The Association of Superannuation Funds of Australia Limited
ABN 29 002 786 290 ACN 002 786 290
Level 6, 66 Clarence Street, Sydney NSW 2000
PO Box 1485, Sydney NSW 2001
t: 02 9264 9300 (1800 812 798 outside Sydney)
f: 1300 926 484
w: www.superannuation.asn.au

File Name: 2013/34

4 July 2013

Neil Grummitt
General Manager, Policy Development
Policy, Research and Statistics
Australian Prudential Regulation Authority
GPO Box 9836
Sydney NSW 2001

Email: superannuation.policy@apra.gov.au

Dear Mr Grummitt,

Second set of draft prudential practice guides for superannuation

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in relation to the second set of draft prudential practice guides (PPGs) for superannuation released by the Australian Prudential Regulation Authority (APRA) on 9 May 2013, consisting of five new superannuation PPGs and three updates to existing superannuation PPGs.

We note that the intent of the PPGs is to include practical guidance from the Regulator on matters that it considers an RSE licensee may take into account when determining how to meet the requirements in the prudential standards. In that context, it is understood that PPGs are intended to provide guidance on APRA's view of sound practice in particular areas and do not create enforceable requirements.

ASFA has consulted with its members and reviewed each of the proposed and updated draft PPGs and our comments are set out below.

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.

The Association of Superannuation Funds of Australia Limited
ABN 29 002 786 290 ACN 002 786 290
Level 6, 66 Clarence Street, Sydney NSW 2000
PO Box 1485, Sydney NSW 2001
t: 02 9264 9300 (1800 812 798 outside Sydney)
f: 1300 926 484
w: www.superannuation.asn.au

General comment

As an overall comment, ASFA is broadly comfortable with the guidance provided in the second set of draft prudential practice guides.

That said, we have raised a number of issues and provided a range of recommendations in the attached submission in relation to each of the draft PPGs for your consideration.

Important issue: offshoring – requirement for consultation

In our previous submissions to APRA on the draft prudential standards (dated 20 July 2012) and on the first set of draft PPG (dated 5 March 2013), ASFA raised an issue around the requirement for RSE licensees to consult with APRA before entering into any offshoring agreement involving a material business activity. This requirement is articulated in paragraph 28 of the *Prudential Standard SPS 231 Outsourcing* and footnote 9 of *Prudential Standard SPS 530 Investment Governance*.

Given the strong concerns that continue to be expressed to ASFA by the industry around this issue, we feel compelled to again draw your attention to these concerns.

Whilst we agree the requirement for prior consultation is appropriate for most of the material business activities that an RSE licensee decides to offshore (eg. administration, call centre etc), we question the appropriateness of this provision in relation 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 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 for RSE licensees and a significant impediment to them being able to invest effectively and efficiently. RSE licensees need to be able to change investment managers quickly, without being delayed by needing to consult with APRA and await its (implicit) approval.

Paragraph 33 of *Prudential Practice Guide SPG 231 Outsourcing* 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 <u>first</u> investment offshore but not with respect to each and every subsequent investment.

The Association of Superannuation Funds of Australia Limited
ABN 29 002 786 290 ACN 002 786 290
Level 6, 66 Clarence Street, Sydney NSW 2000
PO Box 1485, Sydney NSW 2001
t: 02 9264 9300 (1800 812 798 outside Sydney)
f: 1300 926 484
w: www.superannuation.asn.au

Paragraph 33 of SPG 231 goes on to state that "[t]his will allow APRA to provide feedback to an RSE licensee but APRA does not intend to approve individual offshoring arrangements". It seems clear therefore that APRA expects to be consulted regarding every proposed offshoring arrangement to allow the regulator to consider the arrangement and advise the RSE licensee whether or not it has any objection to the proposed arrangement. However, ASFA considers that greater clarity should be provided within SPG 231 regarding how the consultation process is intended to operate.

Recommendations

Firstly, the industry needs clarity on the information APRA expects the RSE licensee to provide when advising the regulator of a proposed offshoring arrangement – a template may be useful for this purpose.

