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5 March 2013

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Dear Mr Grummitt,

Discussion Paper: Prudential guidance for superannuation

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to the discussion paper “Prudential guidance for superannuation” released by the Australian Prudential Regulation Authority (APRA) on 11 December 2012 and the accompanying suite of draft prudential practice guides (PPGs).

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

We note that the initial set of prudential practice guides focus on what APRA consider to be the areas most important for MySuper authorisation: governance, fit and proper, conflicts of interest, investment strategy, risk management, insurance, operational risk financial requirement, outsourcing and business continuity management.

ASFA is in agreement with this focus and commends APRA on the efforts made to give these particular matters priority.

In various places the PPGs use terminology such as ‘APRA expects’, ‘it would be prudent practice’, ‘best practice’ or ‘the following would normally be applied’. The use of such terminology would appear to be somewhat inconsistent with the statement in section 2.1 of the Discussion Paper that “PPGs do not contain enforceable requirements”.

ASFA has interpreted the use of the above words as signifying:

- There are certain matters on which APRA has strong views and would perhaps have liked to have seen included in the prudential standards but, for a range of reasons (including industry views), has decided it is more appropriate to incorporate them into the PPGs.
- There is both an internal and an external audience for the PPGs. PPGs provide guidance to both the industry and APRA staff. To this extent, RSE licensees can expect APRA frontline supervisors to take a particular interest in matters where the above terminology is used.

With respect to those matters where the words ‘APRA expects’ are used, ASFA’s view is that, as there are no enforceable requirements, where an RSE licensee’s process does not accord with the APRA expectation, it should be sufficient for an RSE licensee to be able to evidence:

- an acknowledgment and consideration of the APRA expectation; and
- an alternative justified position.

An example of this is contained in SPG 510 – Governance at paragraph 25:

“At a minimum, APRA expects the Board assessment would ordinarily be undertaken by an external party at least every three years.”

In ASFA’s view, an RSE licensee should be able to have a less frequent external review process, but at the same time do so with the expectation that APRA, as the prudential regulator, will ask it to demonstrate the due consideration it has given to the decision on the frequency of the external review and the variance from the PPG and to have processes in place to reconsider/review the appropriateness of the departure from the regulator’s expectation.

Recommendation

ASFA recommends that a new section be included in each PPG setting out APRA’s expectation regarding an RSE licensee’s use of the PPG and how the RSE licensee should interpret terminology which indicates that APRA has a firm view on a particular matter.

* * * *

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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

A handwritten signature in blue ink, appearing to read 'Fiona Galbraith', is positioned above the printed name.

Fiona Galbraith
Director, Policy

Submission

Discussion Paper: Prudential guidance for superannuation

5 March 2013

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Key recommendations

ASFA has made a range of recommendations in this submission in relation to each of the draft superannuation prudential practice guides. However, there are four key issues which we believe are the most important and are discussed below.

1 **Insurance arrangements [SPG 250]**

The reference to “insurance arrangements” in paragraph 40 of SPG 250 – *Insurance in Superannuation* in terms of the various matters that APRA expects should be included in RSE licensees’ insurance arrangements is problematic in that “insurance arrangements” is defined in paragraph 18 of SPS 250 as essentially being the contract of insurance issued by the insurer (where insurance is acquired from an insurer). That is, any items that must be addressed in the insurance arrangement (i.e. insurance contract) are already listed in paragraph 19 of SPS 250.

However, by virtue of the comprehensive lists of items listed in paragraph 40 of SPG 250, it appears as though this paragraph 40 is attempting to add to the list of items that should also be included in an insurance contract. If this is the case, the relevant items should be stripped out of paragraph 40 and included under paragraph 19 of SPS 250.

In any event, some of the items listed under paragraph 40 of SPG 250 are not currently contained in insurance contracts (and arguably should not be), including:

- underwriting requirements [40(a)]
- decisions relating to a reduction in benefits and premium loadings [40(b)]
- when claims will be admitted or denied [40(c)]
- procedures for deducting premiums from beneficiaries’ accounts and paying premiums to insurers [40(d)]
- aggregate claim limits [40(f)]
- return-to-work and rehabilitation policies [40(h)].

Furthermore, sub-paragraphs 40(i) and 40(j) of SPG 250 overlap with the requirements of paragraph 19(l) of SPS 250 in relation to the need for the insurance contract to contain liability and indemnity arrangements.

Recommendation

ASFA’s view is that, either paragraph 40 of SPG 250 should be deleted entirely or the focus of the paragraph should be altered to specify the items that should be **considered** by trustees (as opposed to listing further items that should be included in the insurance contract). However if paragraph 40 is to be retained, we believe it should make reference to something other than the “insurance arrangements” (eg. possibly to the trustees’ “insurance documentation” which would be broader than just the insurance policy document/contract).

2 Board committees [SPG 510]

Paragraphs 13 – 16 of SPG 510 – *Governance* deal with the formation of Board committees.

Unanswered is the question as to whether non-directors can be appointed to a Board committee. There is a view that the appointment of non-director members to Board committees would bring skills and insights to the committee’s tasks that would augment directors’ skills. ASFA’s view is that such committees should not be limited solely to Board members.

