



# Prudential Practice Guide Draft

## **SPG 230 – Adequacy of Resources**

14 August 2009

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## About this guide

The *Superannuation Industry (Supervision) Act 1993* (SIS Act) and Regulations set out the operating standard for registrable superannuation entity licensees (RSE licensees) in relation to adequacy of resources. The standard was introduced under the licensing provisions inserted into the SIS Act by the *Superannuation Safety Amendment Act 2004* (SSAA). The standard is set out in Regulation 4.15 of the *Superannuation Industry (Supervision) Regulations 1994* (SIS Regulations) and applies to all RSE licensees.

This prudential practice guide (PPG) aims to assist RSE licensees and their directors in complying with these provisions and, more generally, to outline sound practices in relation to this particular area of a licensee's superannuation operations.

It is not the purpose of this guide to provide a restatement of the content of the law or to outline provisions, such as r. 4.15 of the SIS Regulations, which are particularly relevant to the adequacy of resources for RSE licensees.

Not all the practices outlined in this PPG will be relevant for every RSE licensee and some aspects may vary depending upon the size, complexity and risk profile of the licensee.

A reference to a trustee in this guide should be taken as a reference to the RSE licensee of an APRA regulated superannuation fund, approved deposit fund (ADF) or pooled superannuation trust (PST). Depending on the context, the reference will also be applicable to a director of the RSE licensee if it is a corporation or to an individual trustee if the licensee is a group of individual trustees. Also depending on the context, a reference to a fund or to fund members or beneficiaries will be applicable to ADFs and their members or to PSTs and unit holders of those trusts.

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## Introduction

1. The principal object of the SIS Act is to provide for the prudent management of regulated superannuation funds, approved deposit funds and pooled superannuation trusts. In that context, APRA recognises that it is in the interests of beneficiaries that superannuation entities are soundly managed, and that trustees properly carry out their fiduciary duties. Inadequate resources available to the trustee, whether human resources, technical resources or financial resources, may interfere with the capacity of a trustee to properly carry out those duties.
2. Under the SIS Act, trustees are solely responsible and directly accountable for the prudent management of the members' benefits.
3. Part 3 of the SIS Act provides for a system of prescribed standards applicable to the operation of regulated superannuation funds, ADFs and PSTs. Amendments contained in the SSAA widened Part 3 to enable prescription of standards applicable to registrable superannuation entity licensees (RSE licensees). Included in the list of matters in relation to which standards may be prescribed are those relating to the adequacy of resources (including human resources, technical resources and financial resources) of, or available to, trustees of funds, ADFs and PSTs.
4. The adequacy of resources standard is designed to ensure that an RSE licensee has, or has available to it under an enforceable agreement or undertaking, adequate resources to maintain solvency at all times and to undertake the activities for which it holds an RSE licence.
5. The resources which a trustee will be required to maintain at an adequate level include, but are not limited to, financial, technical and human resources.
6. The licensee must meet the requirements of the standard on an ongoing basis. Under section 34 of the SIS Act, a person who recklessly or intentionally contravenes an operating standard commits an offence.
7. The Australian Securities and Investments Commission (ASIC) has separately issued its *Regulatory Guide 166 Licensing: Financial Requirements* (RG 166) and *Regulatory Guide 104 Licensing: Meeting the General Obligations* (RG 104) to assist Australian financial services licence (AFSL) holders to understand and comply with their obligations under s. 912A(1) of the Corporations Act which, among other things requires a financial services licensee to:  
*'have available adequate resources (including financial, technological and human resources) to provide the financial services covered by the licence and to carry out supervisory arrangements.'*  
In this PPG, APRA recognises that APRA regulated entities are specifically excluded from the scope of s. 912A(1)(d) of the *Corporations Act 2001* (the Corporations Act). Nevertheless, in the interests of consistency, this PPG has regard to the guidance issued by ASIC.
8. APRA would expect a trustee's Risk Management Strategy to set out how the trustee will monitor and maintain the adequacy of resources available to it.