As well, it would be helpful for the industry to have greater clarity on the process around such consultations – not just what information to provide to APRA in the first instance, but also whether an RSE licensee is required to await a response from the regulator – and if so, for how long – before it can enter into the proposed offshoring arrangement. Given the uncertainty that currently exists around this issue, ASFA suggests that the consultation process needs to be clarified (within SPG 231).

Secondly, ASFA strongly recommends that offshoring of investment management needs to be treated differently to other material business activities with respect to the requirement of prior consultation with APRA. Specifically, with respect to investment management agreements, we believe that the prudential standard and guidance should be amended 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. An alternative approach may be to necessitate consultation the first time an RSE licensee enters into an investment management agreement in a particular jurisdiction, but not for subsequent agreements in that jurisdiction.

Another key issue – determination of a 'material business activity'

Members have advised us that there appear to be differing positions adopted by APRA offices and APRA officers on whether or not a proposed outsourcing arrangement is a material business activity. In one example, advice from ASFA members reveals a difference in approach between the APRA's Melbourne, Brisbane and Sydney offices as to whether the selection of a Gateway service provider is considered to be the outsourcing of a material business activity. This in turn leads to differing approaches between trustees with respect to their dealings with potential gateway service providers and is a source of frustration for trustees and gateways alike.

The Association of Superannuation Funds of Australia Limited
ABN 29 002 786 290 ACN 002 786 290
Level 6, 66 Clarence Street, Sydney NSW 2000
PO Box 1485, Sydney NSW 2001
t: 02 9264 9300 (1800 812 798 outside Sydney)
f: 1300 926 484
w: www.superannuation.asn.au

Recommendation

SPG 231 should provide guidance as to the determination as to whether, or in what circumstances, a particular activity is considered to be a material business activity.

* * * *

The remainder of ASFA's recommendations with respect to the second set of PPGs are contained in the attached submission.

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

Fiona Galbraith
Director, Policy

Submission

Second set of PPGs for superannuation

4 July 2013

Table of Contents

Recommendations

1 SPG 160 – Defined Benefit Matters

Paragraph	Issue / Recommendation
1	In paragraph 1 the following words are used – *"…aim to ensure a satisfactory financial position is achieved and maintained such that the value of assets is sufficient to cover vested benefits and liabilities are met as they fall due."* ASFA has several comments in relation to this seemingly innocuous statement. Firstly, the use of the term "satisfactory financial position", which derives from the earlier use of "unsatisfactory financial position", may serve to imply that a fund with a Vested Benefit Index (VBI) greater than 100% is in a sound financial state whereas that is not necessarily true. In this context satisfactory is not the opposite of unsatisfactory. We would strongly encourage that care be taken when the SPG uses this term. Secondly, the SPG needs to clarify whether the funding target is about having assets sufficient to cover vested benefits, which is a "point-in-time" measure or liabilities are met as they fall due, which is a "duration" measure, or both. For example, it is easy to conceive of scenarios where, at a point in time, a plan can satisfy one measure but not the other. Actuaries typically consider both, and that may be the intention, in which case this point should be made clear. Finally, we note the use of the words "ensure" and "maintained". ASFA contends that these words can only truly be satisfied where there exists very large surpluses, or there is an open-ended funding commitment by the employer – a point that seems to be reflected in paragraph 10 where the words "…a reasonable expectation…" are used. This first paragraph sets the tone for what follows in the rest of the draft prudential practice guide and, as such, in our view needs to be re-drafted carefully.
6 – 10	Paragraphs 6 to 10, which deal with the timing and frequency when paying defined benefit pensions, do not explicitly mention what is often the most critical factor in providing pensioner security, namely the ranking of pensioner liabilities ahead of many other liabilities in a wind-up. We recommend that this section of the guidance be amended accordingly.
15	Paragraph 15 states that *"…APRA expects the contribution rates would ordinarily be set at a level to address any deficit that has arisen since the previous investigation and to **ensure** the fund will be in a satisfactory financial position at the end of the relevant three year period".* The difficulty here is with the word "ensure". Once again this implies an almost impossible hurdle, because of short-term market volatility, and hence it would be better to use the concept of "reasonably expect" rather than "ensure".
16	Paragraph 16 makes the following statement *"In APRA's view such fluctuations would be temporary and short term".* While it would be nice to know in advance that a small downward movement is temporary, in practice it is not possible to tell this until afterwards. As a consequence, the shortfall test is about reasonable expectation that the fund might recover within a short period without additional funding assistance – this is a matter of probability. As such, ASFA recommends that this wording be altered or possibly even deleted.

