paper. Had this been the policy intent all along, it is difficult to consider why, given its significance, this restriction was not expressly stated in the discussion paper or at the very least raised with the funds in question by APRA during its prudential reviews.

Also, it is unclear as to what problems, if any, this proposed restriction on general insurance arrangements is designed to correct. In particular, our understanding with respect to RSE licensees' current arrangements with general insurers is that:

(i) The entities providing the insurance are all local entities regulated by APRA;
(ii) The underwriting and claims decisions of the general insurers tend to be undertaken locally; and
(iii) In many instances the general insurers offer guaranteed renewable cover.

As such, ASFA considers that the potential negative ramifications for fund members and beneficiaries of this proposed restriction significantly outweigh any issues it is designed to remedy.

It is generally accepted that competition is healthy and important to creating a low cost environment, however all participants must be subject to the same prudential requirements. We therefore recommend that the definition of 'insurance' in the prudential standard be amended such that RSE licensees are legally allowed to obtain IP cover from an insurer that is not a life insurer provided that the company is a general insurer authorised under the *Insurance Act 1973 (Cth)*. This would not only remove the problems discussed above arising from the proposed restriction, but amending the definition of 'insurance' in this manner would also make it clear that SPS 250 applies to all insurance provided through superannuation, not just insurance offered through a life company.

If however APRA's position remains unchanged in relation to this issue, given the difficulty that RSE licensees will have in unwinding arrangements, ASFA recommends a 3-year transition period be introduced in order to allow sufficient time for RSE licensees to establish alternative arrangements.

2 Period in which to build up the Operational Risk Financial Requirement

Paragraph 27 of draft Prudential Standard SPS 114 – Operational Risk Financial Requirement requires RSE licensees to build the financial resources to meet the Operational Risk Financial Requirement (ORFR) within three years on a basis that is fair with regard to the interests of beneficiaries. ASFA considers that three years is an insufficiently short period of time, at the best of times, to spread the cost of building up a reserve and creates considerable intergenerational inequity for the cohort of members who happen to be members of the fund during this period.

It should also be noted that:

- given that the bulk of the impact of funding most of the Government's proposed $467 million SuperStream levy will fall in the next three years; and
- members will have to bear the fund's costs of implementing MySuper, SuperStream and the enhanced governance standards.

As such, this is just about the worst possible three-year period in history in which to ask members to bear the costs of creating an ORFR.

ASFA therefore strongly submits that the period over which the ORFR should be built up should be over the next five years, not three years. One possibility may be that the ORFR should be funded to the tolerance limit within three years and the target limit within five years.

3 Auditor independence

Paragraph 62 of draft Prudential Standard 510 – Governance states that an individual who plays a significant role in the audit of the RSE licensee for 5 successive years, or more than 5 years out of 7, cannot continue to have a significant role until at least 2 further years have passed (except with a written exemption from APRA).

ASFA notes that this audit partner rotation requirement is attempting to mimic the requirements for public companies, however this would be a significant shift in the way audit firms operate currently. Firms currently manage auditor independence with respect to the audit of superannuation funds differently – some firms have a tiered approach (eg. maximum of 5 years for public offer funds and a maximum of 10 years for non-public offer funds). We believe that many audit firms would have a problem with this requirement, particularly from a resourcing and experience perspective.

Notwithstanding the desire to harmonise the prudential standards across all APRA-regulated industries, ASFA contends that this partner rotation requirement is not appropriate for superannuation, which is a highly specialised industry. In particular, we do not believe it would necessarily be in best interest for the industry, and ultimately members of superannuation funds, to mandate a change of audit partner every 5 years.

In the course of auditing public companies, the lead auditor generally spends the majority of their time each year on a few clients. This has the potential to lead to a 'familiarity' problem which could threaten auditor independence. However with superannuation fund audits, lead auditors do not spend anywhere near as much time on each engagement – i.e. there is not the same conditions in the audit of superannuation funds that could lead to the same 'familiarity' problem.

ASFA contends that this requirement is too restrictive in the context of superannuation fund audits. Furthermore, we note that this proposed 5-year audit partner rotation requirement is inconsistent with clause 290.151 of *APES 110 Code of Ethics for Professional Accountants* issued in December 2010, which states that: "In respect of an audit of a Public Interest Entity, and individual shall not be a Key Audit Partner for more than seven years". ASFA contends that, at the very least, superannuation funds should be viewed in the same context as Public Interest Entities for the purposes of audit partner rotation.

We believe paragraph 62 should either be removed entirely or substantially modified – i.e. there should not be a requirement to rotate the audit partner on such a frequent basis (i.e. every 5 years) for superannuation fund audits.

4 Risk appetite

The concept of 'risk appetite' is a new and evolving one for the superannuation industry. For this reason ASFA believes that there is need for flexibility to facilitate this evolution.

We understand that there is recognition by APRA that many funds do not have the resources available to large banks and insurers. Some superannuation funds are novices in risk appetite, but ASFA appreciates that APRA has experience with regulatory issues in regards this concept through its prudential supervisory role of other industries.

ASFA's view is that, whilst the concept of setting a risk appetite sits well within prudential standards, they should not be prescriptive. Greater guidance around estimating the possible maximum impact on beneficiaries in the event that a particular risk is realised is more suitable to associated guidelines and should be addressed in the draft PPG accompanying Prudential Standard SPS 220 – Risk Management.

We also believe that, with regard to this standard, an appropriate transitional period is required to allow trustees to firstly determine their risk appetite and then articulate it appropriately. ASFA sees value in APRA pursuing a pragmatic approach to compliance in this regard.

5 Additional criteria applying to approved auditors

Paragraph 20(c) of draft Prudential Standard SPS 520 states that, in order to be considered fit and proper, an auditor must have a minimum of 5 years' experience in the audit of the business operations of the RSE licensee. ASFA contends that this is too restrictive and would make it difficult for younger audit partners to take over the work from more experienced partners – i.e. it creates an artificial barrier to entry.

In addition, the requirement is unrealistic and is not indicative of the way audit firms operate – if a partner does not have 5 years' experience, they are invariably supported/backed by people within the audit firm that do (otherwise a quality assurance partner is appointed to make sure the risks are properly addressed).

As the number of superannuation funds continues to reduce, we question how audit partners are supposed to attain the required level of experience if they are effectively excluded from providing services in order to gain experience. ASFA considers that effective supervision from more senior audit partners would be a more effective way of achieving the desired outcome.

Also, we believe the inclusion of sub-paragraph (d), which requires auditors to have sufficiently relevant and recent experience so as to provide reasonable assurance that the person is familiar with current issues in the audit of the business operations of RSE licensees, should be a sufficient requirement in terms of relevant experience.

As such, we recommend that sub-paragraph (c) be removed from paragraph 20 of SPS 520.

Detailed recommendations

1 SPS 114 – Operational Risk Financial Requirement

1.1 Draft guidance material

As a general comment, given that this is a new requirement and needs to be addressed in the RSE licensee's draft MySuper application, the industry would appreciate draft guidance with respect to this prudential standard being released ahead of the other draft guidance material as a matter of urgency.

1.2 Definition of 'operational risk'

ASFA believes that the definition of 'operational risk' being principles based and for it to be up to each RSE licensee to determine the scope of such risk. APRA guidance will be required with respect to what it considers to fall within the definition of 'operational risk'.