Recommendation

ASFA recommends that the section on Board committees be reviewed such that clearer direction is provided on the appointment of non-directors to Board committees.

3 Board performance assessment [SPG 510]

Paragraphs 22 – 26 of SPG 510 – *Governance* deal with the assessment of the performance of individual directors and the board as a whole. Specifically, paragraph 25 states that APRA expects, at a minimum, there will be an assessment of Board performance by an external party at least every three years.

ASFA considers that the wording indicates that three years is the maximum acceptable timeframe and that, in certain circumstances, a more frequent assessment may be required. That is, that APRA will take action where the external Board assessment process is less frequent. ASFA considers that the emphasis should be on the process and its adequacy, not the frequency and that it may be open to a board to consider the matter and formulate and document a policy of less frequent reviews (where the RSE licensee considers it appropriate).

ASFA considers that a more appropriate wording for the final sentence of paragraph 25 would be:

“APRA expects that a Board assessment would be undertaken by an external party on a regular basis and that Boards give active consideration to the frequency with which such reviews are undertaken. As a guide, APRA recommends at least three yearly reviews.”

Recommendation

ASFA recommends that the wording of paragraph 25 be revised to remove the inference that external Board reviews conducted on a frequency of more than 3 years are unacceptable to APRA.

4 Offshoring [SPG 231]

Paragraph 33 of SPG 231 – *Outsourcing* states that, as a requirement under SPS 231, an RSE licensee must consult with APRA prior to entering into offshoring agreements. Whilst we agree this requirement is appropriate for most of the material business activities that an RSE licensee decides to offshore (eg. administration), we question the appropriateness of this provision in relation to investment management.

Managing the investment of funds is at the heart of what a superannuation fund trustee does and there is an increasing use of overseas investment managers. Funds need to be able to change

investment managers and move assets quickly, for example to take advantage of a particular investment opportunity. The very nature of investment management agreements is different to all other outsourcing agreements. Prior consultation with APRA in each and every instance would be unduly onerous and a significant impediment to the trustees being able to invest effectively and efficiently. Trustees need to be able to change investment managers quickly, without being delayed by needing to consult with APRA.

The guide states that “[t]his prior consultation is intended to provide an opportunity for APRA to review the **RSE licensee’s assessment of offshoring risks**, and the **processes and controls introduced to mitigate them**” (emphasis added). Given that the review is of the RSE licensee’s risk assessment, controls and mitigation processes – and is not an approval of the individual offshoring arrangement – with respect to investment management agreements it should be sufficient for APRA to review the RSE licensee’s risk management framework with respect to offshoring investments prior to their first investment offshore but not with respect to each and every subsequent change.

Recommendation

ASFA recommends that, with respect to investment management agreements, the guidance be expanded to state that it is sufficient for APRA to review the RSE licensee’s risk management framework with respect to offshoring investments prior to their first investment offshore but not with respect to each and every subsequent change.

Detailed recommendations

1 SPG 114 – Operational Risk Financial Requirement (ORFR)

1.1 ORFR target amount in relation to different investment structures

Paragraphs 15 and 16 state that, where the assets of an RSE licensee’s business operations are fully invested in the assets of another related APRA-regulated entity (eg. PST or a life insurance policy) that is also covered by an ORFR target amount, the RSE licensee may consider the impact of any duplication of financial requirements when determining its ORFR target amount.

The RSE licensee can only partially offset its ORFR target amount in such an arrangement as there are still likely to be differences in the operational risk profiles between the two entities as well as additional risks resulting from transactions between the two entities. We believe the ability for RSE licensees to partially offset their ORFR target amount in such circumstances is appropriate.

However, ASFA questions why this ability to offset its ORFR target amount is only available to in situations where the investment is specifically with **related** APRA-regulated entities. In ASFA’s view, this ORFR target amount offset provision should be available in respect of investments held with any APRA-regulated PSTs/life companies, not just those that are related entities. Many funds invest in PSTs – both related and unrelated. Since PSTs already have to establish and maintain their own ORFR target amount, why can’t all funds use this offset provision? To limit this offset provision to related entities would, in our view, create an unlevel playing field, whereby RSE licensees could be incentivized to invest in related PSTs/life companies (where they can offset their ORFR target amount) rather than in unrelated PSTs/life companies (where they cannot).

Recommendation

ASFA recommends that the requirement be amended such that the ORFR target amount offset provision should be available in respect of investments held with any APRA-regulated PSTs/life companies, not just those that are related entities.

In addition, we question why this ORFR offset provision is only available where funds are **fully** invested in a (related) PST of life office. What about a partial investment in a PST, which is a common arrangement for many superannuation funds? We believe RSE licensees should have the ability to offset their ORFR target amount for partial investments in entities that are themselves required to establish and maintain their own ORFR target amount, albeit the size of the offset available would be smaller for partial investments.

Recommendation

ASFA recommends that RSE licensees be allowed to offset their ORFR target amount for partial, as well as full, investments in entities that are themselves required to establish and maintain their own ORFR target amount.