## General approach

9. In assessing its continuing compliance with the standard, a prudent trustee would consider the nature, scale and complexity of its operations and of the superannuation entities of which it is trustee.

10. Criteria a trustee could consider in determining whether it had adequate resources in its own right or available to it include, but are not limited to:
- (a) type and number of funds under trusteeship; for example, retail, industry, corporate, small APRA funds, and defined benefit funds, which may be indicative of complexity of operation;
  - (b) governing rule provisions where significant discretion rests with the trustee (for example in determining total and permanent disability benefit claims), which may be indicative of complexity of operation;
  - (c) value of assets under trusteeship, as indicative of impact of failure;
  - (d) frequency and methodology for calculating unit prices or crediting rates, and number of investment options offered, as indicative of technical requirements;
  - (e) number of beneficiaries, as indicative of human resource and technical requirements;
  - (f) geographic spread of the trustee's operations; and
  - (g) arrangements for the conduct of material business functions, as indicative of resources required by the trustee (where the function is undertaken by the trustee itself) or by a service provider (where the function is outsourced under an appropriate agreement<sup>1</sup>).
11. Because the operating standard applies to the trustee at all times its RSE licence remains in force, applicants for a new licence should be able to demonstrate to APRA's satisfaction, at the time of making a licence application, that they meet, and will continue to be able to meet, the standard. Some such applicants will have been granted an Australian Financial Services Licence (AFSL) by ASIC. APRA-regulated AFSL holders are subject to APRA's prudential requirements, and the AFSL licensing process relies on APRA regulation in respect of adequacy of resources<sup>2</sup>.
12. If there is an overlap of documentation required under the two licensing processes, applicants for a new RSE licence may provide to APRA copies of documents that have been submitted in the course of a successful AFSL application, provided that such documents are up to date, comprehensive and relevant to the information requested in the APRA licence application form. Applicants that hold an AFSL must demonstrate they meet the operating standard for the purposes of the RSE licence.

## Financial resources

13. The standard does not operate as a 'de facto' capital requirement. Specific capital requirements are applicable to trustees of public offer entities and are set out in Part 2A of the SIS Act and in the SIS Regulations<sup>3</sup>. The operating standard on adequacy of resources of, or available to, trustees is separate from those capital requirements, and applies to all licensed trustees.

<sup>1</sup> See SPG 231 on outsourcing.

<sup>2</sup> *Corporations Act 2001*, para. 912A(1)(d).

<sup>3</sup> See SIS r. 3A.04 and Schedule 5 to the SIS Regulations and SPG 110 Capital.

14. The SIS Act provides that non-public offer funds may have a constitutional corporation as trustee or they may have a group of individual trustees. In both cases, the board of directors or the group of individuals will generally be comprised of equal numbers of employer and member representatives. It is highly unlikely that under either structure the trustee will have any capital or financial resources in its own right, apart from a nominal amount required for a corporate trustee under the Corporations Act. Funding of expenses incurred by the trustee generally will be either out of fund revenues and/or assets, as provided for in the governing rules of the fund or, in some cases, by an employer-sponsor. The standard does not require such trustees to hold financial resources in their own right. In assessing whether a licensee complies with the standard, APRA will have regard to the ability of the trustee to access sufficient funds to satisfy its liquidity and solvency requirements<sup>4</sup>.
15. The standard requires that the financial resources that a trustee should demonstrate on application for an RSE licence, and on an ongoing basis after being granted a licence, include:
  - (a) adequate resources to ensure the ongoing solvency of the trustee; and
  - (b) adequate liquidity to support the business operations of the trustee.
16. In satisfying itself that it has complied with the requirements of the standard, a trustee adopting sound prudential practice would take into account the particular circumstances of its superannuation, and any other, operations and would consider factors such as:
  - (a) the complexity of its superannuation offerings, including factors such as the number and structure of funds under trusteeship, the number and nature of investment strategies offered to members, arrangements for unit pricing or setting crediting rates, the number of members and the geographic spread of operations;
  - (b) reliance on custodian conditions to meet the capital requirements under s. 29DA. Where such trustees also provide in-house administration services this would also be a matter to be considered in assessing the adequacy of financial (and other) resources;<sup>5</sup>
  - (c) the extent of its other business operations. This would include whether operations are conducted under legislation administered by another regulator where that regulator relies on APRA's prudential supervision to satisfy its own capital and risk management requirements in respect of the particular entity; for example, a responsible entity of a managed investment scheme is exempted from capital requirements set out in ASIC's RG 166 where it is also the holder of an RSE licence from APRA;
  - (d) the availability for trustees of non public offer funds of alternative sources of working capital. It is recognised that the number of trustees of non public offer funds that have access to working capital outside of the fund will be limited but some may derive it from, for example, trustee fees (if relevant under fund governing rules) or an arrangement with an employer-sponsor;
  - (e) for non-public offer funds, the extent to which material business activities are performed in-house rather than outsourced to a service provider under contract or relying on staff of a sponsoring employer. In such cases, the trustee's business plan would generally allow for a margin over and above projected normal liquidity requirements as an operational risk margin to meet unexpected contingencies. This would be sound practice where the trustee relies on access to fund assets and earnings to meet fund expenses, as well as in situations where the trustee has access to other sources of working capital.