In particular, given that a unit pricing error is likely to be the single largest operational loss faced by a trustee, guidance is required as to whether the Operational Risk Financial Requirement (ORFR) can be used, not only to cover the costs of correcting the error, but with respect to any losses resulting from the error as well.

1.3 Legal expenses

Paragraph 5 explicitly includes legal risk in the definition of 'operational risk'. Clarification is sought to confirm that legal expenses with respect to an operational error may be paid for from the ORFR.

1.4 Methodology for determining quantum of ORFR

Guidance will be required regarding the methodology for the calculation of the ORFR. Most funds will have little in the way of internal data and, with respect to superannuation and pension funds generally, there is little available in the way of external data either which can be utilised. Accordingly, it appears as though most of the determination will have to be performed on a scenario-testing basis.

1.5 Notification requirement

In paragraph 25, we believe guidance is required in relation to the meaning of "material" (eg. what constitutes a "material amount" or a "material trigger").

Also, we suggest that paragraphs (b), (d) and (e) be amended by inserting the phrase "after the RSE licensee becomes aware", and that sub-paragraph (c) be amended to insert the word "event" after the word "risk" where it first appears.

It is also unclear what the precise difference is between paragraphs (c) and (d), unless it is that paragraph (c) applies before an event occurs and paragraph (d) applies when the trustee was not aware of an event until after it has occurred. We believe clarification may be required.

Paragraph (e) uses a phrase "RSE licensee-determined material trigger event" which is not defined. We recommend that this be linked to the risk management prudential standard. Furthermore, as paragraph 40 of Prudential Standard SPS 220 – Risk Management appears to require notification to APRA in the event of a material change to the risk management plan, sub-paragraph (e) would appear to be redundant and should be removed.

1.6 Commencement of transitional arrangements

As stated in the 'Key recommendations' section of this submission, ASFA considers that three years is an insufficiently short period of time in which to build up the ORFR. We therefore strongly recommend that the period over which the ORFR should be built up should be over the next five years.

1.7 Public Offer licensees

Paragraph 30 requires an RSE licensee of a public offer entity to comply with the obligations imposed by the previous section 29D(1)(g) and section 29DA of the SIS Act until it has met the ORFR for the first time.

We seek confirmation that, once an RSE licensee notifies APRA that it has met the ORFR, APRA will amend the RSE licensee's licence to remove any conditions with respect to guarantees or any other financial requirements.

1.8 Notification to APRA

We suggest that sub-paragraph 31(a) should be amended to read as follows:

> "(a) of the RSE licensee becoming aware that the ORFR has been met for the first time".

1.9 Defined Benefit funds

Often there is no power in the trust deed of a defined benefit fund to levy assets of the fund to, for example, create a reserve. Given the nature of the fund and the employer obligation to contribute to finance both member benefits and expenses of the fund, such a power is unnecessary. Accordingly, the trustees of some defined benefit funds will not have the power to create an ORFR.

2 SPS 160 – Defined Benefit Matters

2.1 Overall focus on vested benefit as opposed to technical insolvency

ASFA supports the focus of the prudential standard on vested benefits.

As there are significant conflicts, however, between the targeting of vested benefits in the prudential standards and the existing technical insolvency requirements in the regulations, to the extent there is overlap it should be removed from the regulations.

In particular, the regulations require the rectification of technical insolvency over a five year period, while the standards require any shortfall in vested benefits be rectified over a three year period.

The inconsistencies between the regulations and the prudential standards will create considerable confusion, inefficiency and cost within the industry and the actuarial profession. Accordingly, the requirements with respect to technical solvency should be removed from the regulations.

2.2 Lack of clarity in the standard, especially with respect to definitions / terminology

It is critical that the standard be drafted as clearly as possible, including the development and use of precise definitions.

With the focus on funding to vested benefits, ASFA contends that it would be desirable for the concept of minimum benefits to be confined to being used for the purposes of the Superannuation Guarantee legislation and benefit certificates and that references in the prudential standard are to vested benefits.

2.3 Defined benefit sub-funds

In paragraph 3 we believe it would be helpful if the prudential standard included a statement to the effect that an RSE licensee is deemed to comply with the standard in respect of the RSE if they comply with the standards in respect of each of the defined benefit sub-funds within the RSE.

2.4 Definition of "defined benefit sub-fund"

This requirement in paragraph 4 is that the interest of each beneficiary in the sub-fund is determined by reference **only** to the rules governing the sub-fund is too restrictive, especially with respect to master trusts and industry funds where DB funds have been transferred in, as the interest is frequently, at least in part, also defined by reference to the rules governing the fund as a whole, not just the sub-fund. ASFA's view is that footnote 2 is a better definition, however there are also some issues with this definition with respect to transfer of money. For example, paying administration and other fees or creating reserves, may violate this definition.

If the definition is not changed it will be necessary for most RSE licensees of master trusts to prepare a single actuarial investigation covering a number of different defined benefit arrangements with different employers. ASFA contends that this would be inappropriate, inefficient and ineffective, and the resulting investigation report cumbersome.

2.5 Shortfall limit

We believe the concept of a shortfall amount, to allow for short-term fluctuations in asset values as a result of variability in the investment market, is a positive and worthwhile idea. However, we have received comments from our members, including actuaries, that they cannot understand how the shortfall limit is intended to work, as it is not as well expressed as it could be.

In particular, amongst other things:

- If it is intended that the shortfall limit be expressed as a percentage of the vested benefits index then this should be reflected in the standards;
- The reference to "within one year or prior to the next regular actuarial investigation of the fund (whichever is the shorter period)" makes little sense, especially where the next actuarial investigation may be imminent. The period should simply be within one year;
- Use of the word "reduction" is not especially helpful and could possibly be replaced.

Consideration could be given to having the actuary sign-off on the appropriateness of the shortfall limit, although that will require the development of professional guidance by the Actuaries Institute.

Finally, it should be clarified that shortfall limits can be set at sub-fund level. While we appreciate that paragraph 3 states that "a reference to a 'defined benefit fund' … is also a reference to a defined benefit sub-fund, unless otherwise expressly indicated", paragraph 9 does not refer to a defined benefit fund but simply to "[a]n RSE licensee … set[ting] **a** shortfall limit".

We suggest that APRA work closely with the Actuaries Institute to determine an appropriate mechanism and to ensure that the prudential standard includes a clear, unambiguous explanation of the purpose of the shortfall limit, how it can be used and how it is intended to work in practice.

2.6 Actuarial investigation – regular and initial investigations

We suggest that the words "defined benefit" may need to be inserted before the word "member" in sub-paragraphs 11(a) and (b).

Paragraph 12 requires an actuarial investigation to be carried out on establishment of a new defined benefit fund. Clarification is required to confirm that, in the event that an existing, stand-alone defined benefit fund is wound-up and successor fund transferred into a defined benefit sub-fund of a master trust or into an industry fund, this is not considered to be the establishment of a new plan for the purposes of paragraph 12.