2 SPG 220 – Risk Management

2.1 General comment – provision of examples

As a general comment, feedback received from ASFA members is that SPG 220 is considered to be a useful guidance document for RSE licensees. It is appreciated that risk management is a vital feature of any prudential oversight, and ASFA’s members are supportive of the higher standards being set here. Nevertheless, and without seeking to back away from any of the requirements, a common theme to the feedback from our members is that the behaviour and level of analysis of risk suggested in the guide would be better supported by more examples of exactly what APRA expects.

Notwithstanding the comment at the beginning of the PPG that not all practices outlined in the guide will be relevant for every RSE licensee and that some aspects may vary depending on size, business mix and complexity of the RSE licensee’s business operations, ASFA recommends that the PPG should better articulate APRA’s expectations especially in regards to small and medium sized superannuation entities who, in the main, have smaller teams of specialists available.

Instances of where examples are provided in the draft PPG that are considered to be particularly useful include:

- *Risk Tolerance*: paragraph 32
- *Controls and Mitigation - Control approaches*: paragraph 47
- *Incident management*: paragraph 53
- *Information systems for reporting*: paragraph 57

In our view, additional areas within the PPG where the inclusion of examples would be useful include:

- *Material risks*: paragraph 12 – An indication of the depth of the analysis an RSE licensee should undertake in contemplating and documenting contagion risks would be useful.
- *Risk appetite statement*: paragraph 21 – Examples of what should be included and guidance as to how granular the information should be would be of value.
- *Risk appetite statement*: paragraph 24 – Could include examples of the evidentiary requirements that APRA would consider appropriate.
- *Risk transfer*: paragraph 49 – The statement half-way through the paragraph “APRA also expects an RSE licensee would consider uncertainties such as timeliness” needs fleshing out insofar as how much detail APRA requires as evidence that the trustee is addressing this issue.
- *Risk transfer*: paragraph 50 – The need to consider the risk mitigants and controls service providers have requires further explanation insofar as the depth of analysis that is required and the evidentiary requirements that APRA would consider appropriate to demonstrate that such analysis has occurred.

Recommendation

ASFA recommends that consideration be given to including useful examples with respect to paragraphs 12, 21, 24, 49 and 50.

2.2 Risk tolerance

Paragraph 32 states that:

“Examples of different forms of risk tolerances and risk limits include, but are not limited to:

- (a) a loss of no more than x per cent of members in a rolling 12-month period;*
- (b) **zero tolerance for a MySuper product delivering net investment returns (post-tax) in the bottom x per cent of all MySuper products over a 10-year timeframe; and***
.....” (emphasis added)

Concern has been expressed by our members that the use of such language as “zero tolerance”, particularly in relation to investment returns, is inappropriate.

Recommendation

Although we recognise that this is only an example provided to assist trustees, nevertheless ASFA recommends that consideration be given to rewording paragraph 32(b) with a view to ‘softening’ the tone whilst still providing a useful example for RSE licensees.

3 SPG 231 – Outsourcing

3.1 Materiality

Paragraph 5 uses the phrase “contractor relationship” to describe the types of activities, including those described in this paragraph, that are not subject to the materiality test. ASFA considers that this term may not adequately capture the distinction, as all outsourced activities will be under some form of contract or other. We also query the appropriateness/relevance of the number of service providers and the duration of the agreement. While the ease and cost of switching is pertinent, we believe the term of the agreement and the number of providers (within reason) are significantly less so.

Paragraph 7 sets out APRA’s view that the use of advisory services would not normally constitute a material business activity. The last sentence of this paragraph notes that there may be circumstances under which it would be considered that an advisory or professional service falls within the definition of a material business activity. Paragraph 3 states that SPS 231 only applies to arrangements to outsource material business activities. Outsourcing is defined in paragraph 2 as being with respect to a business activity that is a function or responsibility of an RSE licensee. It is not apparent how advisory or professional activities could fall under this definition. In particular, it is unclear what is meant by the example of “an RSE licensee **mak[ing] material use** of actuarial services for consulting and/or other purposes” (emphasis added).

Recommendation

ASFA recommends that the last sentence of paragraph 7 be reviewed with a view to it being deleted.

3.2 Factors to consider when entering into outsourcing arrangements

This section deals with the range of matters than an RSE licensee should consider when entering into an outsourcing arrangement. In paragraph 13, the word “benchmark” is qualified by the potentially confusing word “default”. It appears to be specifying a positive benchmark which has to be reached which would be actively negotiated, agreed upon and specified in the agreement. Failure to meet the benchmark would signify that the provider has “defaulted” on the agreement. Given that “default” has a double meaning however, using it to qualify the word “benchmark” is potentially confusing. Further, service levels are often specified in the head agreement and not a separate service level agreement.

Recommendation

ASFA recommends that the paragraph be review with a view to either removing the word ‘default’ or using another descriptor.

The final sentence of paragraph 15 makes reference to an “annual review” of the service provider’s internal control systems by an independent expert and states that consideration of this would be normal. While for an outsourcing arrangement, such as administration or custodian services, this may be justified, for a number of other arrangements this would be excessive.

Recommendation

ASFA recommends that the paragraph be reviewed with a view to providing further guidance as to the circumstances where such a review is, and is not, usual practice.