<sup>4</sup> Company directors have a duty under s. 588G of the Corporations Act to prevent insolvent trading by the company.

<sup>5</sup> See SPG 110 Capital

A prudent trustee would generally establish a margin by taking into account the nature, materiality and complexity of its operations;

- (f) support provided by an employer-sponsor – in the case of a standard employer-sponsored fund where the employer provides administration or other non-financial support, the degree to which the trustee can assured of continued employer support;
- (g) public sector status -the extent to which a trustee’s operations are carried out or underwritten by government agencies, statutory authorities or government controlled corporations; and
- (h) scope and level of insurance cover – whether the trustee maintains adequate levels of insurance against liabilities incurred as a result of a breach of its professional duty as trustee of an entity, and adequate levels of business insurance in respect of its business or undertaking as trustee of an entity. ‘Adequate levels of insurance’ means levels of insurance that are prudent and reasonable in all the circumstances, taking into account the assets (if any) of the trustee, the assets of the entities for which it is trustee, and all circumstances of the trustee and its business or undertakings that are reasonably relevant to the risk for which the insurance concerned provides indemnity. Trustees of public offer entities are expected to have an adequate level of professional indemnity insurance.

17. In assessing whether a trustee meets the requirements of the standard, APRA may require substantiation of claims to adequate financial resources. Relevant substantiation includes, but is not limited to:

- (a) in the case of a for-profit trustee, particularly where other business is conducted or more than one fund is involved, a business plan that demonstrates the trustee’s ability to earn a reasonable return (to the trustee) while charging a reasonable fee for its services to members;

- (b) financial position forecasts that take into account cash flows to meet the trustee’s liquidity requirements<sup>6</sup>;
- (c) outlines of current insurance coverage as well as ongoing commitment to take out and maintain cover, as reflected in an insurance strategy;
- (d) procedures for monitoring ongoing financial performance including liquidity requirements;
- (e) where the trustee conducts no business other than operation of one or more superannuation funds and performs material business activities in-house, a budget showing resources and expected operating costs plotted against fund membership and asset size over time;
- (f) enforceable agreements under which material business functions are outsourced to a service provider;
- (g) evidence of appropriate due diligence which supports the trustee’s satisfaction with the capacity of material service providers, including satisfaction with their financial capacity to remedy any failings in providing the contracted services;
- (h) agreements under which an employer sponsor or other party commits to providing on-going material support to the trustee.

18. While it would not be the norm for APRA to impose as a licence condition a specified minimum level of financial resources to be held by a trustee, it is open to APRA to do so on a case by case basis if it is satisfied neither that the trustee’s demonstrated financial resources are adequate for the nature of its business, nor that the trustee’s proposed response to that perceived inadequacy is sufficient in the circumstances.