Also, paragraph 13 requires an actuarial investigation to be carried out where an RSE licensee becomes the trustee of an existing defined benefit fund. ASFA queries why the normal actuarial valuation cycle should not apply in these circumstances unless the new trustee determines that a valuation is prudent. To mandate the completion of a new valuation (if the last valuation were effective more than a year previously), simply because there has been a change of trustee, would significantly increase the costs for members, sponsoring employers and the fund for little benefit.

2.7 Actuarial investigation – APRA direction

ASFA queries on what grounds would APRA determine that an actuary is not acceptable to them?

Actuaries, as professionals, are members of the Actuaries Institute and in the event of being found to having been engaged in professional misconduct, unsatisfactory professional conduct or conduct likely to bring discredit upon the Institute or profession of actuary are subject to the Institute's Disciplinary Scheme. It is unclear why this is not considered to be sufficient.

If APRA is to have the power to make such a determination, our view is that it must be appealable to the Administrative Appeals Tribunal.

2.8 Actuarial investigation – interim investigation

ASFA contends that the trigger for an interim valuation needs to be more definitive than "it **appears** that the fund may be in an unsatisfactory financial position", as stated in sub-paragraph 16(a). The nature of defined benefit funds is such that, owing to market fluctuations, a fund, or sub-fund, can dip into an unsatisfactory financial position one day and be fine the next. This will also be the case with respect to any shortfall limit which has been set.

The requirement in sub-paragraph 16(a) could be amended such that the RSE licensee's assessment of the value of fund assets against vested benefits be performed on a regular basis, say quarterly, based on unaudited figures. The RSE licensee would then have to determine whether it is reasonably expected that the fund will continue to remain in an unsatisfactory financial position, or below the shortfall limit, for a sustained (or even specified) period of time.

2.9 Actuarial investigation – sub-funds

Paragraph 17 implies that the timing / effective date of actuarial investigations of all defined benefit sub-funds in a particular fund must be aligned. This would create major difficulties for master trusts and industry funds where DB funds have been transferred in, where the defined benefits sub-funds are unrelated and for which there is no good reason why they should be aligned. Amongst other things, it would disrupt the current valuation cycles for employers and would create a significant "hump" of actuarial work with respect to the fund every three years, without the ability to spread the workload, for employers and administrators providing the data to the actuary, for the actuaries themselves in completing the valuation work within the shorter six month timeframe and for the trustee in establishing contribution programs with employers.

Similarly, the requirement for annual investigations once a defined benefit sub-fund commences to pay a pension appears to trigger this obligation for unrelated sub-funds which are yet to commence paying a pension.

2.10 Report of the actuarial investigation – regular and initial investigations

Paragraph 19 requires that an RSE license must obtain an actuarial report within six months of the date at which the investigation was effective. Currently the obligation to provide such a report is 12 months after the valuation date.

Introducing a six month requirement, where currently a 12 month requirement exists, creates significant implications for many participants in the actuarial investigation process, including:

- employers, who would have to provide updated salary data more quickly;
- administrators, who would have to process the annual review data more quickly;
- accountants and auditors, who would have to finalise accounts more quickly;
- tax agents, who would have to sign off on tax provisions more quickly;
- actuaries, who would have to perform the necessary analysis and determine the most appropriate contribution program, involving discussions with the trustee and sometimes the employer; and
- trustees, who would have to co-ordinate all of the above in a truncated timeframe.

Unless a phased in approach is adopted with respect to this, we anticipate that the six month requirement will create major disruptions, especially during a period in which very significant change is occurring. Trustees, quite rightly, should be focusing on implementing the Stronger Super reforms during this period.

Given this proposed change, consideration could be given to the establishment of a phasing-in, stepped down, transitional period, for example by allowing a period of nine months for the next three years, before the requirement for six months commences.

2.11 Unsatisfactory financial position – actuarial requirements

It is unclear what "regular or periodic actuarial function under other relevant legislation" in paragraph 27 means. In particular, it is not evident what is meant by "regular or periodic" and what the difference is, if any, between these two terms.

Note 15 refers to "the provision of actuarial information to enable the RSE licensee to comply with its reporting obligations under the SIS Act and Regulations, the Corporations Act and the *Financial Sector (Collection of Data) Act 2001"*. It has been queried whether the Corporations Act and the Financial Sector (Collection of Data) Act 2001" make any reference to actuarial functions. Further, is the list an exhaustive one, in which case any actuarial functions performed under the Income Tax Assessment Act would be excluded? We believe this needs to be defined with more certainty.

Also, it is unclear as to why, in sub-paragraph (a), no reference is made to the shortfall limit. This does not appear to make sense and would appear to defeat the purpose of having a short fall limit in the first place.

2.12 Unsatisfactory financial position – actuarial requirements

ASFA considers that the requirement under sub-paragraph 28(a)(ii) of three years to return to a satisfactory financial position may be too short a period of time, especially during circumstances such as the global financial crisis. We believe this may place an undue burden on sponsoring employers at the worst possible time, which may cause the employer to withdraw their support from the defined benefit fund at a time when the fund is underfunded. This is not in the best interest of members.

ASFA believes that consideration could be given to a longer period, such as three and a half years (i.e. three years plus six months for the valuation) with trustee discretion to extend the period up to five years if the characteristics of the fund (i.e. benefit / liability exposure, timeframes and demographics) and the solvency of the employer supported such an extension and it is considered to be in the best interests of members. This would need to be documented in the board minutes and subject to APRA approval.

For funds which provide a significant portion of benefits as pension benefits, APRA may wish to consider extending the restoration period to ten years. This is consistent with:

1. The UK Pension Regulator's indication of a maximum restoration period of 10 years for UK pension funds; and
2. The lifespan of such funds, which is generally expected to be over 30 years after the last active member retires (contrasted with a lump sum fund which often terminates on the retirement of the last active member).

Lastly, it should be noted that, for a fund which provides lump sum retirement benefit, the vested benefits may be much lower than the accrued benefits. However, for pension funds, the present value of the pension payments is the vested benefits (and also the present value of the accrued benefits).

Also, sub-paragraph 28(b) requires the actuary to provide to the RSE licensee a statement which describes the minimum actions, recommends a contribution rate and considers the reasonableness of the assumptions within 15 business days of finding the financial position is, or is likely to become, unsatisfactory. Confirmation is required that the 15-day period commences when the actuary has completed their work.

2.13 Unsatisfactory financial position – reduction to amount of benefit payments

Clarification is required as to whether the reference in sub-paragraph 29(c) to "any reduction to the amounts of any benefit payments from the fund during the period" is a reference to reducing the total (final) amount of the benefit paid to members or to only paying an interim (partial) benefit during the period, with a "top-up" benefit payment paid to the member sometime later.

Consideration may need to be given to amending the SIS legislation to give the RSE licensee the power to reduce benefits in these circumstances.

2.14 RSE licensee's view of likelihood contributions will be made as recommended

The obligations in sub-paragraph 30(a) may prove difficult for RSE licensee's to fulfill in practice. Further guidance as to precisely what is expected of RSE licensees with respect to this requirement, in particular the extent of any enquiries and the nature of the conclusion which the RSE licensee is expected to reach.

