



Response to Submissions

Prudential standards for superannuation

15 November 2012

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Preamble

The *Superannuation Industry (Supervision) Act 1993* was amended by the Commonwealth Parliament on 8 September 2012 to provide APRA with a prudential standards-making power for prudentially regulated superannuation entities.

In April 2012, APRA released a response paper and eleven draft prudential standards to implement its proposed prudential framework for superannuation, incorporating those elements of the Government's superannuation reforms that come within APRA's mandate. These draft prudential standards reflected APRA's response to submissions received on a previous discussion paper, released in September 2011. APRA invited comments on its proposals and received a significant number of submissions.

This paper describes APRA's response to the main issues raised in submissions on the April consultation package.

The majority of the requirements in the prudential standards for superannuation will take effect on 1 July 2013. Some transitional provisions will commence earlier, on the day the prudential standards are registered on the Federal Register of Legislative Instruments, to ensure that arrangements entered into with third parties after the date of registration comply with certain requirements of the prudential standards.

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Executive summary

The *Superannuation Industry (Supervision) Act 1993* was amended by the Commonwealth Parliament on 8 September 2012 to provide APRA with a prudential standards-making power for prudentially regulated superannuation entities.

In September 2011, APRA released a discussion paper on APRA's proposals for prudential standards in superannuation. This was followed, in April 2012, by a response paper to the submissions received and the release of eleven draft prudential standards. APRA invited comments on its proposals and received a significant number of submissions. This paper describes APRA's response to the main issues raised in submissions on the April consultation package.

The prudential standards implement APRA's proposed prudential framework for superannuation, covering both topics common to other APRA-regulated industries and superannuation-specific topics. The prudential standards incorporate those elements of the Government's superannuation reforms that come within APRA's mandate.¹

The majority of the requirements in the prudential standards for superannuation will take effect on 1 July 2013. Some transitional provisions will commence earlier, on the day the prudential standards are registered on the Federal Register of Legislative Instruments, to ensure that arrangements entered into with third parties after the date of registration comply with the requirements of certain prudential standards.

Submissions to APRA

APRA received 38 written submissions on its proposals from a wide range of stakeholders including RSE licensees, consultants, industry bodies and professional bodies. In addition to considering written submissions, APRA has presented at a number of seminars on the proposals and has met with a number of RSE licensees and other stakeholders to discuss the proposals.

Submissions were unanimously supportive of APRA's objectives and the broad direction of the prudential standards, including the range of topics that the prudential standards will cover. The submissions, however, indicated several areas where clarification or amendment was felt to be needed; these are addressed in this paper.

Guidance

APRA will consult on draft prudential practice guides (PPGs) to support the proposed prudential standards in two stages: the first will be released for consultation towards the end of 2012 and the second in the second quarter of 2013.

¹ <http://strongersuper.treasury.gov.au/content/Content.aspx?doc=home.htm>

Glossary

APRA	Australian Prudential Regulation Authority
APESB	Accounting Professional Ethical and Standards Board
April consultation package	Response to Submissions: <i>Prudential standards for superannuation</i> and eleven draft prudential standards (released 27 April 2012)
ASX Principles	ASX Corporate Governance Council <i>Corporate Governance Principles and Recommendations with 2010 Amendments</i> , 2nd edition, 2007
AUASB	Audit and Assurance Standards Board
the board	the board of an RSE licensee that is a constitutional corporation
CEO	Chief Executive Officer
Corporations Act	<i>Corporations Act 2001</i>
CPS 231	<i>Prudential Standard CPS 231 Outsourcing</i>
CPS 232	<i>Prudential Standard CPS 232 Business Continuity Management</i>
CPS 510	<i>Prudential Standard CPS 510 Governance</i>
CPS 520	<i>Prudential Standard CPS 520 Fit and Proper</i>
director	a director of an RSE licensee that has a board of directors or, in the case of a group of individual trustees, an individual trustee.
ORFR	operational risk financial requirement
PPG	prudential practice guide
PST	pooled superannuation trust
RSE	registrable superannuation entity as defined in s. 10 of the SIS Act
RSE licensee	a constitutional corporation, body corporate, or group of individual trustees, that holds an RSE licence granted under s. 29D of the SIS Act
RSE licensee's business operations	all activities as an RSE licensee (including the activities of each RSE of which it is the licensee), and all other activities of the RSE licensee to the extent that they are relevant to, or may impact on, its activities as an RSE licensee.
September discussion paper	Discussion Paper: <i>Prudential standards for superannuation</i> (released 28 September 2011)
SG Act	<i>Superannuation Guarantee (Administration) Act 1992</i>
SIS Act	<i>Superannuation Industry (Supervision) Act 1993</i>
SIS Regulations	<i>Superannuation Industry (Supervision) Regulations 1994</i>
Tranche 3 Bill	Superannuation Legislation Amendment (MySuper Measures and Transparency) Bill 2012
Tranche 4 Bill	Superannuation Legislation Amendment (Further Measures) Bill 2012

Final prudential standards

SPS 114 *Prudential Standard SPS 114 Operational Risk Financial Requirement*

SPS 160 *Prudential Standard SPS 160 Defined Benefit Matters*

SPS 220 *Prudential Standard SPS 220 Risk Management*

SPS 231 *Prudential Standard SPS 231 Outsourcing*

SPS 232 *Prudential Standard SPS 232 Business Continuity Management*

SPS 250 *Prudential Standard SPS 250 Insurance in Superannuation*

SPS 310 *Prudential Standard SPS 310 Audit and Related Matters*

SPS 510 *Prudential Standard SPS 510 Governance*

SPS 520 *Prudential Standard SPS 520 Fit and Proper*

SPS 521 *Prudential Standard SPS 521 Conflicts of Interest*

SPS 530 *Prudential Standard SPS 530 Investment Governance*

Proposed final *Prudential Standard SPS 410 MySuper Transition* was released on 3 October 2012. It will be determined following the passage of relevant legislation.

Chapter 1 – Introduction

1.1 Background

On 27 April 2012, APRA issued a response paper, *Prudential standards for superannuation*, and eleven draft prudential standards outlining its proposals for prudential standards in superannuation (April 2012 consultation package). The April 2012 consultation package was developed following consideration of submissions on the discussion paper, *Prudential standards for superannuation*, released by APRA on 28 September 2011 (September discussion paper).

On 8 September 2012, the *Superannuation Industry (Supervision) Act 1993* (SIS Act) was amended to introduce s. 34C, which enables APRA to make prudential standards in relation to superannuation. The prudential standards for superannuation:

- cover both topics common to other APRA-regulated industries and superannuation-specific topics;
- harmonise the requirements for superannuation with those applying to other APRA-regulated industries, where appropriate;
- implement the superannuation reforms that the Government has recommended APRA implement in prudential standards; and
- relocate some existing requirements and guidance into the new prudential standards.

The final prudential standards accompany this response paper and reflect changes to the draft standards released in April 2012 to address a number of the issues raised in submissions. The new prudential standards will take effect from 1 July 2013 (subject to the early commencement of some provisions, as outlined below).

