

SUBMISSION

Submission to APRA –
Strengthening Financial
Resilience in
Superannuation –
SPS/SPG 114 Operational
Risk Financial
Requirements

13 May 2024

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Lodged via email: superannuation.policy@apra.gov.au

13 May 2024

Dear Sir/Madam,

Strengthening Financial Resilience in Super – SPS/SPG 114 Operational Risk Financial Requirements

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to your consultation on *Strengthening Financial Resilience in Superannuation – SPS/SPG 114 Operational Risk Financial Requirements*.

ABOUT ASFA

ASFA, the voice of super, has been operating since 1962 and is the peak policy, research and advocacy body for Australia's superannuation industry. ASFA represents the APRA regulated superannuation industry with over 100 organisations as members from corporate, industry, retail and public sector funds, and service providers.

We develop policy positions through collaboration with our diverse membership base and use our deep technical expertise and research capabilities to assist in advancing outcomes for Australians.

ASFA seeks to ensure that member outcomes are appropriate, optimised and there are no unintended consequences flowing from policy decisions relating to superannuation.

GENERAL COMMENTS

ASFA is generally supportive of strengthening financial resilience in superannuation.

Our member organisations have, however, identified some issues with the draft *SPS 114* and *SPG 114 Operational Risk Financial Requirements*, which are outlined below under Specific Comments.

In particular, holding excess funds in the ORFR results in worse financial outcomes for members.

As at December 2023 APRA regulated funds totalled \$2,566 billion in Funds Under Management (FUM). On the basis that RSEs generally hold 25 bps to meet their Operational Risk Financial Requirements (ORFR), ASFA has estimated that an amount of \$6.4 billion has been set aside for ORFR.

This represents a significant amount of money that is not being invested to produce a return for members. Given this, it is imperative that the right balance is struck between competing public policy interests – adequately provisioning to mitigate operational risk should not be at the expense of member outcomes.

SPECIFIC COMMENTS

1. Superannuation Prudential Standard 114 (SPS 114) should contain a definition of 'Operational Risk'

Member organisations have suggested that Superannuation Prudential Standard 114 (SPS 114) should clearly define what constitutes 'operational risk'.

This will assist to provide clarity to super fund trustees as to the appropriate usage of the ORFR.

Recommendation 1

1. That SPS 114 should clearly define what constitutes 'operational risk'.

2. ORFR target amount – inconsistency between draft SPS 114 and draft SPG 114

Members have identified that there is an inconsistency between the draft standard SPS 114 and the draft supporting guidance SPG 114 with respect to determining the ORFR target amount.

Draft SPS 114 requires the trustee to determine an appropriate ORFR target amount that appropriately reflects the ORFR strategic objectives, uses of the ORFR financial resources and the trustee's business operations (paragraphs 11 to 13). SPG 114, however, indicates that APRA expects the ORFR target amount to be at least equivalent to 0.25% of FUM (paragraph 2).

The proposed approach of holding a minimum target amount of 0.25% as a percentage of FUM fails to take into consideration the operational risk profile of an RSE.

Further, due to the relatively large scale of significant Financial Institutions (SFIs) and the corresponding size of their ORFR (i.e. dollar value), they are better placed to hold a lower percentage of FUM as ORFR.

In addition, reviewing the ORFR target amount on an annual basis is a significant exercise which largely will be wasted effort if the trustee is required to revert to 25 basis points (bps), irrespective of the outcomes of the review.

Members have suggested that one possible approach that APRA could consider would be if APRA were to set the recommended ORFR target amount for the industry at 25 bps but allow RSE licensees to determine a different amount having regard to their risk profile, including their operational risk environment and the maturity of their risk function. SPG 114 could incorporate additional, principles-based, guidance with respect to the appropriate factors that need to be satisfied in order for an RSE licensee to hold an ORFR target amount of less than 25 basis points (bps).

One potential approach that could be adopted is that an RSE licensee could either:

- adopt an ORFR target amount of 25 bps, in which case the requirement for the trustee to review the target amount annually would be removed; or
- determine that a different ORFR target amount for their RSE is appropriate, provided that it meets certain conditions, in which case, if the ORFR amount is less than 25 bp, an annual review of the ORFR target amount would be required.

SPG 114 would outline the appropriate conditions that need to be satisfied in order for an RSE licensee to hold an ORFR target amount of less than 25 basis points (bps).

By way of example, this could include that the RSE licensee is a SFI with more than \$30 billion FUM, as defined in CPS 190, and meets the following conditions:

- it meets the principles prescribed in paragraph 4 of draft SPG 114
- it holds alternative sources of trustee-controlled funding to address operational risk incidents, as prescribed in paragraphs 5 & 6 of draft SPG 114; and
- it has maintained its ORFR within tolerance levels since the commencement of SPS 114, 1 July 2013.