17	Under paragraph 17 the calculation of the shortfall limit is defined (per Reporting Standard SRS 160.0) in the same way as the calculation of the VBI – i.e. as the ratio of net assets available for member benefits (net of ORFR reserves) to vested benefits. However, SPS 160 (paragraph 11) states that the shortfall limit could be "nil" which is potentially confusing. We note that the Actuaries Institute's recent note on shortfall limits points this out and states that "nil" should be interpreted as "meaning the deviation from a Vested Benefit Index position of 100%". We support this interpretation and recommend that SPS 160 be updated to reflect this prior to finalisation.
18	Under paragraph 18 it states that, in setting the shortfall limit, *"APRA also expects the RSE licensee to assess the financial strength of the employer-sponsor(s)...."*. A similar requirement has arisen in exposure draft ED 223 *Superannuation entities*, and the feedback from industry was that it would place an onerous burden on trustees and that it may not be feasible to obtain such information. Whilst this looks like a reasonable requirement, it must be understood that many situations will exist where the RSE licensee is not able to undertake this assessment successfully, despite best efforts. ASFA contends that they should not be held accountable for any failure in this regard. ASFA recommends that greater guidance is required on exactly what is meant by *"assess the financial strength of the employer sponsor(s)".*
19	Paragraph 19 refers to a "*persistent unsatisfactory financial position*". This is a new expression and its meaning/definition is unclear. The intention here might be that, where the VBI lies below the shortfall limit for an extended period (eg. say over a year), then action might need to be taken to address the shortfall, rather than waiting until the next actuarial valuation. However that appears to be contrary to SPS 160 and hence some clarity is needed within the guidance with respect to this.
21	Paragraph 21 refers to the possibility of a shortfall limit in excess of 100%. For clarity of expression and interpretation, ASFA strongly suggests that different terminology be used where a buffer above 100% is applied. We also recommend that the word "prudent" be deleted such that the paragraph commences: *"An RSE licensee may set a funding buffer in excess of vested benefits."*
25 & 29	Paragraph 25 implies that a restoration plan *"…will…return the fund to a satisfactory financial position*". Again this is a matter of probability and not certainty. The wording should be altered such that there is a "reasonable expectation" that the fund will be restored to a satisfactory financial position. The underlying issue here is that the success of the funding plan is affected more critically by the investment performance than by the selected top-up contributions. A similar issue exists with paragraph 29 as with paragraph 25.

Paragraph	Issue / Recommendation
25 – 31	It is not clear within the prudential standard or the guidance that a restoration plan would be extinguished if the RSE reached a satisfactory financial position (i.e. 100% funded) within the period covered by the restoration plan. ASFA contends that this situation needs to be covered, particularly as higher contributions from the employer, or other methods of addressing a breach of the shortfall limit, should no longer apply once the RSE reaches a satisfactory financial position.
25 – 31	Another issue with respect to restoration plans is that, in practice, restoration plans will not run smoothly to their target over a neat three year period. They will succeed and fail, need to be amended and extended and have variations apply. We believe SPS 160 alludes to this issue, but the complexity of possible situations makes it impossible to cover this easily. However, it would be possible within the SPG to give broad guidelines for situations such as where: • the restoration plan goes sideways or very slowly and is unlikely to meet the target; • the restoration plan deteriorates and is likely to miss the target; • the restoration plan improves faster than expected but the employer looks to lower costs; • the restoration plan succeeds more quickly than expected but then the plan starts to go backwards again; • a material deterioration occurs close to the end of the restoration period. These guidelines should allow restoration plans to be re-set and should avoid a requirement to ramp up funding close to the end of the restoration period unless there were circumstances which demanded that this occurs.
31	It is unclear what is intended by the last sentence in paragraph 31. ASFA recommends that this sentence be reworded/clarified.