Paragraph 16 deals with the SPS 231 requirement that business continuity management arrangements be included in the outsourcing agreement and sets out APRA's view as to what these arrangements should achieve. The final sentence deals with an outsourced service provider's subcontracting arrangements. ASFA is concerned that extending the reach to sub-contracting may potentially compromise the RSE licensee's ability to be able to recover damages from the service provider.

Recommendation

ASFA recommends that the last sentence of paragraph 16 be reconsidered with a view to it being removed.

As with paragraph 13, paragraph 17, uses the expression "default arrangements".

Recommendation

ASFA recommends that the paragraph be review with a view to either removing the word 'default' or using another descriptor.

Paragraph 21 addresses the requirement of SPS 231 that the outsourcing agreement must address liability and indemnity issues. The final sentence of paragraph 21 states that "... consideration would usually be given to the extent of liability to both the RSE licensee and service provider in relation to subcontracting arrangements". ASFA considers that as a matter of general principle and at law the service provider should be wholly liable with respect to sub-contracting arrangements.

Recommendation

ASFA recommends that the last sentence of paragraph 21 be reconsidered with a view to it being removed.

Paragraph 22 deals with the need for an RSE licensee to consider obtaining legal advice in assessing the agreement. ASFA finds unclear, in the context of outsourcing, the reference to "ensur[ing] that there are no legal impediments to APRA's access to ... relevant persons employed by the RSE licensee".

Recommendation

ASFA recommends that the paragraph be reworded with a view to making clearer its intent.

Paragraph 24 details APRA's expectation where an RSE licensee is deciding to renew an existing outsourcing contract. ASFA considers that while it may be ideal to subject the renewal of an existing outsourcing agreement to the same level of scrutiny as the decision to enter into a new agreement, such an expectation may be unrealistic as it implies, for example, that if a full tender were conducted for the initial agreement then another full tender would need to be performed with respect to the renewal, when the RSE licensee simply "testing the market" may be sufficient.

Recommendation

ASFA recommends that, in light of the above comments the wording of this paragraph be reviewed to provide clearer guidance.

3.3 Subcontracting

Paragraph 25 expands on the SPS 231 requirement that an RSE licensee is required to address any sub-contracting in the outsourcing agreement with the service provider, and states that typically this would extend to including specific rules on, or limitations to, such arrangements.

Concerns have been expressed by ASFA members that, by providing for sub-contracting in the agreement, this may potentially compromise the RSE licensee's ability to recover from the service provider who, in the absence of any provisions, is ultimately liable for the provision of services and for the conduct of any sub-contractor.

Recommendation

ASFA recommends that a review of this paragraph be undertaken that considers the above concerns.

3.4 Custody agreements

Paragraph 32 sets out APRA's expectation that a custody agreement would clearly address the use and potential use of sub-custodians, stating that "... a prudent RSE licensee will ensure that the custody agreement clearly addresses the use, and potential use, of sub-custodians".

As per the previous comment in 3.2 above with respect to paragraph 16, members of ASFA have raised a concern that, if the custody agreement were to address the use of sub-custodians, this may serve to compromise the RSE licensee's ability to recover damaged from the custodian.

Recommendation

ASFA recommends that, in light of the above comments the wording of this paragraph be reviewed to provide clearer guidance.

3.5 Offshoring

This section of the SPG deals with the SPS 231 requirement that an RSE Licensee consult with APRA prior to entering into offshoring agreements. Whilst this is an acceptable requirement for most functions, ASFA considers that, as stated in the 'Key recommendations' section of this submission, funds need to be able change investment managers and move assets quickly, for example to take advantage of a particular investment opportunity.

Prior consultation with APRA in each and every instance where an overseas investment manager is employed may be unduly onerous and create a significant impediment to the trustees being able to invest effectively and efficiently.

Given that the review is of the RSE licensee's risk assessment, controls and mitigation processes – and is not an approval of the individual offshoring arrangement – ASFA contends that, with respect

to investment management agreements, it should be sufficient for APRA to review the RSE licensee's risk management framework with respect to offshoring investments prior to their first investment offshore but not with respect to each and every subsequent change.

Recommendation

ASFA recommends that, with respect to investment management agreements, the guidance be expanded to state that it is sufficient for APRA to review the RSE licensee's risk management framework with respect to offshoring investments prior to their first investment offshore but not with respect to each and every subsequent change.

4 SPG 232 – Business Continuity Management

The contents of SPG 232 are largely as we would expect and generally appropriate in terms of the level of guidance provided to trustees. ASFA is therefore generally comfortable with SPG 232, with only the following comments for consideration.

4.1 Whole-of-business approach to BCM

Paragraph 3 provides useful examples of some of the business operations for which RSE licensees should consider Business Continuity Management (BCM).

We believe that paragraph 3 should reflect the fact that there are bodies of knowledge available to assist businesses in determining appropriate measures for BCM. To provide greater assistance to RSE licensees, consideration could be given to the possibility of mentioning, within the PPG, other useful publications including:

- Business Continuity Institute (BCI) Good Practice Guidelines;
- Standards Australia HB 221;
- AS/NZS 5050 “Business Continuity – Managing disruption-related risk”; and
- ISO 22301 “Societal security - Business continuity management systems – Requirements”.