1.2 Feedback from consultation

APRA received 38 written submissions on the April consultation package from a wide range of stakeholders including RSE licensees, consultants, industry bodies and professional bodies. In addition to considering written submissions, APRA has presented at a number of seminars on the proposals and has met with a number of RSE licensees and other stakeholders to discuss the proposals.

Submissions were unanimously supportive of APRA's objectives and the broad direction of the prudential standards, including the range of topics that the prudential standards will cover. The submissions, however, indicated several areas where clarification or amendment was felt to be needed; these are addressed in this paper.

In addition to providing specific feedback on the prudential standards, the submissions suggested a number of areas where APRA could consider issuing guidance. APRA has considered these suggestions in developing the prudential practice guides (PPGs) that are to be released for consultation in December 2012.

This response paper summarises the main issues raised in submissions and APRA's response. APRA has refined its proposals in a number of areas to address issues raised.

Some submissions raised legal concerns with the drafting of the prudential standards, specifically around wording related to the best interests duty and the reasonable expectations of beneficiaries. APRA has amended the prudential standards in some areas to address these concerns.

The main issues for each prudential standard are covered in the following chapters. Three prudential standards have only had minor changes made and are addressed below.

1.2.1 Prudential Standard SPS 114 Operational Risk Financial Requirement

RSE licensees and their registrable superannuation entities (RSEs) are exposed to a number of operational risks. Whilst a robust risk management framework enables an RSE licensee to identify, mitigate and monitor risks, it cannot entirely eliminate operational risk.

Whilst submissions received in response to draft *Prudential Standard SPS 114 Operational Risk Financial Requirement* (SPS 114) indicated broad support for the requirements of the standard, some minor amendments were suggested to clarify the purposes for which financial resources held to meet the operational risk financial requirement (ORFR) can be used.

In particular, the provisions in SPS 114 relating to the use of the ORFR have been amended to clarify that it may be appropriate for an RSE licensee to reduce the financial resources held to meet the ORFR (e.g. should the size of an RSE decline) to ensure that the ORFR remains at the target level. There are only minor drafting changes to the remainder of SPS 114.

1.2.2 Prudential Standard SPS 232 Business Continuity Management

Business continuity management is an important component of a risk management framework and is essential to support an RSE licensee in meeting its obligations to its beneficiaries.

Submissions received in response to draft *Prudential Standard SPS 232 Business Continuity Management* (SPS 232) were broadly supportive of the requirements of the standard and SPS 232 has only been amended to make minor drafting changes for clarification.

1.2.3 Prudential Standard SPS 520 Fit and Proper

Persons who are responsible for the management and oversight of an RSE licensee's business operations need to have appropriate skills, experience and knowledge, and act with honesty and integrity. To this end, *Prudential Standard SPS 520 Fit and Proper* (SPS 520) requires RSE licensees to prudently manage the risk that persons in positions of responsibility might be incompetent or dishonest.

Submissions requested greater clarity on the definition of 'senior manager'. Some submissions expressed concern with the introduction of this concept, as it could result in a wide range of individuals being subject to the fit and proper policy. A broad construction of the term 'senior manager' could also increase the difficulty of complying with SPS 510 and SPS 521, which also make reference to an RSE licensee's responsible persons.

APRA considers it important that all responsible persons of an RSE licensee have the appropriate skills, experience and knowledge to manage or oversee an RSE licensee's business operations, and can reasonably be expected to act with honesty and integrity. Accordingly SPS 520 retains 'senior manager' as a responsible person. The definition of responsible person also includes 'executive officer', as defined by s. 10 of the SIS Act. This, in conjunction with guidance to be proposed in an upcoming draft PPG, will provide additional clarity for RSE licensees when applying the concept of 'responsible person'.

1.3 Impact of the legislative timetable

The Government has announced, in the draft Superannuation Legislation Amendment (Further Measures) Bill 2012 (Tranche 4 Bill), that it intends to make a number of legislative amendments to support APRA's introduction of specific prudential standards. These amendments relate to APRA's fitness and propriety requirements and obligations for RSE auditors and RSE actuaries.

These amendments have not yet become law. In the interests of greater certainty for the superannuation industry, however, APRA is releasing 'proposed final' versions of three prudential standards SPS 520, *Prudential Standard SPS 310 Audit and Related Matters* (SPS 310) and *Prudential Standard SPS 160 Defined Benefit Matters* (SPS 160)) with this paper. Should the legislation not be amended as proposed prior to 1 July 2013, APRA will consult further on updated versions of these three prudential standards if required.

As the provisions in these three prudential standards do not take effect until 1 July 2013, APRA will formally determine and register these prudential standards on the Federal Register of Legislative Instruments once the legislation is finalised.

1.4 Transition to prudential standards

Some submissions sought a transition period for, or for APRA to confirm that it will take a pragmatic approach to its oversight of, the implementation of the prudential standards.

After considering further the practical implementation of the requirements in the prudential standards, APRA has included in *Prudential Standard SPS 510 Governance* (SPS 510) and *Prudential Standard SPS 250 Insurance in Superannuation* (SPS 250) additional transition provisions relating to employment contracts and historical claims data. These provisions are discussed in Chapters 2 and 10, respectively.

APRA does not, however, believe that a broad transition period is necessary as it considers that RSE licensees have had sufficient time and notice to prepare for, and implement, the core requirements of the prudential standards. APRA recognises, that some RSE licensees may have particular difficulties implementing some of the requirements. RSE licensees in that situation are encouraged to discuss with their responsible supervisors any need for specific transition relief.

1.4.1 Review of existing contracts

As outlined in the April consultation package, certain provisions in some prudential standards will commence on the date of registration of the prudential standards, which will be prior to the general effective date of 1 July 2013.

The provisions that commence on the date of registration require an RSE licensee seeking to enter into a new contractual arrangement that falls within the coverage of the new outsourcing, business continuity management and insurance prudential requirements to comply with provisions in the prudential standards that relate to decisions to enter into contractual arrangements.

The relevant provisions are in *Prudential Standard SPS 231 Outsourcing* (SPS 231), SPS 232, SPS 250 and SPS 510. These provisions require an RSE licensee to assess all existing contractual arrangements against the new prudential requirements and, where the arrangement does not reflect the new requirements, take all reasonable steps to renegotiate the arrangement. Where an RSE licensee determines that to renegotiate the terms of the arrangement would be contrary to be best interests of beneficiaries, it must be able to demonstrate to APRA why this is the case. The RSE licensee must also notify APRA of the anticipated end-date of any agreement that does not meet the requirements of the relevant prudential standard.

A number of submissions, whilst agreeing with the intent behind the transition provisions, suggested that APRA consider providing relief from the re-negotiation requirement where an existing contract expires soon after the commencement of the standards. APRA accepts that it is reasonable that an RSE licensee with an existing contract that is due to expire prior to 31 December 2013 should not have to re-negotiate the contract. As a result, the transition provisions have been amended. RSE licensees are still required, however, to review all arrangements against the new prudential requirements, regardless of their end date, and advise details of this assessment to APRA by 1 July 2013.

1.5 Proposed guidance material

As previously indicated, APRA intends to issue PPGs to assist industry's implementation of the prudential standards.

Submissions on the April consultation package suggested a number of areas where APRA could consider issuing guidance. APRA expects to release the first set of draft PPGs before the end of 2012, with further PPGs to be released for consultation in the first quarter of 2013.