2.15 Self-insurance

With respect to the obligations under paragraph 33 for RSE licensees that are permitted to self-insure, ASFA believes that confirmation is required that:

- defined benefit funds are able to continue to self-insure accumulation members;

- the definition of "self-insured" does not include 'incidental' self-insurance which may arise a result of market declines or similar factors or immaterial self-insurance, where a member has been declined cover in excess of a specified level;
- the reserves to be maintained are notional reserves and that there is no need to set aside an allocated amount of money as a reserve, with contributions to the reserve and payments out needing to be tracked; and
- all that is required to make the annually attestation that self-insurance continues to be in the best interests of beneficiaries is that the trustee consider whether anything has materially changed in the previous year.

2.16 Transfer of insurance assets and obligations

With respect to sub-paragraph 33(d), it may not always be possible to transfer some self-insured arrangements to an insured arrangement and, as such, some elements of self-insurance may need to remain on foot for quite a few years.

2.17 Commencement and transitional arrangements

ASFA contends that the six month restoration period stipulated in paragraph 38 is too inflexible. In particular, the requirement is problematic where a contribution program to restore a fund to a satisfactory financial position is in place as at 1st July 2013 and the period is longer than three years. We believe the contribution program in place, which has been recommended by the actuary and approved by the board, should be allowed to run its course and reviewed at the next regular actuarial investigation / valuation.

2.18 Fully or partially unfunded public sector schemes

In drafting this prudential standard, consideration should be given to the application, or otherwise, to unfunded public sector schemes. Care should be taken to ensure that the drafting does not result in the inadvertent application of requirements to such schemes where it may not have been intended.

3 SPS 220 – Risk Management

3.1 The role of the Board and senior management

Paragraph 6 states that the Board is ultimately responsible for the risk management framework. There is a general understanding that APRA will test this requirement in order to satisfy itself that the Board understands and has ownership of the risk management of the fund. However, ASFA believes guidance is needed on precisely what evidence APRA will be expecting here.

Also, ASFA suggests that paragraph 7 should be incorporated into paragraph 11.

3.2 Material risk

ASFA contends that the wording in this paragraph 10 is confusing. We recommend that the wording be amended to read – "An RSE licensee must assess the materiality of each ~~material~~ risk …..".

As well, we believe the language in this paragraph 11 is unnecessarily prescriptive. ASFA recommends that the wording be used as a guide only, thereby allowing a risk management framework to map to the words in included in sub-paragraphs (a) to (g).

3.3 Risk management framework

ASFA recommends that APRA issue guidance in regards to paragraph 14. Specifically, we believe guidance is needed around "reasonable assurance" and the word "prudently".

3.4 Strategic and business planning

ASFA also recommends that guidance be issued by APRA in regards to paragraph 17. This paragraph appears to suggest that business plans cannot be skewed to being overly commercial but instead need to be more balanced so as to consider more than commercial considerations – i.e. regulatory thinking. APRA's intentions need clarification in this regard.

3.5 Risk management strategy

We believe that guidance is also required with respect to paragraph 22. For example, ASFA considers that the procedure for identifying and assessing material risks and controls is not something that needs to be subject to specific regular review. While this would be considered when updating the RMS, it is unlikely to change unless there is a reason (eg. it was discovered that some material risks had not been identified).

The same sort of logic applies to the other policies and processes. There needs to be a thorough review if there has been a problem or if circumstances have changed significantly, but to schedule a formal review of each policy and process according to a predetermined timetable is over engineering the process. We believe the time and resources could be better spent in actually managing the fund's risks.

Also, guidance is needed as to what APRA is seeking here in terms of testing mitigation strategies and control mechanism. Is it "stress testing" or something more generic? This issue should be addressed in the PPG accompanying this prudential standard.

3.6 Risk management function

ASFA acknowledges the shift in APRA's thinking from the discussion paper of September 2011 where a "dedicated" risk management function became a "designated" one (paragraph 24). Nevertheless ASFA believes that there is still room for further clarity especially in regards to sub-paragraph (b) which refers to the risk management function being "functionally independent" from the business units of the RSE licensee.

ASFA recommends that this be changed to "operationally independent", thereby making the terminology consistent with paragraph 27.

In addition, ASFA recommends that clarification be provided in relation to APRA's expectations with respect to sub-paragraph 24(c). Is APRA mandating formal qualifications in risk management? At present, a number of ASFA members report that in many cases the individuals currently performing risk management roles started as auditors. As a result, they may not have formal risk management qualifications, but nevertheless have appropriate experience in this area. Again, we believe this is an issue that should be clarified in the guidance.

4 SPS 231 – Outsourcing

4.1 Materiality

In sub-paragraph 8(f), ASFA considers that the affiliation or other relationship between the RSE licensee and service provider is not in any way a determinant of materiality and should be removed.

In addition, our view is that sub-paragraphs (a) to (e) are only rough proxies regarding materiality and are principles-based. It would be preferable if a risk management approach were adopted, where the likelihood and consequence of risk and potential losses are assessed.

Furthermore, it appears as though both insurance contracts and investment agreements may be considered to be material outsourced agreements. We submit that, in accordance with paragraph 5, as both banking and insurance are business activities which cannot be undertaken by the RSE licensee itself, they should not be considered to be an activity which has been outsourced. It should also be noted that banks and insurance companies are regulated by APRA.

If investment management agreements are considered to be material outsourced agreements, it is unclear whether all agreements will be caught or just those of a certain magnitude.

4.2 Outsourcing policy

The reference in paragraph 15 to the requirement that "the arrangement is conducted at arm's length" should be amended to be "the arrangement is conducted on an arm's length **basis**".

4.3 Assessment of outsourcing options

Sub-paragraph 18(c) requires an RSE licensee to undertake a due diligence review of the service provider. ASFA considers that clarification and guidance is required as to the extent of the due diligence assessment of such matters as the data integrity controls and adequacy of the governance and risk management frameworks of the service provider that the trustee will be required to perform. This may be difficult to do in practice and the cost may outweigh the benefits. As such, we submit that the extent of due diligence should be commensurate with the level of risk involved.

As well, we note that the requirement under sub-paragraph 18(j) to develop contingency plans to enable outsourced business activities to another provider or in-house may be difficult to achieve in practice, especially with respect to administration. Also, contingency plans can become out of date. Guidance material should clarify the linkages between the service provider's Business Continuity Plan (BCP), the RSE licensee's BCP and the RSE licensee's contingency plan.

4.4 The outsourcing agreement

Paragraph 19 requires all outsourcing arrangements to be contained in a legally binding agreement enforceable in Australia and subject to Australian law. It may be difficult, or even impossible, to ensure that an agreement with a foreign service provider be subject to Australian law. In particular, if investment management is considered to be a material outsourced agreement, foreign investment managers, where the RSE licensee's business is only a small proportion of their investment managers business, may well refuse to have their agreement subject to Australian law.

We also note that, in some circumstances, it may be appropriate to have a rolling provision as opposed to an end date.

4.5 APRA access to service providers

Paragraph 23 requires outsourcing arrangements to include the right for APRA to conduct on-site visits to the RSE licensee's service providers. ASFA considers that, if investment management services are considered to be material outsourced arrangements, with respect to most agreements with foreign investment managers, this may be impossible to achieve (especially with hedge funds).