These documents, and others, are relatively useful in providing a common understanding and definition of BCM and would be more useful beyond SPG 232 alone. Specifically, there are some good definitions of business continuity and a number of other terms used in the PPG.

Recommendation

ASFA recommends that consideration be given to amending the PPG to include references to other useful BCM related publications, such as those listed above.

4.2 Alternate site

The wording in sub-paragraph 23(f) could possibly be made a little clearer. For example, “whether the site is geographically disparate enough from primary operational site so as not to be impacted by likely continuity scenarios, including considerations around whether the alternate site and the primary operational site share the same power grid, telecommunications network or other physical infrastructure”.

Recommendation

ASFA recommends that, for the purposes of greater clarity, consideration should be given to amending sub-paragraph 23(f).

5 SPG 250 – Insurance in Superannuation

5.1 Insurance for choice members

For clarity and correctness, the wording in paragraph 3 in respect of default life and TPD insurance should be amended from “... and to offer them to choice members” to “... and may offer them to choice members”.

Recommendation

ASFA recommends that the wording in paragraph 3 be amended as outlined above.

5.2 Insurance management framework

Paragraph 8 outlines the risks that would normally be dealt with in the RSE licensee’s policies relating to the management of insured benefits. With respect to sub-paragraph 8(a), in addition to the risks relating to the appropriate transfer of insurance risk to another insurer, we believe the RSE licensee’s policies relating to the management of insured benefits should also deal with risks relating to changes of the fund’s insurance offering with the incumbent insurer.

Recommendation

For completeness, sub-paragraph 8(b) should be expanded to “... holding **or having access to** adequate data...”. Also, our view is that sub-paragraph 8(e) should be amended to “risks relating to the due diligence **in selecting** an insurer”.

Recommendation

In addition to the 5 sub-paragraphs (a) – (e), we recommend the following sub-paragraphs be added to paragraph 8:

- (f) risks involved in deducting and remitting premium amounts; and
- (g) risks associated with member communications not accurately reflecting the terms of the insurance policy.

5.3 Management of insured benefits

Paragraph 11 discusses the approach RSE licensees should adopt in relation to the management of insured benefits.

Recommendation

ASFA’s view is that the second sentence in this paragraph should be amended slightly to “An RSE licensee would instead be expected to have an understanding of the underwriting and claims processes of the insurer **and the administrator...**”.

Recommendation

In relation to paragraph 12, ASFA recommends the last sentence be amended (for simplicity) such that the words “outcome of requests for” are deleted.

5.4 Data management – claims experience

Paragraph 14 states that SPS 250 requires an RSE licensee to maintain records of at least 5 years' duration about the claims experience for each RSE within its business operations. ASFA contends that this requirement should be clarified to state that the claims that trustees need to maintain for at least five years' duration should be in respect of claims **incurred** (as opposed to claims received/notified in the last five years that relate to claims incurred a long time ago).

Also, it is important to note the importance of maintaining records other than just claims experience – eg. premiums received, terms altered, underwriting information etc.

Recommendation

ASFA recommends that paragraph 14 be amended to clarify that the claims that trustees need to maintain for at least five years' duration should be in respect of claims incurred.

Paragraph 16 lists the claims experience information that an RSE licensee would ordinarily maintain.

Recommendation

To be truly helpful to trustees in terms of providing guidance on the claims experience information they should maintain, our view is that the introductory paragraph wording should be amended from "... would ordinarily maintain" to "... should use their best endeavours to maintain" and the list of items should be broken up into 2 categories in the form of a table:

- (a) information that should be maintained for insurance selection purposes; and
- (b) information maintained for alignment with the insurance strategy.

The table could also specify which items must be maintained vs which items it is recommended to maintain.

Recommendation

For completeness, and to ensure the same information is maintained by all funds, the following items should be added to the list of claims experience info a trustee would ordinarily maintain:

- cause of claim (eg. suicide, cause of TPD etc);
- sum insured;
- monthly IP benefit;
- period of payment (IP);
- status of claim (pending, withdrawn etc).

Also, based on feedback from members of ASFA's Insurance sub-committee, ASFA recommends that the dates that payments start for each IP claim should be removed from the list.

Recommendation

Paragraph 16(d) in our view should be split into 2 parts: general insurance information (eg. PDS information) that should be disclosed to members on taking up cover; and loadings/exclusion information which also needs to be maintained by the fund.

Recommendation

ASFA recommends that paragraph 16(e) be clarified as to whether disputed claims refer to disputes between the trustee and the member or the trustee and the insurer.

We have drafted an amended version of paragraph 16 for APRA's consideration, with the additional items and suggested changes incorporated therein, and presented in the table format discussed above (attached as **Appendix A** to this submission).

5.5 Insurance strategy

Paragraph 23 outlines the considerations that an RSE licensee's insurance strategy would ordinarily include.