<sup>6</sup> Applicants should consult with APRA if the compilation and provision of financial position forecasts conflicts with disclosure and other obligations imposed by ASIC or the Australian Stock Exchange.

## Technical resources

19. Adequate technical resources include adequate systems to handle necessary transaction processing as well as any planned, forecast or likely significant changes or increases in business size or capacity. Where material business activities are outsourced, a prudent trustee would ensure that the service provider has adequate technical resources to perform the relevant functions, as well as appropriate hardware and software maintenance and replacement policies. In addition APRA would expect the trustee or its service provider to have demonstrated effective disaster recovery and business continuity plans in the event of failure of its technical systems.
20. The technical resources that a trustee would be expected to maintain, or have access to, include but are not limited to:
  - (a) adequate information technology and communication systems, including hardware and software adequate for the complexity of the processing tasks, the number of transactions and the number and location of users;
  - (b) adequate technical skills to maintain and upgrade those systems, and provide help to front-line users;
  - (c) adequate procedures and resources to ensure protection, security and privacy of confidential, personal and sensitive material, whether stored in soft or hard copy or obtained from members face to face or through a call centre;
  - (d) adequate technical resources to handle any significant changes or increases in business size or capacity that are planned or forecast or that are likely to occur;
  - (e) adequate disaster recovery and business continuity plans;
  - (f) adequate records maintenance systems.
21. APRA may require substantiation of claims to adequate technical resources. Relevant substantiation includes, but is not limited to:
  - (a) a description of systems in place and programs for development of those systems to cater for growth requirements and obsolescence of hardware and software, including, where relevant, a methodology to manage legacy systems and products;
  - (b) evidence of the inclusion in the risk management framework of processes in place to ensure adequate protection of information against loss and unauthorised alteration of records, including capacity to identify and reconcile for irregularities, inaccuracies and errors in information and to ensure compliance with statutory privacy laws;
  - (c) evidence of the inclusion in the risk management framework of appropriate disaster recovery and business continuity arrangements, and evidence of testing and review of those arrangements; and
  - (d) evidence of the due diligence undertaken by the trustee to satisfy itself that outsourced providers of material services have adequate technical resources available to them to fulfil their contracted obligations to the trustee.

## Human resources

22. In order to show that it meets the operating standard, a prudent trustee would be able to demonstrate that it employs or has continuing access to adequate human resources. Adequacy would be assessed in terms of overall staffing levels; and the appropriate skills, knowledge and expertise to enable the trustee to carry out its obligations effectively and in conformity with its risk management framework. Where the trustee outsources material business activities, it would ordinarily conduct due diligence to ensure that the service provider has adequate human resources to perform the relevant functions at the service levels specified under the outsourcing agreement.

23. Where business activities are undertaken in-house, rather than being outsourced, APRA expects to see measures in place to ensure:
- (a) the trustee has appropriate internal control procedures and that staff are trained in their use;
  - (b) beneficiary complaints and queries can be responded to quickly and accurately;
  - (c) appropriate recruitment and induction processes, as well as succession planning for key roles;
  - (d) staff are monitored and supervised and, particularly where the trustee's operations are diverse, supervisors have sufficient capacity to supervise staff adequately; and
  - (e) future operational demands are continuously assessed to ensure there are sufficient resources to meet demands.
24. Where activities are outsourced, APRA expects to see evidence as to how the trustee has satisfied itself that the service provider has measures in place to achieve the outcomes in paragraph 23.
25. APRA may require substantiation of claims to adequate human resources. Relevant substantiation includes, but is not limited to, documentation in respect of:
- (a) appropriate policies and procedures for staff recruitment, training and performance management necessary to ensure trustees duties are discharged;
  - (b) appropriate policies and procedures in place to address succession, redundancy, or retrenchment issues and the effect of these issues on the trustee's ability to properly perform its duties;
  - (c) appropriate controls to address risks associated with human error and fraud including appropriate insurance cover;
  - (d) human resources policies that encourage proactive risk management and regulatory compliance; and
  - (e) outsourcing arrangements that meet the requirements of the operating standard on outsourcing.



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