4.6 Offshoring – requirement for consultation

Footnote 7 of draft Prudential Standard SPS 530 Investment Governance states that "[w]here an RSE licensee engages an external service provider for investment activities, the RSE licensee must comply with the requirements in Prudential Standard SPS 231 Outsourcing". Paragraph 27 of SPS 231 states that "[a]n RSE licensee must consult with APRA prior to entering into any offshoring agreement involving a material business activity so that APRA may satisfy itself that the impact of the offshoring arrangements has been adequately address as part of the RSE licensee's risk management framework".

With respect to investment management it is unclear precisely what it is that APRA will be seeking to satisfy itself about, and what expertise APRA will be employing to satisfy itself that the investment management agreement is acceptable to them.

Managing the investment of funds is at the heart of what a superannuation fund trustee does. There is an increasing use of overseas investment managers, especially as the size of the pool of funds under management in Australia is beginning to exceed the value of annual GDP.

For superannuation funds that utilise a number of overseas investment managers, who need to be able change investment managers and move assets quickly, for example to take advantage of a particular investment opportunity, this may prove onerous and a significant impediment to the trustees being able to invest effectively and efficiently. Even where trustees of superannuation funds do not change investment managers frequently, in circumstances where they are entering into a new agreement they need to be able to do so quickly, without being delayed by needing to consult with APRA and await their (implicit) approval.

Accordingly, if investment management is to be considered a material outsourced arrangement requiring compliance with SPS 231, we submit that they should be exempted from the requirement to consult with APRA prior to entering the agreement and replaced with a requirement to notify APRA once the agreement is signed.

Clarification will also be required as to the extent to which a trustee is expected to trace whether a function delegated to an outsourced service provider may be partially, or temporarily, offshored.

4.7 Audit arrangements

Paragraph 33 states that APRA may request the external auditor of an RSE licensee, or an appropriate external expert, to provide an assessment of the risk management processes in place.

Whilst we do not have an issue with the requirement itself, ASFA contends that the ability for APRA to make such a request should only be exercisable when APRA has reasonable grounds to be concerned about the risk management processes that are in place.

4.8 Commencement and transitional arrangements

We believe that clarification is required regarding whether rolling over an existing arrangement, or exercising an option to extend an arrangement, is considered to be entering into a new arrangement. The precise definition of "end date" will need to be clarified.

5 SPS 232 – Business Continuity Management

ASFA is generally comfortable with the requirements in this prudential standard, subject to the following comments.

5.1 The role of the Board and senior management

We believe paragraph 8 in relation to the appropriateness of the RSE licensee's approach to business continuity management (BCM) is open to interpretation by trustees. ASFA's view is that sufficient guidance will need to be provided within the PPG accompanying this prudential standard to assist trustees in complying with this requirement.

5.2 Business continuity planning and reviewing / testing of the BCP

Paragraph 23 and 26 respectively require an RSE licensee to satisfy itself as to the adequacy of an outsourced service provider's BCP and that the outsourced service provider adequately reviews and test its BCP at least annually.

ASFA considers that clarification is required as to how the RSE licensee must satisfy itself that these obligations are being met by the service provider – i.e. is attestation sufficient or is a full review of the service provider's program required?

5.3 Notification requirements

Paragraph 27 requires an RSE licensee to notify APRA of any "major disruption that has the potential to have a material impact on the interests, or reasonable expectations, of beneficiaries or the financial position of the RSE licensee…". We believe this wording could be open to wide interpretation by RSE licensees and, as such, consideration should be given to potentially adjusting the wording slightly to provide trustees with clearer guidance. For example, RSE licensees could be required notify APRA if a threshold stipulated in their BCP is breached.

6 SPS 250 – Insurance in Superannuation

6.1 Interpretation of 'insurance'

As stated in the 'Key recommendations' section of this submission, ASFA disagrees with any proposal that require all insurance offered through superannuation funds to be offered by a life company (for the reasons articulated previously). We believe the potential negative impact on fund members and beneficiaries of this proposed restriction far outweigh any issues it is designed to remedy.

ASFA recommends that the definition of 'insurance' in the prudential standard be amended such that RSE licensees are legally allowed to obtain IP cover from an insurer that is not a life insurer provided that the company is a general insurer authorised under the *Insurance Act 1973 (Cth)*.

6.2 Insurance management framework

ASFA considers that the requirement under paragraph 13 for RSE licensees to ensure all persons in roles relevant to insurance activities are <u>fully</u> aware of the insurance management framework is excessively onerous, particularly given the insurance management framework consists of "the totality of systems, structures, policies, processes and people to manage the offering of insured benefits". For example, there will be administrative or specialist employees (such as claims personnel) who will not require a full understanding of the insurance management framework in order to perform their tasks appropriately.

In our view, the wording in this paragraph should be amended to "An RSE licensee must have in place policies to ensure that all persons in roles relevant to insurance activities… are **appropriately** aware of the insurance management framework **in relation to the insurance activities which those persons are responsible for performing**."

6.3 Maintenance of records

Paragraph 14 requires an RSE licensee to maintain records of sufficient detail regarding claims experience, membership, sums insured and premiums paid in relation to beneficiaries for at least 5 years.

ASFA contends that an RSE licensee should be able to rely on other parties (eg. intermediaries) to maintain records of sufficient detail on their behalf. It should be noted that RSE licensees generally do not hold and maintain these the records at present, and requiring them to do so would be a doubling-up of the record-keeping function with no discernible benefit to members.

RSE licensees should be responsible for aggregating all data and checking its reasonableness as they are the only party that has full visibility of all components (i.e. member data, product history, claims data across multiple insurance partners etc). In short they 'own' all the fund's data.

However, RSE licensees should be able to rely on outsourcing policies with insurers, administrators etc (under the outsourcing prudential standard) to maintain these records on their behalf. RSE licensees should not be required to maintain real-time data but should instead be allowed to update this data fully every, say, 6 months. To ensure RSE licensees are able to achieve this, outsourced providers should be required to provide the relevant data to the RSE licensee on request.

6.4 Insurance policies and agreements

Sub-paragraph 20(k) – "claims cost" is somewhat ambiguous and should be clarified to ensure that it includes the cost of administering, reporting and transacting claims.

6.5 Commencement and transitional arrangements

There appears to be an inconsistency with respect to the commencement date of paragraph 24, which states that:

> "24. An RSE licensee that has been offering insurance benefits other than those permitted by the SIS Regulation must, from the **effective date** [emphasis added], pursue an orderly phase-out of the non-permitted insurance products under a process and timeframe to be agreed with APRA in writing."

We note that the effective date is specified as 1 July 2013.

However, paragraph 23 states that paragraphs 24 to 26 inclusive commence on the **registration date** – i.e. the date of registration of this Prudential Standard on the Federal Register of Legislative Instruments. This seems to contradict the start date within paragraph 24 itself. In order to rectify this inconsistency, we recommend that paragraph 23 should be amended to read as follows: "Paragraphs 25 and 26 of this Prudential Standard commence on…".

As well, ASFA considers that sub-paragraphs 26(a)-(c) should be amended so that they make reference to paragraphs 19 and 20 (not 17 to 20 inclusive). That is, we do not believe paragraphs 17 and 18, which are about the process the RSE licensee undertakes to select of an insurer, should be included as part the assessment the RSE licensee is required to conduct in relation to agreements entered into prior to the registration date.