Recommendation

Our specific recommendations with respect to the various sub-paragraphs are as follows:

- 23(a) should be amended to "which beneficiaries are to be provided with insured benefits **and at what level**, including...".
- 23(c) should be clarified to "the circumstances under which members' eligibility for insurance cover would cease" (i.e. this item should be about trustees high-level strategic considerations about members' eligibility for cover as opposed to the particular terms of their insurance contract(s)).
- 23(e) should be amended to "administrative capabilities, including ease of underwriting and claims processes".
- In sub-paragraph 23(f) the word "beneficiaries" should be replaced with "members" as beneficiaries is too broad in the context of preserving individuals' insured benefits in the situation of a successor fund transfer.

5.6 Selection of insurer

Paragraph 32 discusses what APRA considers good practice in relation to the provision of information to prospective insurers as part of a selection or tender process.

Recommendation

In ASFA's view, the last sentence should be amended to "... APRA considers it sound practice for the RSE licensee to provide the same information to all prospective insurers **at the same time.**" This will help to ensure there is a level playing field between tendering insurers and would avoid any potential preferential treatment, whereby an important piece of information is provided to one or more insurer much later than other insurers.

Paragraph 34 outlines the important factors (other than cost) that RSE licensees should consider as part of the selection process.

Recommendation

ASFA recommends that sub-paragraph 34(d) be amended to “the insurer’s long term viability or sustainability **and financial strength**”.

Paragraph 35 discusses the various factors that an RSE licensee could consider in order to form a view regarding the sustainability of a prospective insurer and the insured benefits to be provided. With respect to sub-paragraph 35(a), ASFA questions how an RSE licensee would know the prospective insurer’s access to capital and whether it is in fact APRA’s role to determine this. If it is to be responsibility of the RSE licensee, how far beyond asking the question do they need to go in order to form a view on whether an insurer has sufficient access to capital?

Recommendation

ASFA’s view is that the wording around this sub-paragraph needs to be expanded to provide greater clarification to RSE licensees in relation to their expected obligation around assessing a prospective insurer’s access to capital.

Recommendation

ASFA also recommends that sub-paragraph 35(c) be amended to “any additional risks that may be involved in increasing benefits made available to beneficiaries (e.g. life-style increase options **and increases in automatic acceptance limits**)”, since increases in AALs have the potential to pose significant risks (and they occur relatively frequently).

The relevance of paragraph 38 to the selection of an insurer is unclear.

Recommendation

Our view is that paragraph 38 could be deleted.

5.7 Insurance arrangements

As stated in the ‘Key recommendations’ section of this submission, ASFA contends that the number and nature of items listed in paragraph 40 that should be included in “insurance arrangements” is problematic in that “insurance arrangements” are defined in SPS 250 as essentially being the contract of insurance issued by the insurer (where insurance is acquired from an insurer) – yet many of the items listed in paragraph 40 are, in our view, not appropriate to include in an insurance contract.

Recommendation

ASFA recommends that, either paragraph 40 of SPG 250 should be deleted entirely or the focus of the paragraph should be altered to specify the items that should be **considered** by trustees (as opposed to listing further items that should be included in the insurance contract). However if paragraph 40 is to be retained, we believe it should make reference to

something other than the “insurance arrangements” (eg. possibly to “insurance documentation” which would be broader than just the insurance policy document/contract).

5.8 Service levels

Paragraph 41 lists the service levels that would typically be outlined in an insurance arrangement between the RSE licensee and the insurer.

Recommendation

In addition to the 4 sub-paragraphs (a) – (d), we believe the following sub-paragraphs should also be added to paragraph 41:

- (e) processing the assessment of claims; and
- (f) the provision of current member data to the insurer.

6 SPG 510 – Governance

6.1 Composition of the Board

Paragraphs 5 – 10 deal with the composition of the Board. Paragraph 5 makes reference to the term ‘independent director’ and its specific applicability to the SIS Acts equal representation requirements.

Paragraph 6 introduces the term ‘non-affiliated director’ with respect to non-equal representation Boards. ASFA is concerned at the introduction of another definition with respect to a person ‘who is free from any business or other association that could materially interfere with the exercise of their independent judgment’.

Recommendation

ASFA recommends that additional wording be included to inform the reader of why the use of a term such as a ‘non-affiliated director’ is required.

ASFA is also concerned that the emphasis in this section on ‘independent’ and ‘non-affiliated’ may distract Boards from the key issue of ensuring that Board appointees possess the necessary skills and expertise to competently undertake the role of a Trustee Director.

ASFA considers it a fundamental duty of a trustee to put the interest of beneficiaries before their own personal interest or the interest of others. To improve the balance in the section, ASFA suggests that this concept of a trustee’s duty be given prominence.

Recommendation

ASFA recommends that paragraphs 5 – 10 be reviewed with a view to:

- addressing the imbalance between the need for independence and the perhaps more important task of ensuring the competency of individual appointees; and
- giving prominence to ensuring that trustees fully understand the basic trustee duty.

6.2 Board committees

As stated in the ‘Key recommendations’ section of this submission, ASFA contends that Board committees should not be limited solely to Board members. In our view, the appointment of non-director members to Board committees would bring skills and insights to the committee’s tasks that would augment directors’ skills.