2 SPG 221 – Adequacy of Resources

Paragraph	Issue / Recommendation
N/A	ASFA has no significant concerns with SPG 221, provided there are no additional regulator expectations that have not been set out within the document. For example, there appears to be no expectation that financial forecasts should be stress tested. As a general comment, the PPG does not appear to adequately address/recognise the difficulty in obtaining the expected information from outsourced providers. ASFA considers that difficulty in getting the expected information will apply in most, if not all, cases. This matter is expanded on in our comments below on specific areas of SPG 221.
N/A	ASFA considers that, with financial resources, there should also be a focus on risk – the likelihood of an event occurring and the impact on the business should it occur. For example, were an investment manager with 2% of the fund assets to go out of business, the impact will most likely be minor, particularly as the assets are held through a custodian. However, the failure of an insurer would be a major issue. ASFA considers that, given the difficulty of obtaining detailed financial information in many cases, the expectation should be that RSE licensees focus their efforts on those providers which a risk analysis process has identified as high risk to the RSE licensee or to the RSE.
11	Paragraph 11 states that, where an RSE licensee outsources material business activities, it is expected that due diligence would be undertaken to ensure that the service provider has and maintains adequate human resources. ASFA is concerned as to how these twin objectives can effectively be achieved. The general reason services are outsourced is because the RSE licensee is not in the business of undertaking that particular activity. Where this is the starting point for outsourcing an activity, the RSE licensee will not know what human resources are required to manage this completely different business – either at a basic level or to achieve specific service levels. By way of example, take outsourcing to a software provider. How does a trustee evaluate that the human resources of a software provider are adequate both in terms of number and skills? It will generally only be evident after a problem has arisen that resources were inadequate or have fallen to an inadequate level. The same issue also arises with respect to assessing the technical resources of outsourced service providers (discussed below).
15	The guidance set out in sub-paragraphs 15(a), (b) and (c) is particularly helpful. However, as set out above in relation to human resources, an RSE licensee's lack of knowledge of the service provider's industry may make it difficult to make the expected level of judgement about the required level of technical resources. An obvious example here is administrators – how do RSE licensees evaluate the adequacy of the software employed? Whilst ASFA can appreciate the risk in contracting out services, we consider that there is a limit to the resources RSE licensees can, and arguably should, reasonably devote to evaluating all the details for each service provider.

	Given that it is no longer sufficient to obtain comfort letters, it would appear that RSE licensees must now expend considerable resources reviewing and analysing service providers. There is a concern that, in many instances, the expense may be disproportionate to the risk. The economic impact on the industry is compounded where multiple RSE licensees are reviewing the same service provider. In summary, the use of the word ‘ensure’ in the guidance seems to be suggesting that where an RSE licensee uses an outsourcing arrangement, it should satisfy itself that nothing will go wrong. ASFA is concerned that this may lead to RSE licensees expending inappropriately high levels of resources in trying to eliminate, rather than manage, risks. ASFA recommends that the wording of paragraphs 11 and 15(d) be reviewed to provide clarity as to whether there is a requirement for absolute certainty, or whether it would be sufficient for the RSE licensee to make reasonable endeavours to satisfy itself that the risk management processes of the service provider are appropriate.