In addition, we believe the timeframe in which trustees must take reasonable steps to renegotiate the terms of an agreement under sub-paragraph 26(c) is unclear. In our view, consideration should be given to amending wording to:

> "(c) where an agreement does not comply with paragraphs **19 and** 20, take all reasonable steps to renegotiate the terms of the agreement **within a reasonable timeframe** in order to minimise, as far as reasonably practical, any inconsistency between the terms of the agreement and this Prudential Standard".

7 SPS 310 – Audit and Related Matters

7.1 Annual appointment of approved auditor

Paragraph 4 requires an RSE licensee to annually appoint an approved auditor by no later than the last day of each year of income to which the appointment relates. Although this requirement currently exists in the SIS legislation, annual appointment does not happen in practice. An engagement letter is signed each year (which lends support for an annual process), but the actual appointment of the auditor is not done annually. Rather, auditors are usually appointed for a fixed/renewable term (or indefinitely unless the auditor is removed/replaced). ASFA contends that it would not be realistic (and indeed, it would likely be very costly) to require trustees to appoint the auditor annually.

As well, we believe that appointing the auditor on the last day is too late – i.e. accepting an appointment on 30 June would not allow auditors sufficient time to undertake the required planning and pre-work. Typically an auditor commences work (eg. assessing controls, key risk areas etc) much earlier than year-end. We believe the appointment of the approved auditor should take place no later than 60 or 90 days prior to the start of the financial year being audited.

We therefore recommend that the wording in paragraph 4 be amended to "An approved auditor must be in place for each RSE for which the RSE licensee acts as trustee by no later than [60/90] days prior to the start of the year of income being audited."

7.2 Terms of engagement of the approved auditor

Paragraph 6 requires an RSE licensee to set out the terms of the engagement of the approved auditor in a legally binding contract.

Although there is nothing technically wrong in what this paragraph is requiring of trustees, we believe the wording needs a subtle change in focus as it is coming from the wrong direction. In practice, an RSE licensee does not drive the terms of the engagement letter (nor does it have the expertise to do so). Rather, these are driven by the auditor pursuant to the requirements of the auditing standards. That is, the auditor draws up the engagement letter and provides it to the trustee for approval, from which the parties enter into an agreement (legally binding contract).

Therefore, we recommend that the first sentence should be amended to "An RSE licensee must ensure that a legally binding contract is entered into between RSE licensee and the approved auditor which sets out the terms of engagement of the approved auditor."

7.3 Approved auditor being fully informed of all prudential requirements

Paragraph 8 states that an RSE licensee must use all reasonable endeavours to assist the approved auditor in being fully informed of all prudential requirements applicable to the RSE licensee. This is completely unworkable and should be deleted. It is unclear how RSE licensees are supposed to show compliance with this requirement – are RSE licensees expected to run training sessions for auditors?

Also, this requirement is superfluous as it is already covered off under the fit and proper standard – i.e. for an auditor to be fit and proper under the prudential standards, they need to understand the industry in which the entity is operating, which includes being fully informed of all prudential requirements applicable to the RSE licensee.

We therefore recommend that paragraph 8 be removed from Prudential Standard SPS 310.

7.4 Responsibilities of the approved auditor – reporting

Paragraph 22 states that an audit report must be prepared on the basis that APRA may rely upon the report. However, auditors are engaged by the RSE licensee, they are not employed by APRA. That is, sub-paragraph (a) is superfluous (and technically meaningless) since APRA is not party to the auditor's engagement.

Also, auditors are required to prepare their report in the approved form (paragraph 21) and must contain certain information (paragraphs 15-20). Furthermore, auditors are required to be fit and proper and the audit is required to be conducted in accordance with pre-existing auditing standards and their professional obligations.

It is up to APRA to decide whether or not it relies upon the audit report in the performance of its functions. However we do not believe it is necessary to include what is, in effect, a cautionary notice to auditors to do their job properly given the audit and governance related requirements already included in the various prudential standards. Also, we believe it has no place in a prudential standard directed at RSE licensees.

We therefore recommend that sub-paragraph (a) be removed.

7.5 Other responsibilities of the RSE licensee

Paragraph 23 requires RSE licensees to obtain and provide any information and documentation requested by APRA that is relevant to the performance of the auditor's functions. A strict reading of this paragraph would suggest that RSE licensees may be required to obtain the auditor's working papers and provide this to APRA on request. We note that APRA already has the power to obtain the working papers directly from the auditor through the provisions of *Guidance Statement GS 001 – Concise Financial Reports Under the Corporations Act 2001* and the SIS Act. Also, auditors do not generally provide their working papers to clients and, indeed, there may be circumstances under which it may be useful for APRA to obtain a copy of the auditor's working papers directly from the auditor without going through the RSE licensee.

As such, we suggest that paragraph 23 could be amended to specifically exclude the auditor's working papers from information that RSE licensees may be required to obtain.

7.6 Special purpose engagements

Paragraphs 26 to 29 relate to special purpose engagements that APRA may require RSE licensees to establish, which would require the appointment of an approved auditor to provide limited assurance. It should be noted that there are many other circumstances (not just on request from APRA) under which an RSE licensee might appoint an auditor for a special purpose engagement. Furthermore, these special purpose engagements are often not done on a limited assurance basis, but rather on a reasonable assurance basis or under an agreed upon procedures basis.

To make it clear that the requirement in the prudential standard relates solely to special purpose engagements requested or required by APRA, we suggest that the first sentence of paragraph 27 should be amended to: "An auditor appointed **by an RSE licensee on request by APRA** for a special purpose engagement must provide limited assurance on the matters upon which the auditor is required to report…".

For the same reason, the first sentence of paragraph 28 should be amended to: "An auditor appointed for a special purpose engagement **requested by APRA** must submit, within three months…".

7.7 Terminology

The use of "unqualified" in paragraph 19(b) is old terminology and should be changed to "unmodified" in line with the wording in the auditing standards.

Similarly, "qualify" should be changed to "modify" in paragraph 29.

7.8 Audit reports

It is our understanding that ALL audit reports (i.e. not just those relating to the annual return and prudential requirements included as Attachments A and B respectively) are agreed each year by APRA in consultation with representatives of the audit profession. The specific inclusion in the prudential standard of Attachments A and B implies that only certain areas may be subject to consultation going forward.

ASFA's view is that the existing process should continue. That is, the form and content of all audit reports should be agreed each year between the regulator and the audit profession.

8 SPS 510 – Governance

8.1 The role of the Board and senior management

Paragraph 10 requires the Board to ensure that the directors and senior management of the RSE licensee collectively have the full range of skills needed for the effective and prudent operation of the RSE licensee's business operations. Clarification is sought that the term 'senior management' refers to the group of persons identified as being 'senior managers' in paragraph 15 of SPS 520 – Fit and Proper.

Paragraph 10 also requires that each director of the Board has skills that allow them to make an 'effective contribution' to Board deliberations and processes. Clarification is sought on the term 'effective contribution' and specifically whether this is intended to reference the criteria to determine if a responsible person is fit and proper as set out in paragraphs 17 and 18 of SPS 520.

8.2 Board renewal

Paragraph 18 requires RSE licensees to have in place a formal policy on Board renewal and that this policy must include a process for appointing and removing directors. We note that there is no longer a specified maximum term of board tenure, nor a requirement that a Board set a maximum term of Board tenure. ASFA supports this change.