The proposed PPGs to be released in December 2012 are:

- *Prudential Practice Guide SPG 114 Operational Risk Financial Requirement;*
- *Prudential Practice Guide SPG 220 Risk Management;*
- *Prudential Practice Guide SPG 231 Outsourcing;*
- *Prudential Practice Guide SPG 232 Business Continuity Management;*
- *Prudential Practice Guide SPG 250 Insurance in Superannuation;*
- *Prudential Practice Guide SPG 510 Governance;*
- *Prudential Practice Guide SPG 520 Fit and Proper;*
- *Prudential Practice Guide SPG 521 Conflicts of Interest;*
- *Prudential Practice Guide SPG 530 Investment Strategy – Formulation;* and
- *Prudential Practice Guide SPG 531 Investment Strategy – Implementation.*

A second set of proposed PPGs is expected to include guidance on audit, defined benefit matters and further aspects of investment governance. Other potential areas of guidance include self-insurance, the use of reserves in superannuation and cross-industry guidance on the management of data risk.

1.6 Process and timetable

The key milestones in APRA's implementation of the superannuation reforms are:

December 2012	Release of first set of PPGs for comment by March 2013
January 2013	MySuper authorisation commences
March 2013	Release of final reporting standards
May 2013	Release of second set of PPGs for comment by July 2013
July 2013	Release of first set of final PPGs
1 July 2013	New prudential and reporting standards effective
1 July to 30 Sept 2013	First reporting period under new standards (first data submitted Oct 2013)
October 2013	Release of second set of final PPGs

Chapter 2 – Governance

Good governance benefits all stakeholders of an RSE licensee and helps to maintain public confidence in an RSE licensee’s business operations. *Prudential Standard SPS 510 Governance* (SPS 510) requires an RSE licensee to develop a sound governance framework and structures to allow it to make reasonable and impartial business judgements in the best interests of beneficiaries.

2.1 Issues raised during consultation

Submissions were largely supportive of the requirements set out in draft SPS 510. Significant comments, however, were received on a number of the proposed requirements. These are discussed below.

A number of submissions expressed support for greater levels of independence on RSE licensee boards. Requirements relating to board composition, including the role of independent directors, are a matter for Government policy and are not considered in this paper. APRA will consider the views relating to independence in the development of guidance on governance matters.

2.1.1 Remuneration

Draft SPS 510 included a range of requirements relating to remuneration arrangements within the RSE licensee’s business operations. These requirements included:

- a remuneration policy that aligns the RSE licensee’s remuneration arrangements with its ongoing capacity to meet the reasonable expectations of beneficiaries and with its risk management framework. This policy covers a range of responsible persons; and
- the consideration of all forms of remuneration when meeting the requirements of SPS 510 regardless of where, or from whom, the remuneration is sourced.

Comments received

Some submissions argued that only remuneration paid to responsible persons out of the assets of the RSE, or for whom the majority of their remuneration is derived from activities directly associated with the activities of the RSE licensee, should be captured by the provisions of SPS 510. Submissions otherwise expressed broad support for the provisions of SPS 510 relating to remuneration.

APRA response

The objective of APRA’s remuneration requirements is to support remuneration practices which discourage excessive risk-taking that is not in the best interest of beneficiaries.

APRA’s view, therefore, is that all forms of remuneration paid to those persons whose risk-taking activities have the potential to impact on the benefits of beneficiaries, regardless of the source of the payment and whether the remuneration is paid directly or indirectly. Given the wide variety of structures in RSE licensees’ business operations, APRA continues to be of the view that all remuneration paid to persons with respect of the functions they perform for the RSE licensee’s business operations must be addressed by the RSE licensee’s remuneration policy in order for the remuneration requirements to achieve their objective. SPS 510 therefore continues to apply to all forms and sources of remuneration.

2.1.2 Composition of board committees

Draft SPS 510 proposed that each RSE licensee be required to put in place a Board Remuneration Committee and a Board Audit Committee, both of which would be comprised of non-executive directors. APRA also proposed that only a director of the RSE licensee could chair any board committee responsible for activities relating to protecting the interests of beneficiaries or the long-term financial soundness of the RSE licensee or any of the RSEs or connected entities.

Comments received

A number of submissions noted that it is common for RSE licensees to have in place arrangements where non-directors serve as the chair on board committees, including Board Investment Committees, which would fall under the description of the additional board committees described in SPS 510.

Submissions indicated that these arrangements support the provision of relevant expertise to the respective committee where the board thought this was necessary. Submissions also argued that the need to attract suitable candidates to board committees may rely on the ability to offer the position of the chair.

APRA response

APRA's view is that it is important that the chair of a board committee responsible for matters relevant to the RSE licensee continuing to meet its obligations to beneficiaries also has the responsibilities of being a director of the RSE licensee. The provisions of SPS 510 do not prevent non-directors from being members of board committees.

Allowing only directors to chair relevant board committees supports effective governance, both within the board committee itself and in the relationship between the board and the board committee, by ensuring continuity of responsibility. APRA's view is that the requirements in SPS 510 do not restrict the board or its committees from obtaining expert advice where it considers this to be appropriate. As such, the board committee provisions in SPS 510 are unchanged.

2.1.3 Directors ordinarily resident in Australia

Draft SPS 510 proposed to require all senior management and all directors to be resident in Australia.

Comments received

A number of submissions suggested difficulties with all directors being required to be resident in Australia and queried why APRA was seeking to depart from the existing requirements for RSE licensees of public offer funds.

APRA response

APRA recognises that the practical compliance difficulties for some RSE licensees outweigh the benefits that might flow from all directors being resident in Australia. APRA now considers that residence in Australia of a majority of directors is sufficient. The provisions of SPS 510 therefore align with the requirement in *Prudential Standard CPS 510 Governance* (CPS 510).

2.1.4 Auditor independence

Draft SPS 510 contained a range of proposed requirements to support the independence of the auditor engaged to perform work of a prudential nature. This included requirements relating to the length of time served by any person who plays a significant role in the audit function.

Draft SPS 510 limited the length of time that an individual can play a significant role in the audit of the RSE licensee to five out of seven consecutive years. Further, the individual cannot continue to play a significant role in the audit until two more years have passed. This requirement mirrors the provisions of CPS 510 and the requirements in section 324DA of the *Corporations Act 2001* (Corporations Act) applying to publicly listed companies.

Comments received

Submissions expressed support for setting a maximum period of time for a person to play a significant role in the audit. However, the submissions highlighted an inconsistency with the mandatory Accounting Professional Ethical and Standards Board (APESB) standards for members of the professional accounting bodies. Specifically, APESB 110 Code of Ethics for Professional Accountants, which applies to audits of 'public interest' entities, requires that an individual cannot act as a key audit partner for more than seven years.

Submissions argued that APRA's position represents a significant shift away from the current practices of auditors.

APRA response

APRA notes the difference between the position in SPS 510 and the standards set by APESB, but has not amended SPS 510. Equivalent requirements to those in SPS 510 have applied for some time to the banking and insurance industries without difficulty.