Recommendation

ASFA recommends that the section on Board committees be reviewed such that clearer direction is provided on the appointment of non-directors to Board committees.

6.3 Board Risk Committee

Paragraph 19 identifies as a responsibility of the Board Risk Committee the review of the risk management framework of the RSE licensee. However there is no specific mention of a requirement to review the entity's compliance with regulatory requirements. Is there an assumption that regulatory compliance is a sub-component of the risk management framework?

Recommendation

ASFA considers that, as non-compliance with regulatory requirements poses significant risk for an RSE licensee, the topic should be considered for separate mention.

6.4 Board Remuneration Committee

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

Recommendation

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.

6.5 Board performance assessment

Paragraph 25 states that APRA expects, at a minimum, there will be an assessment of Board performance by an external party at least every three years. The wording indicates that three years is the maximum acceptable timeframe and that, in certain circumstances, a more frequent assessment may be required. That is, that APRA will take action where the external Board assessment process is less frequent.

As stated in the 'Key recommendations' section of this submission, ASFA considers that the emphasis should be on the process and its adequacy, not the frequency and that it may be open to a board to consider the matter and formulate and document a policy of less frequent reviews (where the RSE licensee considers it appropriate).

Recommendation

ASFA recommends that the wording of paragraph 25 be revised to remove the inference that external Board reviews conducted on a frequency of more than 3 years are unacceptable to APRA. ASFA considers that a more appropriate wording for the final sentence of paragraph 25 would be:

"APRA expects that a Board assessment would be undertaken by an external party on a regular basis and that Boards give active consideration to the frequency with which such reviews are undertaken. As a guide, APRA recommends at least three yearly reviews."

7 SPG 520 – Fit and Proper

7.1 Criteria to determine if a responsible person is fit and proper

This section (paragraphs 13 – 16) deals with those matters which an RSE licensee must consider when making an assessment as to whether a person meets the SPS 520 ‘fit and proper’ requirements.

Sub-paragraph 14 (b)(ii) specifies that one such relevant matter is whether the person ‘has breached a fiduciary obligation’. The wording ignores the possibility that a person may have ‘breached a fiduciary obligation’ without that coming to the notice of the regulator or any other person. Similarly, subparagraph 14 (b)(iii) uses the term ‘has perpetrated’.

Recommendation

ASFA recommends that consideration be given to rewording each of these tests to either:

- make it an objective assessment (has been found to have), or
- make it a subjective assessment (is considered likely to).

7.2 Process for assessment of fitness and propriety

Paragraphs 28 and 29 deal with the extent of enquires that could be made and when assessment of fitness and propriety should be made or remade. There is some uncertainty as to the extent to which an RSE licensee should go in ensuring that senior managers of service providers are fit and proper where those service providers are responsible persons of the RSE licensee.

Recommendation

ASFA recommends that the guidance contemplate that a responsible person of an RSE licensee may be an employee of a service provider.

7.3 Attestations and representations

This section (paragraphs 30 – 34) deals with the attestations which an RSE licensee should require and assessments which an RSE licensee should make prior to engaging a person who is subject to the RSE licensee’s Fit and Proper Policy.

Paragraph 32 deals with the situation where the attestation is received or the assessment made after the appointment and the person is later found to be disqualified from holding a position under the SIS Act. ASFA seeks modification of this paragraph such that it caters for the situation set out in paragraph 19 where it is acknowledged that, under the equal representation requirements, there may be situations where it is not possible to undertake an assessment or receive attestations prior to a person being appointed to a Board. In such situations the assessment should be made as soon as possible after the appointment.

Recommendation

ASFA recommends that the wording of paragraph 32 be modified such that it recognises the situation contemplated by paragraph 19.

8 SPG 521 – Conflicts of Interest

8.1 Conflicts management framework

Paragraph 11 deals with the frequency of undertaking a review of the conflicts management framework.

The opening sentence refers to an ‘annual review’. The Prudential Standard SPS 521 sets out a requirement for a three yearly review (paragraph 20) and an annual review (paragraph 23):

“Review of conflicts management framework

20. An RSE licensee must ensure that the appropriateness, effectiveness and adequacy of its conflicts management framework are subject to a comprehensive review by operationally independent, appropriately trained and competent persons at least every three years.

...

23. In addition to the comprehensive review required in paragraph 20, an RSE licensee must, on an annual basis, review its conflicts management framework and report the results of this review to the Board.”

Recommendation

ASFA recommends that the wording of paragraph 11 of SPG 521 be amended to direct the reader to the specific review requirement in SPS 521 that is being addressed by paragraph 11 of the SPG.

8.2 Assessment of relevance of duties and interests

This section (paragraphs 19 – 26) deals with assessing whether a particular person’s duties or interests should be entered onto the register of conflicts and interests and provides some very useful guidance on how to assess whether such conflicts exist and are material.

Paragraph 22 states that:

“A director of an RSE licensee will often be nominated or appointed by, and may be under an expectation that they will represent the interests of, a nominating body or appointer. APRA considers that this would ordinarily give rise to the director having a duty to the nominating body or appointer.”