However, we also note that it appears implicit from the language of the paragraph ("provide details of how the Board intends to renew itself in order to ensure that it remains open to new ideas") that the regulator considers that no Board appointment should be open-ended or automatically renewed but rather be part of the annual Board performance assessment process.

Consideration should be given to the inclusion of a clear statement to the effect that a Board renewal policy will need to consider whether maximum terms are appropriate. As it stands, the combination of 'give consideration', 'could or could reasonably' and 'materially' in this sentence (*"The policy must give consideration to whether directors have served on the Board for a period that could, or could reasonably be perceived to, materially interfere with their ability to act in the best interests of beneficiaries"*) results in a requirement that we believe is somewhat opaque.

8.3 Remuneration policy

Paragraphs 23 and 24 deal with situations where performance-based components are an element of a person's remuneration. Clarification is sought as to the applicability of the standard to existing contractual arrangements. Is there an expectation that where employment contracts currently in existence do not permit for 'the Board to adjust performance-based components of remuneration downwards, to zero if appropriate' then such contracts are to be renegotiated so as to provide such a capacity?

ASFA suggests that this should be a prospective requirement. That is, the requirement should be for the remuneration policy to provide that, as new employment contracts are entered into and as existing contracts come up for renewal, their content should be examined to ensure they comply with this requirement.

Paragraph 25 sets out who must be covered by the remuneration policy. Sub-paragraph (a) specifies that the policy must cover all responsible persons, excluding actuaries and approved auditors. In its Response to Submissions, APRA stated that the approach in this standard aligns with CPS 510. We note, however, that the corresponding paragraph in CPS 510 (paragraph 48) excludes non-executive directors. ASFA questions why the SPS 510 does not align with CPS 510 in this regard and suggests that there appears to be no reason why they should not be so aligned.

8.4 Board Remuneration Committee

Paragraph 34 requires the Board Remuneration Committee to have at least three members, all of whom must be non-executive directors.

We note that the draft standard does not specify a minimum Board size or a set minimum number of non-executive directors and suggest that the paragraph 34 requirement be reworded to reflect that situation.

8.5 Board Audit Committee

ASFA notes the changes that require RSE licensees to have a Board Audit Committee as well as the requirements under which the Committee must operate and supports these changes. In particular, we support the capacity for APRA, under paragraph 67, to vary the requirement that all members of the Committee be non-executive directors. This is important for RSE licensees with small Boards.

We also note that the ASX Guidelines recognise that it is not always necessary or efficient to have a separate Board Audit Committee and that there is no mandatory requirement for such outside of the top 300 companies.

ASFA requests that consideration be given to permitting small boards (i.e. those where APRA approves the participation of executive directors on the Board Audit Committee) to meet the Board Audit Committee requirement by including Board Audit Committee subject matter as a discrete item on a Board meeting agenda, and with that part of the meeting being chaired by a non-executive director. Such an arrangement would remove the need for convening separate meetings whilst still ensuring that an objective, non-executive review is undertaken of the effectiveness of the RSE licensee's financial reporting and risk management framework.

8.6 Auditor independence

As stated in the 'Key recommendations' section of this submission, ASFA contends that it would not necessarily be in best interest of the industry, and ultimately members of superannuation funds, to mandate a change of audit partner every 5 years. This audit partner rotation requirement is too restrictive in the context of superannuation fund audits and, as such, we believe paragraph 62 should be removed or substantially modified.

9 SPS 520 – Fit and Proper

9.1 Responsible persons

Paragraph 10 sets out the group of persons considered to be 'responsible persons' for the purposes of SPS 520. ASFA notes that APRA has considered the concerns raised in submissions about the intention to use the broader CPS 520 definition of 'responsible person' but has determined that it considers the CPS definition is appropriate.

ASFA has concerns that implementing the requirements within SPS 520 to this broader group of individuals may be reasonably difficult to implement in the short term for some funds and request that APRA acknowledge these difficulties when carrying out its prudential supervision role.

9.2 Senior managers

Paragraphs 15 and 16 set out the group of persons considered to be 'senior managers' for the purposes of the standard. ASFA supports the definition of 'senior managers' in paragraphs 15 and 16, but we note that there may be wide variation in interpretation across the industry at present.

9.3 Additional criteria applying to approved auditors

As stated in the 'Key recommendations' section of this submission, we believe the requirement for auditors to have a minimum of 5 years' experience in the audit of the business operations of the RSE licensee is too restrictive and would create an artificial barrier to entry – i.e. it would make it difficult for younger audit partners to take over the work from more experienced partners.

ASFA recommends that sub-paragraph (c) be removed from paragraph 20.

9.4 Additional criteria applying to actuaries

Paragraph 18 outlines the criteria for determining whether a responsible person, including a fund's actuary, is fit and proper.

Paragraphs 24 and 25 impose additional criteria for fitness and propriety of an actuary for the purposes of the SIS Act. Specifically, paragraph 25 states that "an actuary must not be an employee of the RSE licensee".

We note that sub-paragraph 26(a) establishes a process for an RSE licensee to seek APRA approval for an actuary to be an employee of the RSE licensee where "the RSE licensee reasonably considers that there are exceptional circumstances".

We draw your attention to the existence of a situation where the actuary of a very large RSE licensee is an employee and note that this situation may not be uncommon.

Given the professional standards that actuaries are subject to, we question the need for the restriction on an actuary being an employee of the RSE licensee and suggest that a sufficient restriction may be a requirement on the licensee to notify APRA where such an arrangement exists.

9.4 Whistleblowing

Paragraph 38 requires the Fit and Proper Policy to include adequate provisions to allow whistleblowing. ASFA notes that many funds already have a published whistleblowing policy and seeks clarification as to whether such a published policy can be incorporated by reference into the Fit and Proper policy or whether physical inclusion is required.

This comment applies also to other areas of the prudential standards where existing policies already exist.

9.5 Informing APRA

Paragraph 45 requires an RSE licensee to provide prescribed information for each responsible person to APRA within 28 days of the application of the prudential standard (i.e. 1 July 2013 for existing RSE licensees).

Clarification is sought as to whether, in the circumstances where such information has already been provided to APRA (and the relevant details remain unchanged), the requirement is to re-lodge the complete information or, alternatively, whether an RSE licensee can simply update the information to include the required details with respect to the additional persons captured under the expanded definition.

10 SPS 521 – Conflicts of Interest

10.1 Role of the Board and senior management

Paragraph 7 sets out a requirement for a Board to have a conflicts management framework. Paragraph 8 states that the framework is the “totality of systems, structures, policies, processes, and controls” that deal with conflicts. ASFA suggests that this wording is excessive and is inflating what is actually needed to properly manage conflicts.

Rather, we would argue that “policies, procedures and controls” (which may in themselves specify what committees, registers and reporting is needed) should be considered to be sufficient for dealing with conflicts. This is particularly so as they are considered to be sufficient for dealing with any other material risk.

ASFA’s view is that conflict management should form a part of a trustee’s risk framework and, as such, we consider that the language in this section should reflect the language of SPS 220 – Risk Management, which talks of the need for a risk management framework that sets out the “policies, procedures and controls” that deal with each material risk (SPS 220, paragraph 15(d)).