2.1.5 Transition to full compliance with SPS 510

As noted above, draft SPS 510 included requirements in relation to how responsible persons and other relevant persons are remunerated, including providing for the board to adjust performance based components of remuneration downwards, to zero if appropriate, in certain defined circumstances.

Draft SPS 510 also proposed requirements relating to the composition and chairing of board committees.

Comments received

A number of submissions noted that RSE licensees are likely to encounter practical difficulties when implementing some of the proposed governance requirements.

In particular, submissions argued that the remuneration policy requirements would have a significant impact on existing employment and service contracts with terms that extend beyond the effective date of SPS 510, but which do not comply with the requirements of SPS 510. The requirements of SPS 510, it was argued, should apply only to contracts entered into after the standard commences so as to not unreasonably affect existing employment and service contracts.

The submissions also highlighted the need for transition relief with respect to the requirements relating to the composition of board committees. Where RSE licensees have arrangements in place where, for example, non-directors act as the chair on board committees, a breach of contract with a non-director may occur if the RSE licensee attempts to discontinue these arrangements by the effective date of SPS 510.

APRA response

To ensure that RSE licensees are not required to unreasonably terminate existing employment or service contracts, APRA has included specific transition provisions in SPS 510. The effect of these provisions is to require all RSE licensees to identify all relevant employment and service contracts after the registration date of SPS 510 and take all reasonable steps to renegotiate them to achieve compliance with SPS 510. Where compliance with the provisions in SPS 510 relating to employment and service contracts cannot be achieved through renegotiation of existing arrangements, an RSE licensee would be permitted to keep the contracts in place subject to notifying APRA of the end-date of the contracts.

Chapter 3 – Conflicts of interest

Managing conflicts of interests and duties is a key aspect of RSE licensee compliance with the overarching legislative obligation to act in the best interests of beneficiaries. This chapter responds to feedback on *Prudential Standard SPS 521 Conflicts of Interest* (SPS 521).

3.1 Issues raised during consultation

3.1.1 Application of the conflicts management framework

Draft SPS 521 proposed that RSE licensees develop and maintain a conflicts management framework, containing a comprehensive system of internal controls and reporting, with the objective of supporting a culture across the RSE licensee's business operations in which conflicts are identified, avoided or managed and reported.

Comments received

Submissions generally supported the requirement to develop a comprehensive conflicts management framework, but suggested that SPS 521 include greater clarity as to how the framework might be applied to the entirety of an RSE licensee's business operations. This is important, the submissions noted, because many RSE licensees have a range of internal policies and procedures that apply to all employees, not just those holding responsible persons positions.

APRA response

The conflicts management framework required in SPS 521 is designed to assist RSE licensees in establishing and maintaining an organisational culture in which conflicts are routinely identified, avoided or managed and reported. SPS 521 has been amended to explicitly require an RSE licensee to include all employees within the scope of the conflicts management framework. However, the requirements in relation to the registers of duties and interests apply only to the RSE licensee and its responsible persons.

3.1.2 Disclosure obligations

Draft SPS 521 proposed to require RSE licensees to disclose both their conflicts management policy and their registers of relevant interests and duties. These proposals were designed to enhance the transparency of the RSE licensee's approach to identifying, avoiding or managing and reporting on conflicts.

Comments received

Submissions supported the requirement to have a comprehensive conflicts management policy and registers of relevant interests and duties. Some submissions, however, expressed concern about the requirement to publicly disclose an RSE licensee's conflicts management policy on its website. In particular, submissions argued that this would be likely to lead to RSE licensees preparing less detailed conflicts management policies that were suitable for the public rather than effective policies for the internal use. This approach, it was argued, would ultimately provide no discernible benefit to beneficiaries.

Submissions also queried the purpose of the proposed disclosure of the registers of duties and interests. In particular, submissions noted the regulatory burden involved, lack of relevance to beneficiaries and the risk of providing information to the public without also being able to provide necessary context. Respondents also commented on the difficulty of preparing a list of duties given the wide range of statutory, general law and licensee duties that exist in superannuation.

APRA response

After considering the matters raised in submissions, APRA proposes not to require the public disclosure of the conflicts management policy in SPS 521. The removal of this requirement harmonises SPS 521 with APRA's other prudential standards, which do not require the public disclosure of internal policies.

APRA remains of the view that the registers of duties and conflicts are key elements of an RSE licensee's conflict management framework. They assist in providing reasonable assurance that all conflicts are being clearly identified and managed. APRA also maintains the view that disclosure of these registers will enhance the transparency and accountability of RSE licensees, which is in the best interests of beneficiaries.

APRA considers, however, that the disclosure of both the conflicts management policy and the registers would be more efficiently achieved using existing disclosure requirements in the Corporations Act and associated regulations. The Government has indicated, in the Superannuation Legislation Amendment (MySuper Measures and Transparency) Bill 2012 (Tranche 3 Bill), that legislative amendments to require the disclosure of certain information will be included in s. 29QB of the SIS Act, with details specified in the SIS Regulations.

As such, APRA has not included the requirement to publicly disclose the registers of duties and interests on an RSE licensee's website in SPS 521.

3.1.3 Materiality assessments

Draft SPS 521 proposed to require RSE licensees to develop and maintain registers of all duties and interests (expressed as 'all interests, gifts, emoluments and benefits'). Under these requirements, an RSE licensee would have flexibility to set materiality thresholds for the registers that reflected the nature of its business operations, subject to the process for determining materiality being documented and agreed by the board.

Comments received

Some submissions requested that APRA clarify the requirement to determine a level of materiality for inclusion of interests on the registers. It was also suggested that broad materiality criteria be permitted, instead of a requirement to set a dollar amount threshold.

APRA response

APRA maintains its view that an RSE licensee is best placed to assess the interests that may be sufficiently material to require disclosure but recognises that an approach limited to dollar amount considerations may be unnecessarily restrictive. Accordingly, SPS 521 proposes to require an RSE licensee to determine an appropriate materiality threshold for the registers that is related to whether the interest is likely to have a significant impact on the capacity of the person holding the relevant interest to act in a manner that is inconsistent with the best interests of beneficiaries.

Further, SPS 521 now clarifies that the relevant duties that must be considered in an RSE licensee's conflicts management framework and on the register of relevant duties are those duties that are relevant to the responsible person performing their functions for the RSE licensee. As such, SPS 521 now requires an RSE licensee to also have a process for determining what is a relevant duty, in addition to what is a relevant interest, for the purposes of the registers.

APRA intends to issue guidance on factors to consider when determining an appropriate level of materiality, including the application of a dollar value or other limits with respect to relevant interests.

Chapter 4 – Risk management

Robust risk management is a key element of APRA's prudential requirements. An effective risk management framework allows RSE licensees to have sound oversight of the entirety of their business operations. This chapter responds to feedback on *Prudential Standard SPS 220 Risk Management (SPS 220)*.

4.1 Issues raised during consultation

Submissions generally expressed support for the provisions of draft SPS 220 and, in particular, the flexibility to implement risk management approaches that are appropriate and necessary to reflect different circumstances and risks. As a result, SPS 220 has not changed substantially following the consultation.