3 SPG 222 – Management of Reserves

Paragraph	Issue / Recommendation
6	Paragraph 6 outlines some of the common types of reserves APRA has observed. ASFA considers that sub-paragraph 6(b), regarding the use of investment reserves, potentially is not just a crediting rate issue – i.e. there is no reason why an investment reserve cannot be used in a unit pricing environment. ASFA suggests that this sub-paragraph should be amended accordingly. As well, consideration should be given to including an additional sub-paragraph *(e) General reserve*, as this is also a fairly common reserve that is used.
8	Paragraph 8, which deals with when a reserve is established, states that "*[a]n RSE licensee may seek appropriate independent advice to assist it in formulating its strategy and managing and reviewing the operation of reserves*". It is unclear whether this sentence has been included to indicate that APRA expects that an RSE licensee would seek appropriate independent advice. ASFA recommends that, in order to avoid any confusion, this should be clarified in the guidance.
9	Paragraph 9 discusses the measures APRA would regard as sound practice in a strategy for the management of a reserve. ASFA recommends that the wording in sub-paragraph 9(b) should be augmented as follows: *"… amounts may be transferred from one reserve account to another* ***or to members****".*
10	Paragraph 10 should not deal just with the quarantining of any undistributed reserve or its equitable merging with the rest of the successor fund, but should also provide guidance to trustees around the need to consider how any quarantined/undistributed reserve will be used.
11	ASFA recommends that the opening sentence in paragraph 11 be augmented as follows: *"… APRA envisages that the RSE licensee would distribute the balance equitably among members* ***and/or employers where appropriate****".*
12	Paragraph 12 states that *"When an investment reserve becomes exhausted and remains at a zero balance for a sustained period of time, APRA would expect…"*. ASFA considers that the expression "a sustained period of time" requires clarification, possibly by way of an example, to give greater guidance to trustees as to exactly what APRA's thinking is in relation to this – eg. 3 months, 6 months, 12 months?

4 SPG 270 – Contribution and Benefit Accrual Standards

Paragraph	Issue / Recommendation
12 – 13	In a choice of fund environment, it is generally unrealistic to expect RSE licensees to estimate and follow up future contributions at an *individual member* level. Contributions for a member may cease because the member has exercised choice of fund, or ceased work with a particular employer, either temporarily or permanently. ASFA contends that following up the non-receipt of "expected" or "estimated" member contributions would not be an efficient or prudent use of fund resources in most cases.
22 – 31	This section on contributions made in error is generally very useful, as the management of such amounts can cause difficulty for RSE licensees. However, in our view: • the wording of paragraph 30 is somewhat unclear. It aims to distinguish between two sub-types of administrative error – one of which can result in the return/cashing out of a purported contribution, and one which cannot result in the return/cashing out of the purported contribution because it is considered to remain a preserved amount. The use of examples to illustrate this is helpful but we believe the paragraph should also include a clear statement of the key characteristics of each sub-type. • it would be helpful if paragraphs 28 and 29 included one or two examples of situations where contributions may not be refunded.
43	Paragraph 43 states that APRA considers clearing houses to be a material business activity. ASFA contends that whether an outsourced clearing house is material will depend on the particular circumstances. If all contributions are received via a clearing house operated by the fund's administrator (for example), this would certainly be a material business activity. However, in cases where the licensee of a large, multi-employer fund uses an external clearing house only for a small number of employers, this may not, in the circumstances, be 'material'.
N/A	The SPG contains extensive comments about the use of clearing house services, but is silent about the use of gateway services. Once employers begin remitting contributions in accordance with the superannuation data and payment regulations and standards, gateways will become an important part of the superannuation system. ASFA therefore considers that it would be helpful if the SPG could include commentary addressing the use of gateways.