At first reading, these sentences convey the impression that APRA considers that, where a person is appointed or nominated by a body as director of an RSE licensee, they will ordinarily owe a duty to the nominating body or appointer. ASFA does not consider that, as a matter of law, a director *ordinarily* owes a duty to its nominating body. However there may be cases where this is so, depending on any role the person has within the nominating body. To the extent that the paragraph suggests that the director owes a duty by the mere fact of being appointed by a particular nominating body, we believe this is not a correct view.

ASFA requests that consideration be given to re-wording the paragraph such that its correct intent is conveyed. Additionally, whilst the guidance given about disclosing the conflict where the director *does* owe a duty to a nominating body (or might be perceived to have a conflict) is useful, ASFA requests that consideration be given to strengthening the guidance by recommending that the RSE licensee's processes for managing any such conflict should reinforce the paramount duty owed by a director to the beneficiaries of the RSE.

Recommendation

ASFA recommends that the first two sentences of paragraph 22 be reworded to more clearly reflect the separate situations where:

- the director does owe a duty; and
- the director may be under the perception they owe a duty.

We also recommend that the guidance in paragraph 19 be strengthened by recommending that the RSE licensee's processes for managing any perceived or actual conflicts should reinforce the paramount duty owed by a director to the beneficiaries of the RSE.

8.3 Attachment A

Attachment A provides various examples to assist interpretation. ASFA requests that more informative examples be provided which 'play out' the issue of the duty of priorities in relation to an individual's appointment on an RSE Licensee Board and that of a service provider. For example:

- To what extent does this duty override the duty of confidentiality?
- Does superannuation legislation override duties that a director of a responsible entity regulated under the Corporations Act might have.

Recommendation

ASFA recommends that that more informative examples be provided which 'play out' the issue of the duty of priorities in relation to an individual's appointment on an RSE Licensee Board and the Board of a service provider.

9 SPG 530 – Investment Strategy – Formulation

As a general comment, there is a view from certain ASFA members that potential exposure of RSE licensees and Directors to claims made by members in respect of investment losses will be significantly increased from 1 July 2013 as a result of the implementation of the Stronger Super reforms.

This increased exposure arises from:

- the expansion of the number and scope of the statutory covenants applicable to RSE licensees and directors and, in particular, the expansion of the scope of the statutory covenants in relation to investment;
- the increased requirements imposed by Prudential Standard SPS 530 – Investment Governance and the associated Prudential Practice Guides;
- the detailed requirements imposed by a number of other prudential standards; and
- the narrowing of the scope of the statutory defence available to trustees in relation to claims made by members.

9.1 Investment objectives

Paragraph 9 defines a single security option as “an individual share or bond”. This paragraph also states that a unit trust with an underlying portfolio of investments is not a single security option. ASFA considers that it would be useful to RSE licensees for the guidance on what is not a single security option to be broadened.

Recommendation

ASFA recommends that paragraph 9 be amended as follows:

“... For the purposes of this PPG, a single security option is an individual share or bond. A unit trust, Exchange Traded Fund or Listed Investment Company with an underlying portfolio of investments is not a single security option.”

10 SPG 531 – Investment Strategy – Implementation

10.1 Offshoring – requirement for consultation

Under SPS 231 – Outsourcing, investment management is considered a *material business activity*. Therefore notification of investment manager appointments is required as soon as possible and within a maximum of 20 days of execution of the outsourcing agreement. In relation to offshoring (i.e. outsourcing by an RSE licensee of a material business activity to a service provider where the outsourced activity is to be conducted outside Australia), prior consultation with APRA is required.

ASFA believes that prior consultation with APRA on the appointment of offshore investment managers could give rise to insider trading by ‘front running’ pending purchases and sales resulting from management changes.

Recommendation

ASFA recommends that APRA consider protection of market sensitive information in developing its internal operational arrangements, and limit the dissemination and access to such information.

ASFA further recommends that funds should have their due diligence and appointment processes reviewed in detail by APRA annually, with audit certification of process compliance annually.

Appendix A – suggested revised wording for SPG 250

16. Claims experience information to be maintained by an RSE licensee

An RSE licensee should use its best endeavours to ensure it maintains, for at least five years' duration, the following information about claims experience for each RSE within its business operations.

Information	For insurance strategy	For selection of insurer / tender
	<i>Mandatory (M) or Recommended (R)</i>	
Event type i.e. the reason behind the claim	M	M
Cause of claim	R	R
Date of event giving rise to the claim	M	M
Date on which the claim was notified	R	R
Details of insurance cover disclosed to the member – general policy terms	R	M
Details of insurance cover disclosed to the member – individual exclusions and restrictions applicable and disclosed	R	M
Date that the claim was admitted for death and TPD and terminal medical condition claim or the date the claim was denied	R	R
Disputed claims and the reason for the dispute, including whether the dispute is between the trustee and the insurer or trustee and the member	M	R
Date(s) the claim was paid	M	R
Amount of the claim paid	M	M
Sum insured	M	M
Amount of (monthly) income protection benefit	R	M
Period of payment of income protection benefit (2 years, to age 65 etc)	M	M
Status of claim (pending, withdrawn etc)	R	R