4.1.1 Duration of business plan

Draft SPS 220 proposed that an RSE licensee have a written business plan that sets out the strategic direction of its approach to managing its business operations. Draft SPS 220 proposed that the business plan be a three-year rolling plan that is reviewed at least annually (or as close to annually as is practical), with the results of the review reported to the board.

Comments received

Submissions queried whether APRA would allow flexibility as to the length of this plan and the relationship between a longer-term strategic plan and a shorter-term rolling business plan. Submissions emphasised that some RSE licensees have a strategic plan that covers three to five years, with a one-year rolling business plan that forms part of this strategic plan.

APRA response

APRA considers there is merit in allowing some flexibility for an RSE licensee to set its business plan outside of a three-year planning cycle, particularly where there is an annual review process, as long as this planning cycle does not exceed five years. The provisions of SPS 220 now reflect this position.

4.1.2 Risk tolerance limits

Draft SPS 220 proposed to require an RSE licensee, as part of its risk appetite statement, to identify the maximum level of risk within which they are willing to operate, referring to this as 'risk tolerance'.

Comments received

Some submissions suggested that, instead of the risk tolerance requirement, APRA should consider requiring an RSE licensee to develop a program of periodic stress tests for a sample of material risks, in conjunction with less frequent stress tests for all material risks.

APRA response

APRA considers that risk tolerance limits provide a clear and transparent approach for monitoring risks. Whilst recognising the value of stress testing, APRA's view is that the proposed requirement would be more complex and potentially more costly for the industry. The provisions relating to risk tolerance in SPS 220, therefore, remain unchanged and do not preclude an RSE licensee from adopting a stress-testing approach. APRA will also consider this issue further in the upcoming guidance material.

Chapter 5 – Outsourcing

Many RSE licensees rely heavily on outsourcing. Core functions are often outsourced, including administration, custody, investment management and other support functions (such as secretariat and information technology). It is critical that governance over these arrangements is sound. All outsourcing arrangements involving material business activities must be subject to appropriate due diligence, approval and ongoing monitoring. This chapter responds to feedback on *Prudential Standard SPS 231 Outsourcing* (SPS 231).

5.1 Issues raised during consultation

Submissions expressed broad support for the provisions in draft SPS 231. Concerns were raised, however, in relation to the operation of transition provisions and the legal form of the agreement, and to the application of the requirement for prior consultation for offshoring agreements, particularly for investment management arrangements. Chapter 1 deals more broadly with the operation of the transition provisions across a number of the prudential standards; the latter two issues are discussed below.

5.1.1 Legal form of the outsourcing agreement

Draft SPS 231 proposed that all outsourcing arrangements must be contained in a documented legally binding agreement that is enforceable in Australia and is subject to Australian law.

Comments received

A number of submissions raised concerns in relation to this provision, indicating that it would be difficult or impossible for all agreements to be subject to Australian law. This was considered to be a particular concern in relation to agreements for offshoring arrangements, such as for the management of international investments.

APRA response

APRA recognises the complexities that might flow from the original provision and has, therefore, amended SPS 231 to require all outsourcing arrangements to be contained in a documented legally binding agreement but without reference to Australian law. This approach is consistent with that taken in *Prudential Standard CPS 231 Outsourcing* (CPS 231).

5.1.2 Offshoring arrangements

Draft SPS 231 proposed requirements in relation to offshoring that aligned with those currently in place for other APRA-regulated industries in CPS 231. The key requirement with respect to offshoring agreements was the proposed requirement for prior consultation with APRA before entering into offshoring arrangements.

Comments received

A number of submissions expressed concerns with this proposed requirement for prior consultation, particularly where the material business activity is an investment management arrangement. Some respondents indicated that an RSE licensee can have a very large number of investment arrangements in place at any time, and may need to regularly put new arrangements in place. In addition, changes to investment arrangements may need to be implemented at very short notice, making compliance with the prior consultation requirement difficult.

Submissions also queried whether outsourcing arrangements would be considered to be offshoring where there were only elements of offshoring, or there was only the potential for offshoring, within the agreement.

APRA response

APRA considers that offshoring involves particular risks to an RSE licensee's business operations. These include risks arising from different jurisdictions (e.g. due to different business and legal practices, including different insolvency laws), the risk of assets being more difficult to trace or recover, and the increased likelihood of substantial costs or delays that may occur even where assets may be recoverable.

The prior consultation requirement for offshoring agreements applies to other APRA-regulated industries and APRA's view is that it should also apply to superannuation.

The provisions relating to offshoring in SPS 231 therefore remain unchanged. APRA will issue guidance on the practical application of these requirements as part of the package of draft PPGs to be released before the end of 2012.

Chapter 6 – Investment governance

Robust investment governance is critical for an RSE licensee to manage the investments in each RSE to protect the interests, and meet the reasonable expectations of beneficiaries with respect to their retirement outcomes. This chapter responds to feedback on *Prudential Standard SPS 530 Investment Governance* (SPS 530).

6.1 Investment reporting measures

The Government has proposed, in the Tranche 3 Bill, amendments to the Corporations Act to introduce a new obligation for RSE licensees to make publicly available a product dashboard for each MySuper product and choice product.² APRA also proposes that RSE licensees be required to comply with reporting standards made under the *Financial Sector Collection of Data Act 2001* (FSCOD Act) that will include the investment reporting measures in the product dashboard and historical returns.³

To ensure an RSE licensee's investment governance framework adequately supports its obligation to disclose and report on investment reporting measures, APRA has included in SPS 530, as part of the requirements for the investment governance framework, a new obligation to develop and formally document the methodology for determining the product dashboard measures and historical returns relevant to investment reporting.

APRA's view is that the development, documentation and subsequent monitoring of investment reporting measures will provide greater transparency and a better understanding as to how investment risk and returns are measured. These requirements will also support improved comparability between MySuper products and between choice investment options.

6.2 Issues raised during consultation

Submissions broadly supported the proposed requirements in draft SPS 530, recognising the importance of robust investment governance practices in the superannuation industry.

Submissions predominately sought clarification about how SPS 530 would apply to the range of organisational and investment structures of RSE licensees across the superannuation industry. In particular, some submissions queried how the requirements of SPS 530 would apply to RSE licensees that offered a large number of choice products.

Substantive issues identified in the submissions, and APRA's responses to those issues, are outlined below.

6.2.1 Application to choice products

Both the September discussion paper and the April response paper made it clear that the requirements in SPS 530, which include setting an investment objective, are intended to apply to RSE licensees generally, regardless of whether they offer a variety of choice products or only a single investment option, such as a MySuper product.

Comments received

A number of submissions sought clarity as to how the requirement in SPS 530 for setting investment objectives and an investment strategy would apply in the context of choice products. In particular, submissions highlighted difficulties for RSE licensees in determining investment objectives and strategies in circumstances where investments are made through collective investment vehicles managed by third parties or where RSE licensees provide superannuation products that offer a wide range of underlying investments from which beneficiaries may choose.

² Refer to proposed s. 1017BA of the Corporations Act.

³ Refer to proposed ss. 1017BA(2) and (3) of the Corporations Act.

APRA response

Amendments to the SIS Act have introduced a new s. 52(6), which amends the existing investment covenants in s. 52(2)(f). Section 52(6) applies to all investment options offered by the RSE licensee, including choice options. As such, it is appropriate that the requirements in SPS 530 to set investment objectives for each investment option, in addition to requirements relating to the processes for monitoring and reviewing investment strategies, be applied to all investment options offered by the RSE licensee.