5 SPG 280 – Payment Standards

Paragraph	Issue / Recommendation
19	In cases where a member over preservation age indicates that they have “retired”, it should not be necessary for an RSE licensee to obtain a statement from their employer. If it is appropriate to accept a statutory declaration from the member regarding their intention not to again be gainfully employed, an RSE licensee should similarly be able to rely on the member's statutory declaration about the cessation of their employment. ASFA contends that requiring separate proof of cessation of employment be obtained is not an efficient use of fund resources.
25	Paragraph 25 states that *“[a] prudent RSE licensee’s policy* [on the early release of benefits] *would take into account whether the member is entitled to other Commonwealth government assistance from the Department of Human Services”*. ASFA contends that it is not appropriate for the RSE licensee to investigate other sources of government assistance available to the member. The intent of the current requirements was to make them as objective as possible and reasonably simple and efficient for licensees to administer. Investigating other potential forms of government assistance requires knowledge of what is available and a detailed knowledge of the member’s circumstances. This would require additional fund resources and is likely to extend into matters that the RSE licensee may not be appropriately qualified or licensed to advise upon. It would also potentially be intrusive for the member and as such ASFA considers this reference should be removed.
28	Regulation 6.28 of the SIS Regulations state that a benefit must not be rolled over unless the member has given the trustee their consent to the roll-over or the trustee believes on reasonable grounds that the trustee of the receiving fund has received the member’s consent. The section on rollovers and transfers notes this need to ensure that the member has given their consent. ASFA supports the need for member consent. ASFA considers that this section should address how RSE licensees are to be satisfied about consent in circumstances where a rollover out is initiated by the member through the receiving fund in accordance with the superannuation data and payment standards and regulations. Those regulations and standards require a rollover to be processed within three business days where the transferring fund has received all prescribed information, which does not include a specific statement about the member's consent. ASFA contends that this requirement to obtain consent does not allow sufficient time for the transferring fund to make separate enquiries to confirm that the member did in fact consent to the transaction. Accordingly, where the rollover request has been initiated via the receiving fund, the need to obtain consent will generally result in funds breaching the requirement to roll-over in three days. The SPG will need to provide guidance to a trustee to address the issue of where they are not in a position to rollover by day 3 as consent has not yet been obtained. Consideration may need to be given as to the appropriateness of the three day

	requirements where the rollover request has come through the receiving fund and consent must be obtained.
30	It would be helpful to have guidance on when additional confirmation of the member's identity may be required before an RSE licensee processes a rollover. Under the superannuation data and payment regulations and standards, RSE licensees are required to rollover benefits within 3 business days and not require provision of further information if they have received all the prescribed information and received validation of the member's details through the ATO's Super TIC service. Licensees are also required to guard against illegal early release and fraud as well as Money Laundering & Terrorism Financing (ML/TF). The APRA letter mentioned in paragraph 34 provides useful guidance regarding rollovers and transfers to SMSFs, and it would be helpful if similar guidance could be provided about when a licensee may require further ID for transfers to APRA regulated funds. Further guidance about how the request for, and provision of, further information impacts the timeframes for processing of rollovers would also be appreciated.
47	Paragraph 47 notes that there are *"five different death benefit arrangements under the payment standards"*. It would be helpful if the SPG provided specific cross-references to the relevant legislative provisions, to ensure there is sufficient clarity about each of the different arrangements.

6 SPG 511 – Remuneration

<table>
<tr><th>Paragraph</th><th>Issue / Recommendation</th></tr>
<tr><td>22</td><td>Under this paragraph, the expectation is that an RSE licensee will take an active approach to ensuring that the remuneration of relevant persons is in line with the RSE licensee's approach to remuneration outlined in the Remuneration Policy, including:
• directors who are paid by another entity within a corporate group, and
• member and employer representative directors who are remunerated by a nominating body.

ASFA is concerned at the practicality of the expectation that a board will have control over how nominating bodies remunerate directors. While the RSE licensee may advise the nomination body of the remuneration policy, it is not clear how an external party could be required to abide by the RSE licensee's internal policy.

ASFA recommends that paragraph 22 be revised to provide guidance as to how the objective can effectively be achieved.</td></tr>
<tr><td>26 – 31</td><td>ASFA is concerned with the practicality of some of the content of these paragraphs. Similar to the comments above with respect to paragraph 22, while RSE licensees may seek to gain agreement, they may have difficulty in enforcing it.

For example, investment managers set their remuneration policies to suit their business model. As such, they will not necessarily agree to client input, and in practice would have great difficulty in incorporating conflicting requirements from different clients.

