

Australian Prudential Regulation Authority

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Ross Jones
DEPUTY CHAIRMAN

Ref No IRD

29 June 2010

Letter to Trustees
APRA Regulated Superannuation Fund(s)

Dear Trustee

INVESTMENT RISK DESCRIPTION

I am writing to advise that APRA is releasing guidance for RSE licensees ('trustees') on the labelling of investment options offered by superannuation funds.

PURPOSE

Objective criteria are necessary to allow superannuation fund members to understand and compare the key characteristics of investment options. At present there are no standard risk descriptors and there has been no industry-wide standard asset allocation for different "labels", such as "balanced" "conservative" or "growth". This leads to confusion on the part of fund members and makes it difficult to properly compare investment performance.

In consultation with the industry associations and the Australian Securities and Investments Commission (ASIC), APRA has developed the attached guidance on appropriate descriptors of risk for investment offerings. The approach focuses on outcomes, expressed as the probability of negative returns in x out of y years, at a given confidence level. It also will ensure a strengthening of trustee risk management processes in this important area.

APRA has discussed this approach with the Investment and Financial Services Association (IFSA), Association of Superannuation Funds of Australia (ASFA) and ASIC who all support this approach. This outcome is seen as a first step in developing and achieving industry standards for disclosure and data collection purposes.

GUIDANCE FOR TRUSTEES

It has been agreed that the best way forward is for APRA to provide brief, early guidance. In due course, this will be followed up with more detail in a suitable form, including a possible prudential practice guide (PPG). ASFA and IFSA have indicated they will work with their membership to develop industry-based good practice guidance around modelling and confidence levels that should be used to enhance comparability further.

Given the lead time to change disclosure documentation, it is important that this first step be taken now rather than deferring it until APRA develops more comprehensive material. Releasing guidance on the descriptors now will allow industry to move to a consistent approach in a timely fashion. This initial guidance is set out in the Attachment to this letter.

We look forward to the further development of industry standards in co-operation with your industry associations, and to your support for this important initiative. If you have any queries we encourage you to communicate with your industry association.

Yours sincerely

A handwritten signature in black ink, appearing to read "Reo J", with a long horizontal flourish extending to the right.

Attachment

ATTACHMENT

GOOD PRACTICE GUIDANCE - INVESTMENT RISK DESCRIPTION

Labelling of investment options offered by superannuation funds

Guidance

APRA considers it would be good practice for trustees to adopt a suitable classification process that would ensure that members can more readily distinguish the characteristics of each investment strategy offered by the trustee. This can be assisted by trustees ensuring that, for each strategy offered, it is clearly stated what the expected frequency of negative returns of that strategy is over a 20 year period.

Substantiation

In determining the expected frequency of negative returns, trustees need to be able to demonstrate that they have a proper basis for the conclusion reached.

APRA would expect trustees to have access to robust data, systems and processes which substantiate the decisions to categorise investment strategies in this fashion.

It is not enough for trustees to make an assertion - there is a need to justify the classification decision, for example through use of appropriate modelling. Professional assistance might well be required.

APRA is not, currently, suggesting guidance on the risk level appropriate for labels such as “conservative”, “balanced”, “growth” etc. This is something we would expect the industry to develop good practice material around over time.

Reporting

APRA is not currently proposing to require reporting against such classifications. Rather, in the course of normal supervision, APRA would be looking at the trustee’s processes that lead to the determination of the risk categorisation of particular investment strategies.

ASIC will be considering this issue as part of their monitoring of trustees’ disclosure obligations. It is envisaged that Regulatory Guidance will be issued by ASIC in the first year of transition to the shorter PDS requirements under the *Corporations Amendment Regulations 2010 No. 5*. This guidance will take into account the requirements of APRA and joint industry guidance in this regard.

Dated: 29 June 2010