SPS 530 therefore applies to all investment options. APRA's proposed guidance material will address APRA's expectations regarding how RSE licensees may apply the requirements to different business models, including platform structures.

6.2.2 Investment governance framework

APRA proposed, in draft SPS 530, minimum requirements for an investment governance framework, which includes the systems and processes in place for an RSE licensee to manage and monitor investment risk.

Comments received

Some submissions expressed concern that the obligation for an RSE licensee to manage and monitor all sources of investment risk was onerous. Submissions indicated that it was not reasonable to expect an RSE licensee to be able to consider all possible risks as there will always be some risks beyond the knowledge of the RSE licensee. This uncertainty would make full compliance with the requirements in the standard impossible.

APRA response

The requirements of SPS 530 are clearly linked to the requirements of the risk management framework in SPS 220. SPS 530 now makes clear that that an RSE licensee's investment governance framework must reflect the *identified* risks that are associated with investments as required by SPS 220.

6.2.3 RSE licensee's role statements

Draft SPS 530 proposed to require an RSE licensee's functions for monitoring and implementing investments to be clearly articulated in the role statements of persons who undertake these roles.

Comments received

Submissions sought clarification regarding the responsibilities of those people within an RSE licensee's business operations responsible for monitoring investments and how they differ to those responsible for implementing investments. A number of submissions noted that smaller RSE licensees, or those with in-house investment functions, may find it problematic to separate these functions in practice as it is customary for the people responsible for implementing investments to monitor the performance of these investments.

APRA response

SPS 530 requires an RSE licensee's investment governance framework to include structures, policies and processes for investment performance reporting. APRA's view is that, to ensure the robustness and integrity of an RSE licensee's investment governance framework, persons undertaking investment performance measurement for the purposes of prudent investment monitoring should not also be responsible for implementing the investments.

SPS 530 now clarifies that an RSE licensee must have in place a process where persons applying and assessing investment performance measures reported to the board are operationally independent from persons responsible for implementation of investments.

6.2.4 Asset allocation targets and ranges

APRA proposed that RSE licensees be required to identify and manage factors in relation to setting asset allocations, including determining an allowance for reasonable variation around asset allocation targets. Draft SPS 530 proposed a requirement for an RSE licensee to determine a rebalancing policy in order to monitor and correct deviations of established asset allocation ranges.

Comments received

Submissions commented that a number of RSE licensees were moving away from strategic asset allocations, and instead employing a dynamic allocation approach. As such, there was concern that the use of a rebalancing policy to correct deviations, as required by SPS 530, may be interpreted as constraining the variety of approaches undertaken by an RSE licensee.

Further, submissions sought clarification regarding whether the inclusion of an asset rebalancing policy in an investment strategy, as specified in SPS 530, would be required for each investment option or whether it could be applied at the RSE level.

APRA response

APRA's view is that it is appropriate to require an RSE licensee to establish a policy to monitor and manage the asset allocation within determined ranges, although this does not specifically need to be a rebalancing policy.

In addition, SPS 530 now requires an RSE licensee to also determine the basis for which changes would be made to asset allocation targets and ranges, thus providing further clarity on how the asset allocation will be maintained.

Chapter 7 – Defined benefit matters

Employer-sponsors of defined benefit funds generally bear the investment risk for beneficiaries. Nevertheless, prudential oversight of defined benefit funds is important because the RSE licensee must pay the benefits prescribed in the trust deed. This chapter responds to feedback on *Prudential Standard SPS 160 Defined Benefit Matters* (SPS 160).

The Government has proposed that the term ‘actuary’ in s.10(1) of the SIS Act be replaced with ‘RSE actuary’ to create a clearer distinction between persons appointed as an actuary of an RSE and those appointed as an actuary of a self-managed superannuation fund. This term is used throughout SPS 160.

7.1 Issues raised during consultation

Submissions generally expressed broad support for the proposed requirements in draft SPS 160, but sought clarity on a number of issues as well as a phased introduction of certain requirements.

A number of submissions disagreed with the two-tier approach to funding of defined benefit funds on the grounds that a holistic framework was needed and that the funding and solvency certificate regime (which interacts with the *Superannuation Guarantee Administration Act 1992* and the technical insolvency regimes) should be significantly revised.

The two-tier approach is a Government policy matter. Accordingly, SPS 160 addresses funding to vested benefit level and the technical solvency provisions will remain in the SIS Regulations.

7.1.1 Reporting timeframes

Draft SPS 160 proposed that the timeframe for reporting on the triennial actuarial investigation be reduced from the current 12 months to six months to allow a more timely response to funding issues identified in the actuarial investigation.

Comments received

Submissions included substantial feedback on the practicality of introducing this change without a transition period. Submissions indicated that a six-month timeframe would be achievable if APRA provided a transition period of up to three years before application of the six-month timeframe.

APRA response

APRA acknowledges that an immediate commencement of the reduced reporting timeframe may result in practical difficulties. As a result, SPS 160 has been amended to provide a transition period which has the effect that actual investigations with an effective valuation date between 1 July 2013 and 30 June 2016 must be reported on within nine months. The six-month timeframe will commence for investigations with an effective valuation date of 1 July 2016 or later.

7.1.2 Shortfall limit

Draft SPS 160 proposed that a shortfall limit be set by the board to allow some flexibility between regular triennial investigations to manage vested benefits coverage in a period of market volatility. This would avoid triggering the requirement to undertake an actuarial investigation and implement a restoration plan where the market value of assets falls (temporarily) below the level required to cover vested benefits, but is expected to return to a level that covers vested benefits within a short period.

Comments received

Several issues were raised in relation to the shortfall limit. These included a request for clarity on the purpose of the shortfall limit, how it should be expressed and whether it was relevant in the case of those public sector schemes that are partially funded under their enabling legislation or trust deed. Further, submissions queried why the shortfall limit might not be utilised in funds where vested benefits are close to or equal to minimum benefits, whether a shortfall limit should be allowed during the course of a restoration plan and whether there should be a requirement to regularly monitor and review the shortfall limit.

APRA response

Having considered the issues raised in submissions, APRA is proposing to exempt partially funded public sector schemes from the requirement to set a shortfall limit. APRA has also included a requirement to determine and implement a monitoring process. Otherwise, the provisions relating to the shortfall limit remain unchanged other than edits to improve clarity of the requirements. APRA intends to issue guidance on the practical aspects of setting a shortfall limit as part of the second set of PPGs to be released for consultation in 2013.

7.1.3 Restoration plans

Draft SPS 160 proposed that a restoration plan be implemented within six months of the commencement of SPS 160 where a fund had been found to be in an unsatisfactory financial position on, or prior to, that date.

Draft SPS 160 also set a maximum timeframe for a restoration plan of three years, with provision for this to be varied by APRA during the period of the plan.

Comments received

Several submissions commented that SPS 160 needs to make provision for funds that are in an unsatisfactory financial position on commencement of SPS 160, but where the RSE licensee is already taking remedial action to restore funding to vested benefits level. This would allow RSE licensees that had initiated a restoration plan following the most recent triennial investigation to continue with that plan.