Recommendation 2

2. That APRA could consider adopting an approach whereby an RSE licensee could either:
 - adopt an ORFR target amount of 25 bps, in which case the requirement for the trustee to review the target amount annually would be removed; or
 - determine that a different ORFR target amount for their RSE is appropriate, in which case, if the ORFR amount is less than 25 bp, an annual review of the ORFR target amount would be required.

3. ORFR replenishment requirements – paragraph 18 of draft SPS 114

Members have noted the requirements with respect to the replenishment of the ORFR outlined in paragraph 18 of draft SPS 114 and have suggested that APRA provide further clarity with respect to an appropriate ORFR replenishment duration period.

Recommendation 3

3. That APRA provide further clarity with respect to an appropriate ORFR replenishment duration period.

4. Permitted usage of the ORFR – interaction with sub-section 56(2A) of the SIS Act

Member organisations have noted the broadening of the permitted usage of the ORFR under draft SPS 114 and have suggested that APRA provide clarity that, as a result of sub-section 56(2A) of the *Superannuation Industry (Supervision) Act 1993*, a superannuation trustee is not required first to use the ORFR prior to utilising other trustee capital/reserves.

Recommendation 4

4. That APRA provide clarity that a superannuation trustee is not required first to use the ORFR prior to utilising other trustee capital/reserves.

5. Permitted usage of the ORFR – clarification of permitted usages

Members have identified that in APRA's *Discussion Paper: Financial resources for risk events in superannuation*, released in November 2022, the proposed usage of the ORFR was intended to enable the 'baseline component' of the ORFR to fund:

- activation of a financial contingency plan under CPS 190
- activation of a resolution plan under CPS 900; or
- activation of the transfer/receipt of members under SPS 515.

Members have suggested that, in the finalisation of the upcoming draft SPG 114, APRA clarify whether these are still considered to be permitted usages of the ORFR.

Recommendation 5

5. That APRA clarify whether the usages outlined in APRA's November 2022 Discussion Paper are still considered to be permitted usages of the ORFR.

6. Purpose and permitted use of the ORFR

Member organisations understand the need to maintain an ORFR strategy, that includes how the ORFR is invested, used, and replenished, as well as such matters as approval mechanisms.

Members have, however, questioned the need for an individualised ORFR strategy objective.

Paragraphs 8, 14 and 15 of draft SPS 114 set out the purpose and permitted use of ORFR. Given this, members have suggested that APRA clarify why, under paragraphs 9(a) and 12(a) of draft SPS 114, a superannuation trustee is required to define its 'ORFR strategy objectives'.

If this is still to be required, members have sought confirmation whether, for example, it would be appropriate for a superannuation trustee to specify its ORFR strategy objective along the following lines:

ORFR Strategy Objectives: To ensure the RSE licensee maintains, manages and utilises financial resources, in order to protect beneficiaries from losses due to operational risks related to RSEs within its business operations, in accordance with Prudential Standard SPS 114 *Operational Risk Financial Requirement*.

Recommendation 6

6. That APRA clarify why a superannuation trustee is required to define its 'ORFR strategy objectives'.

7. Use of ORFR financial resources to prevent an operational risk event

Members have welcomed the expansion of the use of the ORFR financial resources to prevent an operational risk event.

It will be important to provide clarity with respect to APRA's expectations of what would constitute appropriate governance and evidence/documentation to support utilising funding from the ORFR to prevent an operational risk event.

Further, members have indicated that there will need to be guidance from ASIC as to how funding from the ORFR that is used to prevent an operational risk event would be assessed from the perspective of RG97 *Disclosing fees and costs in PDSs and periodic statements*.

Recommendation 7

7. That APRA clarifies its expectations of what would constitute appropriate governance and evidence/documentation to support utilising the ORFR to prevent an operational risk event.

8. Operational Risk Trustee Capital

Member organisations have advised that the requirement to hold ORFR financial resources as operational trustee capital in a form that is equivalent to Common Equity Tier 1 (CET1) can prove difficult to apply in the context of an RSE.

Given this, they have recommended that APRA consider reframing the definition in paragraph 17 of the draft SPS 114 to include explicit references to the two primary characteristics of CET1, namely the availability and certainty of funding.

Recommendation 8

8. That APRA consider reframing the definition in paragraph 17 of the draft SPS 114 to include explicit references to the availability and certainty of funding.

9. Use of independent experts

Member organisations have advised that, as part of the annual assessment to determine the adequacy of the ORFR, some funds utilise the services of independent experts.

Members have indicated that further guidance is needed with respect to the circumstances in which APRA may request the use of an independent expert and the associated appointment process.

Recommendation 9

9. That APRA consider providing further guidance with respect to the circumstances in which it may request the use of an independent expert and the associated appointment process.

If you have any queries with respect to the content of our submission, please contact Fiona Galbraith, Director Policy, on 0431 490 240 or by email fgalbraith@superannuation.asn.au.

Yours sincerely

James Koval
Head of Policy and Advocacy