Is it APRA's expectation that an RSE licensee should not contract with a party that will not comply with its remuneration requirements? If this is the expectation, and there is widespread resistance from service providers, especially investment managers, this would reduce the pool of available providers. This may place RSE licensees in the position of having to consider the appointment of a provider, such as an investment manager, that is less likely to outperform simply because they are more "cooperative". This is not to say that RSE licensees should appoint providers with high-risk remuneration practices, but beyond that it does not appear to be realistic to expect providers' remuneration models to reflect those of their clients.

In the extreme case, an RSE licensee's policy may completely exclude incentive payments. Is it APRA's expectation that, in such circumstances, the RSE licensee should require all their service providers to adopt the same policy?

ASFA recommends that this section be reviewed with a view to working through the practical difficulties, issues and potential outcomes of applying an RSE licensee's remuneration policy to non-employees.</td></tr>
<tr><td>34</td><td>This paragraph requires the level of performance-based remuneration to reflect the levels of risk to which the RSE licensee is exposed by an individual in performing his or her role.

To do so requires quantification of risk, a task that not all funds will be able to do in a scientific manner. ASFA recommends that this paragraph include a footnote that references the guidance provided by paragraph 39.</td></tr>
</table>

7 SPG 532 – Investment Risk Management

Paragraph	Issue / Recommendation
N/A	The feedback ASFA has received from its members with respect SPG 532 focuses on a few general points around liquidity. We note that the SPG is comprehensive with a significant focus on liquidity risk. In particular, we note that liquidity stress testing is required to be performed annually, as compared to valuation which is required to be performed on a quarterly basis. ASFA considers that funds are more likely to have a significant issue with liquidity rather than valuation. In addition, there is no mention in SPG 231 of the provision of third party liquidity facilities – either a government-provided committed liquidity facility (CLF) or privately provided as occurs with other types of financial institutions and across the commercial world more broadly.
9	The SPG contains minimal references to counterparty risk other than in relation to hedging programs. ASFA considers this to be a critical investment risk, particularly with the use of: • derivatives to manage more dynamic risk allocation; • investments that minimise tracking errors to benchmarks; and • overseas investments requiring hedging. ASFA suggests that counterparty risk could be regarded as a significant risk and therefore included in paragraph 9.
9(b)	We question whether sub-paragraph 9(b) is correctly labelled ("drawdown" seems to reflect market valuation rather than withdrawals).
9(c)	We also question how easy it is for a fund to manage "sequencing risk", particularly where a fund has a large and broad demographic.

8 SPG 533 – Valuation

Paragraph	Issue / Recommendation
N/A	The general feedback ASFA has received from its members on SPG 533 is that the guidance appears quite broad, allowing a reasonable amount of flexibility, while guiding towards the use of establishing frameworks and governance processes, as well as the use of experts where needed in a very complex area. We also note that that there is no discussion of currency exposure and foreign exchange rates as an input. As the system grows we may see a greater allocation to overseas investment, which would make this area more important. Similarly, to the extent that investors look at more emerging markets, some of these jurisdictions may have or may introduce capital controls in periods of stress which also would have an impact on valuations.
53	Paragraph 53 states that "*sound practice would typically involve a valuation of unlisted investments being undertaken on at least a quarterly basis*". Based on feedback received from our members, ASFA considers that a valuation frequency of at least quarterly would appear to be overly frequent for certain types of assets, in particular those with especially long lives (such as infrastructure), whose value typically may not move in that period of time. Therefore, such frequent valuation for these assets would simply result in higher costs being incurred by funds (and borne by fund members) for little benefit. We recognise that, in periods of extreme volatility, the valuations may change more frequently due to changes in inputs over that period of time. However, in such circumstances, undertaking more frequent valuations would not necessarily reflect the true long-term value of the asset. Indeed, such frequent valuations during periods of extreme volatility may in fact be counterproductive. ASFA recommends that, with respect to these types of long-term unlisted assets (eg. infrastructure), RSE licensees should have greater flexibility with respect to the frequency of valuation, in line with the obligations under Australian Accounting Standard (AAS 25) – *Financial Reporting of Superannuation Plans*.