Some submissions argued that the three-year maximum period for a restoration plan was too short and that RSE licensees should be able to negotiate a longer period with APRA at the outset, rather than being subject to later review.

APRA response

APRA's view is that a specific transitional provision would provide some certainty to those RSE licensees that had taken action to address an unsatisfactory financial position prior to the commencement of SPS 160, provided the remedial action being taken is largely consistent with the features of the restoration plan required by SPS 160. For example, a plan to return a fund to a satisfactory financial position over a period well in excess of the three years contemplated in SPS 160 would not be acceptable unless it had been explicitly approved by APRA. SPS 160 has been amended accordingly.

APRA's prudential standards include an adjustments and exclusions provision that enables APRA to vary an obligation set out in the standard from application as it applies to a particular entity. This provision can be used to address an application by an RSE licensee to implement a restoration plan longer than three years. APRA intends to issue guidance on factors that may be taken into account in considering a request for a longer period to return the fund to a satisfactory financial position, as part of the second set of PPGs to be released in 2013.

7.1.4 Reserving – ORFR

Draft SPS 160 proposed that the valuation of assets during a regular triennial actuarial investigation should disregard money held within a defined benefit fund to meet the ORFR in respect of the fund. The rationale for the ORFR supports this approach. If the ORFR amount were to be critical in determining whether or not the fund is in a satisfactory financial position, the funding level of vested benefits would immediately be jeopardised on the occurrence of an operational risk loss for which the ORFR had to be used, which would defeat the purpose of the ORFR.

Comments received

Several submissions argued against this approach, stating that the ORFR amount should be considered as an asset for the purpose of determining whether a fund is in a satisfactory financial position or technically insolvent, as these tests are effectively an analysis of the fund's ability to pay vested benefits or minimum benefits in a wind-up situation.

APRA response

APRA supports the view that an amount set aside in a defined benefit fund to meet the ORFR should be available to address a deficiency on wind-up, insofar as it is attributable to defined benefit members. APRA does not agree, however, that the ORFR should be counted for the purpose of determining whether a fund is in an unsatisfactory position at a point in time other than on wind-up. As noted above, if the ORFR amount were to be critical in determining a satisfactory financial position, the funding level of vested benefits would immediately be jeopardised on the occurrence of an operational risk loss, which would defeat the purpose of the ORFR.

7.1.5 Self-insurance

Draft SPS 160 included proposed requirements relating to self-insurance of death and disability benefits of defined benefit members, including reserving requirements for funding of current and future self-insurance liabilities, and actuarial assessment of the adequacy of those reserves.

Comments received

Several submissions opposed the reserving requirement in relation to self-insurance on the basis that provision for claims is factored into the contribution rate or level.

APRA response

The objective behind the proposal for a self-insurance reserve was to ensure proper funding of claims on an ongoing basis. APRA considers that, where the actuary makes a regular assessment of the accrued self-insured claims liability (including for incurred but not reported claims) that is taken into account in determining contribution levels, the policy intent of the self-insurance provisions in SPS 160 would not be undermined by allowing such a process as an alternative to establishment and maintenance of a reserve. Accordingly, SPS 160 has been amended to require the RSE licensee to have 'a reserve, or *other arrangement approved* by APRA, in place to fund current and future self-insurance liabilities'. The use of the expression 'arrangement' also covers public sector schemes where the funding of death and disability benefits is paid directly by the relevant government or government agency rather than from contributions to the fund.

Chapter 8 – Audit requirements

The external audit of an RSE provides support for the effective governance of the entirety of an RSE licensee's business operations. This chapter responds to feedback on *Prudential Standard SPS 310 Audit and Related Matters* (SPS 310).

The Government has proposed that the term 'approved auditor' in s. 10(1) of the SIS Act be replaced with 'RSE auditor' to create a clearer distinction between auditors responsible for the audit of RSE licensees' business operations and auditors responsible for the audit of self-managed superannuation funds.

8.1 Issues raised during consultation

Submissions generally expressed broad support for the proposed requirements in draft SPS 310, but sought clarity on a number of issues in the draft prudential standard. The overarching theme of submissions was a need to align with industry practice. APRA has noted the pragmatic nature of these comments and, where appropriate, has made editorial changes to clarify the standard.

8.1.1 Relationship with AUASB standards and guidance

Draft SPS 310 contained requirements pertaining to compliance with relevant Audit and Assurance Standards Board (AUASB) standards and guidance material, subject to there being no inconsistency with the requirements in the prudential standard. If an inconsistency did arise, draft SPS 310 stated that APRA's provisions would prevail unless APRA specifies alternative standards or guidance to be used.

Comments received

A number of submissions raised concerns about the broader implications for auditors if they are required by the prudential standard to undertake an audit that does not comply with AUASB standards and guidance. In particular, concern was expressed with respect to insurance coverage for auditors.

APRA response

The provision in SPS 310 that refers to the relationship between APRA's prudential standard and the AUASB standards and guidance is designed to deal with the rare situation where APRA's prudential requirements take effect prior to changes in the AUASB standards and guidance. This provision is consistent with provisions in the audit prudential standards applying to other APRA-regulated industries and seeks to resolve any temporary misalignment between the two sets of standards.

APRA works closely with the AUASB in establishing mandatory audit requirements for APRA-regulated industries and intends to continue to do so in order to minimise the risk of misalignment in requirements.

8.1.2 APRA reliance on the auditor report

Draft SPS 310 proposed that, in preparing a report or assessment under the SIS Act or draft SPS 310, the auditor must consider that APRA may rely upon the report.

Comments received

The submissions questioned whether the requirement was necessary given that APRA determines the scope of the audit and prescribes heightened minimum requirements for RSE auditors in addition to those obligations that apply as part of professional memberships. Further, the submissions highlighted that APRA is not a party to the audit.

Comments suggested that existing audit-related requirements for the superannuation industry are sufficient for APRA to determine whether reliance can be placed on the work of the auditor. Feedback suggested that draft SPS 310 make no reference to the auditor report being prepared with APRA in mind as a potential audience.

APRA response

APRA establishes audit requirements in all APRA-regulated industries for the purpose of facilitating independent oversight. Whilst the RSE licensee is ultimately responsible for ensuring compliance with the prudential standards, the auditor will have obligations under the SIS Act to comply with the prudential standards (refer to proposed s. 35C of the SIS Act). The requirement in draft SPS 310 for the auditor to consider that APRA may rely on the report as part of its functions under the SIS Act, serves to highlight that the audit also serves a prudential purpose. SPS 310, therefore, has not been amended.

8.1.3 Practicality of approach

The provisions in draft SPS 310 were drawn from existing requirements applying to the audit of the superannuation industry, as well as audit prudential standards applying to other APRA-regulated industries.

Comments received

The submissions included substantial feedback on the practicality of the application of a number of requirements in draft SPS 310 to the superannuation industry. To the extent that APRA remains committed to alignment of audit requirements for all industries, the submissions suggested that APRA should align more closely with *Prudential Standard LPS 310 Audit and Related Matters* (LPS 310).

APRA response

APRA has revised SPS 310 to improve the clarity of the requirements, including drawing on the provisions of LPS 310.