10.2 Conflicts management framework

This section sets out the requirements for the structure, content and disclosure of the RSE licensee’s conflicts management framework. In particular, paragraph 17 states that “the RSE licensee must publicly disclose the registers required… on a publicly accessible area of its website or by other appropriate means”. ASFA seeks clarification as to whether ‘other appropriate means’ would include providing information on its website as to how the register may be accessed.

The concern of RSE licensees is not about disclosing the information but rather gaining some insight into who is accessing the information and how the registers may be being used.

10.3 Conflicts management policy

This section sets out a requirement for an RSE licensee to have a Board approved conflicts management policy and for that policy to be publicly disclosed. ASFA notes that while RSE licensees typically already have written conflicts management policies in place, these policies may have to be rewritten to make them suitable for public disclosure.

Whilst we are broadly supportive of the enhanced disclosure requirements stipulated by the prudential standards, ASFA would like to put on the public record that increased public disclosure on websites or through other means will result in funds incurring costs associated with maintaining those documents and websites to ensure the information is current and accurate.

Also, there is likely to be little benefit in disclosing such comprehensive information to members if they are unlikely to understand what it means for them on a practical level. It may be more appropriate (and useful) for funds to provide a cut-down Conflicts Management Statement, consisting of a short (one-page) document outlining the conflicts of interest principles and practices adopted by the RSE licensee.

10.4 Review of conflicts management framework

This section sets out the requirement for an annual review of the RSE licensee's conflicts management framework and for the results of the review to be reported to the Board. In particular, ASFA notes that the requirement in paragraph 21 is for RSE licensees to annually review the conflicts management framework and not the policy. As such, we consider that this requirement is both appropriate and achievable.

11 SPS 530 – Investment Governance

11.1 Investment strategies

Paragraph 5 requires the Board of an RSE licensee to approve an investment strategy for the whole of the RSE and in respect of each investment option offered in the RSE. The investment strategy for "whole of RSE" is really a combination of the investment strategy of each option and the funds invested in each option. Therefore the Board's approval of a "whole of RSE" investment strategy can only be a generic, high level statement which will be different to the investment strategies for each individual option.

11.2 Investment governance framework

The definition of investment risk within the investment governance framework (paragraphs 8 & 10) should be made prospective. That is, monitoring "all sources" of investment risk is not a reasonable expectation of an RSE licensee. The requirement to manage "all sources of investment risk" leaves the RSE open to a legal responsibility which is too wide. ASFA suggests that the words "all sources" be removed from paragraph 8 and after "investment risk" add the words "where the investments of an investment option may perform differently to the objectives for that investment option".

Paragraph 13 requires separation of roles between persons responsible for monitoring investments and implementing investments. ASFA notes that the separation of monitoring and implementing investments is problematic for the widely used Implemented Consulting model, which has no division of such responsibilities. In-house investment teams would also face similar problems with this standard. The "monitoring" role needs to be defined for these situations. The interpretation of the paragraph is that the RSE licensee must have its own independent monitoring function as well as being satisfied with the external managers' monitoring function. ASFA would prefer a more generic statement about adequate separation of monitoring and implementation duties.

11.3 Investment objectives

Paragraph 14 requires RSE licensees to take into account certain considerations when formulating investment objectives for each investment option. We support the need for RSE licensees to consider the factors set out in paragraph 14. However, ASFA considers that the increased burden placed on RSE licensees by the expanded covenants in section 52 of SIS highlights the need for trustees to be able to rely, to some extent, on the information provided by fund managers in meeting these requirements.

The practicality of satisfying the obligations in an efficient and timely manner means trustees should be able to rely on certain information obtained from investment managers rather than expecting RSE licensees to investigate each and every piece of information provided by each investment manager in respect of each investment option.

ASFA view is that certain basic information provided by an investment manager to the RSE licensee as to the investment manager's compliance with SPS 530, certified by an independent auditor, should be able to be relied on by an RSE licensee without the need for the RSE licensee to conduct unreasonably burdensome expensive and independent investigations.

We note that, where an RSE licensee receives such information from an investment manager, it still has a duty to consider the information with respect to each investment option and strategy. To simply have received the information is not sufficient – there must be some evidence of consideration and of regular review. However, provided the selection and monitoring of the investment manager has been conducted in accordance with the RSE licensee's outsourcing policy and the requirements of Prudential Standard SPS 231 – Outsourcing, we believe the RSE licensee should be able to rely on the information.

Our view is that the implementation of a regime of this nature will require APRA to make provision for it either in the prudential standards themselves or within the Prudential Practice Guides (PPGs) to be released later this year / next year in support of the prudential standards.

11.4 Diversification for each investment strategy

Paragraph 14 requires RSE licensees to take into account certain considerations when determining an appropriate level of diversification for each investment strategy. ASFA considers that “appropriate levels of diversification" are very complex issues that RSE licensees would find difficult to specify. It is unclear if APRA requires funds to focus on "risk factors" or "risk exposures"?

Forecasts of these variables and inter-relationships have not been very accurate in the past despite the huge industry and academic research effort. Realistically, RSE licensees would have to outsource these forecasts to expensive specialists who take no responsibility for the accuracy of their intellectual property anyway.

Also, “appropriate levels of diversification” could pose an issue in circumstances where the RSE licensee is required to invest as per the terms of the trust deed (eg. investment in life policies may be a requirement) and, as a result, it may not be possible to diversify the relevant investment in such circumstances.

11.5 Stress testing

Paragraphs 17 and 24 require RSE licensees to determine and undertake appropriate stress testing based on a range of factors prior to implementing an investment strategy. ASFA supports this requirement, however the term “comprehensive” in paragraph 24 is unrealistic and should be amended to “appropriate” in line with sub-paragraph 17(a).

11.6 Asset allocation targets and ranges

Paragraph 18 states that an RSE licensee must, at a minimum, include in each investment strategy that includes multiple assets and/or asset classes, appropriate asset allocation targets and ranges. We question the appropriateness of this requirement given that many funds have moved away from the strategic asset allocation convention using market benchmarks and narrow ranges which is implied in the paragraph. ASFA considers that the reference to "targets" in sub-paragraph (a) should be removed as many funds use more dynamic asset allocation processes.

Also, in sub-paragraph (b) the use of a rebalancing policy to "correct" deviations reflects too much reliance on optimisation/mean variance analysis. In contrast, paragraph 27 implies a more dynamic approach.

11.7 Giving effect to the investment strategy

Paragraph 20 requires an RSE licensee to have processes and criteria for selecting each investment and to ensure that effective due diligence is undertaken prior to the selection of an investment. It is unclear whether this requirement intended to apply to the selection of each individual investment or each individual investment manager. Similarly, it is unclear whether this paragraph is intended to apply to the due diligence process for selecting investment managers or to in-house teams selecting individual investments. ASFA's view is that this requirement should only apply to the selection of an investment manager (not to the selection of the individual investments), otherwise there is the potential for RSE licensees to undermine the expertise of investment managers (with possible detrimental effects for fund members).

Also, we suggest that the words “will perform” in sub-paragraph 21(a) should be replaced with “is expected by an RSE licensee to perform”.