8.1.4 RSE licensee access to working papers

Draft SPS 310 proposed an obligation for the RSE licensee to provide APRA with information and documents, such as auditor working papers, that are relevant to the functions performed by the auditor under the SIS Act or audit prudential standard. This obligation of the RSE licensee was to be included in the terms of engagement with the auditor.

Comments received

Submissions highlighted that the auditor is not required under AUASB standards and guidance to make these documents available to clients. The submissions did acknowledge that from time to time auditors may agree to provide copies of documents such as certain working papers to clients, but this is not usual industry practice.

Further, submissions argued that, as APRA has power in s. 255 of the SIS Act to directly require the auditor to produce any information or document for regulatory purposes, the provision in draft SPS 310 was redundant.

APRA response

The requirement in draft SPS 310 relating to provision of audit-related information and documents to the RSE licensee was intended to be read in conjunction with the requirement in the SIS Act to provide such documents to APRA. Whilst the provisions in SPS 310 have not changed, APRA will, in line with existing practice, continue to work closely with RSE licensees and the audit profession to ensure a practical and efficient approach to providing relevant audit information, where necessary, to APRA.

Chapter 9 – Insurance in superannuation

The Government's reforms have placed a new emphasis on the role insurance plays for beneficiaries. *Prudential Standard SPS 250 Insurance in Superannuation* (SPS 250) supplements the legislative requirements relating to insurance in superannuation by requiring RSE licensees to manage and monitor the insurance benefits offered to, or acquired for the benefit of, beneficiaries.

9.1 Issues raised during consultation

Submissions expressed general support for the requirements contained in SPS 250 but requested that APRA allow sufficient flexibility and time for RSE licensees to transition to the new requirements.

Significant feedback was received on both draft SPS 250 and proposed amendments to the SIS Act and SIS Regulations relating to insurance. Submissions expressed strong concerns about APRA's proposed implementation of an anticipated restriction in the law to prohibit RSE licensees from offering protection insurance provided under a general insurance policy.

A number of submissions also expressed concerns about the restrictions on self-insurance, the restriction on types of insurance that can be offered by RSE licensees, and the requirement for certain types of insurance to be offered to members. These are matters of Government policy and are not addressed in this paper.

9.1.1 Interpretation

APRA had proposed in draft SPS 250 that insurance be defined as insurance that is acquired by an RSE licensee from a life insurer. This extended an existing licence condition applied to public offer RSE licensees to all RSE licensees, on the basis that life insurers are permitted to offer benefits with terms and conditions that are guaranteed renewable at the end of the contract. APRA's considered that this provided greater security of insurance provision for beneficiaries and less risk for RSE licensees.

This restriction would have meant, however, that RSE licensees could not acquire insurance from general insurers for the insured benefits offered to members.

Comments received

A number of submissions opposed the proposed restriction on general insurers being able to provide insurance to a member of an RSE as it unnecessarily restricted competition in the insurance market.

Insurance benefits offered by general insurers, the submissions argued, are generally offered at a lower cost and include substantially more generous terms and conditions, such as reduced waiting periods and higher benefits, than those offered by life companies. Some submissions indicated that they had previously had difficulties sourcing adequate insurance cover from life companies for certain groups of employees that made general insurance the only available means of providing adequate insurance to beneficiaries.

APRA response

The objective behind APRA's proposal was to support the offering of insurance benefits that are clearly aligned with the best interests of beneficiaries. Arrangements also have to comply with the Government's announced prohibition on self-insurance, except in very limited circumstances relating to defined benefit members.

A key difference between general insurance and life insurance policies is that a general insurance policy must have a term of no more than three years, whereas the term for a life insurance policy can be for many years. As a result, a general insurance policy can be cancelled, or have significant changes to the terms and conditions, within three years of commencement. In contrast, the terms and conditions of benefits offered by life companies (but not the premiums) are guaranteed to be renewed without change for a longer period – indeed indefinitely for some arrangements. In APRA's view, the guaranteed renewability of terms and conditions is closely aligned to the best interests of beneficiaries and should ensure that the risk of self-insurance is minimised.

APRA does not accept that there is any inherent reason why general insurers would be able to offer materially more generous terms and conditions than life companies. Nevertheless, APRA now considers that a principles-based approach can achieve an appropriate outcome. Accordingly, adjustments have

been made to the definition of insurance in SPS 250 so that the use of general insurance policies is not precluded. SPS 250 also includes additional provisions requiring the risks involved in offering insurance through a general insurer, as well as a life insurer, to be considered and addressed by RSE licensees. Further information on APRA's expectations in relation to insurance will also be provided in the guidance material to be released in December 2012.

9.1.2 Insurance management framework

APRA proposed that an RSE licensee would be required to have an insurance management framework to manage insurance offered to, or acquired for the benefit of, beneficiaries. APRA also expanded on the requirements that an RSE licensee must meet in order to meet the insurance strategy requirements in the SIS Act. The concept of a framework is reflected in a number of the draft prudential standards for superannuation and is intended to encourage RSE licensees to take a holistic approach to the management of member insurance, encompassing all aspects of the governance and management of member insurance. This would include consideration of all of the processes, policies and people involved in the offering of insurance by the RSE licensee and in strategic planning and decision-making related to member insurance.

Comments received

A number of submissions expressed concern about the role of the RSE licensee in some aspects of insurance that are considered to be the remit of the RSE licensee's selected insurer(s). The comments indicated that draft SPS 250 did not provide sufficient recognition of the roles that the RSE licensee, the insurer and any other external party (e.g. the administrator) can play and how this should be reflected in the insurance management framework.

APRA response

The requirements of SPS 250 in relation to the insurance strategy and the insurance management framework require strategic planning and oversight of the management of member insurance. These

processes and documents must reflect the RSE licensee's role and responsibility in the process of managing member insurance and do not supplant the processes of the insurer. APRA proposes to provide additional clarity to assist an RSE licensee in structuring an insurance management framework appropriate to its business operations and make this distinction clearer in guidance to be released in December 2012.

9.1.3 Transition to full claims data

Draft SPS 250 proposed that an RSE licensee must maintain at least five years of claims data to support its obligation to offer insurance that is in the best interests of beneficiaries.

Comments received

Submissions queried how this requirement might sensibly work in practice as RSE licensees move to full compliance with the requirements in the standard. It would be unreasonable, the submissions argued, for APRA to expect full compliance with this requirement from 1 July 2013 when there has not been a formal requirement to maintain data of this nature for the five-year period beforehand and given that access to historical information can be difficult.

APRA response

APRA considers that allowing an RSE licensee a full five years to comply with the data requirement would unreasonably extend the risks that currently exist due to inaccurate data. APRA recognises, however, that full compliance with these requirements of SPS 250 from 1 July 2013 will not be achievable for many RSE licensees.

APRA has therefore included a three-year transition period to reach full compliance with the claims data requirement in SPS 250. As an interim step, each RSE licensee will be required to assess the quality of the data that they currently have available before 1 July 2013. The RSE licensee would be required to notify APRA prior to 1 July 2013 as to when it expects to reach full compliance with the obligation, including the interim steps it intends to take to move towards full compliance.



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